SKY'S RESPONSE TO OFCOM'S SEPTEMBER 2017 FURTHER WLA MARKET REVIEW CONSULTATIONS ON 'PROPOSED CHARGE CONTROLS FOR WHOLESALE STANDARD AND SUPERFAST BROADBAND' AND 'PROPOSED QUALITY OF SERVICE REMEDIES FOR WLR, MPF AND GEA'

EXECUTIVE SUMMARY

1. Poor Openreach quality of service is a fundamental concern within the communications sector. Only four months ago Sharon White, Ofcom's CEO, set out a vision for the industry with more emphasis on "*getting it right first time*" for consumers and that, underpinning this change, Ofcom were "*planning tougher rules for Openreach to repair faults and install new lines more quickly*".

2. It is particularly disappointing, therefore, that Ofcom's latest WLA proposals inexplicably relieve the pressure on Openreach to deliver under its service level agreements, and do not address the concerns that Sky has repeatedly raised in relation to late provisioning of service, services that are 'dead on arrival' and 'early life failures'.

3. Consumers continue to be seriously affected by these quality of service issues. Which? recently published the results of a survey that found that 53% of people had a problem with their broadband in the last year. These issues disrupt consumers' access to communications services and deter consumers from switching, cementing BT's position as the largest broadband provider in the UK.

4. Sharon White stated that "*success*" in addressing quality of service issues would mean "*Openreach, not Ofcom setting its own stretching service standards*". The minimum service levels proposed in this consultation fail on both counts. They cannot be considered "*stretching*" given that Openreach already exceeds them and while it does appear that Openreach is setting its own standards simply by asserting that it cannot improve them materially, Sky seriously doubts that this is what was intended.

5. Ofcom should reject the late and unreliable 'evidence' provided by BT to support its assertions. Ofcom's consultants raised concerns about how Openreach's model operated, concluding that Ofcom should treat the data with caution and that it would not be appropriate for Ofcom to rely on Openreach's data alone. However, due to information asymmetry, neither Ofcom nor CP stakeholders have sufficient information to engage meaningfully on the robustness of BT data or to improve BT's model.

6. Sky continues to reject the proposition that Openreach should be able to charge more for meeting marginally improved minimum service levels. So far as Sky is aware, BT has not provided any reliable evidence supporting its demands for increased charges. BT has benefited year on year from excessive profits which it has systematically failed to reinvest in its network, resulting in unacceptable service quality. It should not be rewarded for this. Moreover, effective regulation should replicate real world commercial conditions of a competitive market, where operators improve their efficiency to deliver better service whilst simultaneously reducing costs.

7. More broadly, Ofcom's revisions to the proposed charge controls demonstrate that information asymmetry, inappropriate accounting practices and gross over-charging by BT continue to blight the effectiveness of Ofcom's regulation of the UK's communications

markets. Consumers and competition continue to suffer as a result. This asymmetry and the lack of improvement in BT's accounting practices from one market review to the next have undoubtedly resulted in BT earning excessive profits, consumers paying too much, service quality being lower and competition being weaker.

8. Sky's concerns relating to lax charge controls are exacerbated by Ofcom's proposal not to cap the prices of faster GEA services, which will distort competition and harm consumers in its own right. Sky considers that regulated charges should be lower than proposed with significant initial price cuts and extended to these faster services. For more than a year, Sky has continued to raise concerns that imposing a charge control on only BT's lowest speed GEA variant – and ignoring the 55/10 and 80/20 Mbps GEA services – would incentivise BT to move the focus of competition to higher speed products, where its competitors do not benefit from a charge-controlled input and cannot compete effectively. These concerns have materialised with BT's recent announcement that it would upgrade its 2.4m Infinity 1 customers that are able to achieve higher speeds to its Infinity 2, 76 Mbps service – something that would not have been rational, absent BT's vertical integration.

9. Failing to impose effective charge controls prevents communications providers from achieving the scale and certainty they would need if they were ever to contemplate investing in a competing network.

10. In light of these serious concerns regarding the reliability of BT's data, and the inability for Ofcom, its consultants or affected stakeholders to scrutinise that data, Sky urges Ofcom to:

    (a) reject BT's Resource Allocation Model as unreliable;

    (b) reject BT's "*glass ceiling*" for service levels;

    (c) revert to the minimum service levels it proposed in its March 2017 consultation;

    (d) increase scrutiny of data provided by BT and impose sanctions for inappropriate accounting practices so BT cannot continue to game the system; and

    (e) rollback the most recent proposed increases to wholesale local access charge controls and extend charge controls to higher speed GEA products.

DOCUMENT STRUCTURE

11. The remainder of this document is structured as follows:

Section 1 – Information asymmetry and overcharging by BT blights the communications sector

Section 2 – Charges for co-mingling, cablelink, tie-cables and aborted visits should be significantly lower

Section 3 – It is appropriate to reduce starting charges in the charge controls

Section 4 – Ofcom is correct to forecast lower cumulo costs

Section 5 – Ofcom should introduce charge controls for all GEA variants

Section 6 – Minimum service levels need to be higher for no extra cost

Section 7 – Ongoing concerns with Openreach's quality of service that have not been addressed

SECTION 1: INFORMATION ASYMMETRY AND OVERCHARGING BY BT BLIGHTS THE COMMUNICATIONS SECTOR

1.1 Several issues have to come to light in the wholesale local access (WLA) market review that clearly show that information asymmetry between BT and Ofcom and between BT and communications providers (CPs) continues to inhibit effective regulation aimed at delivering stronger competition and better outcomes for consumers. In these cases, BT continues to hold more information than Ofcom or CPs. Most recently, Ofcom's further consultations on the proposed WLA market review charge controls and on quality of service outline a series of 'unearthed' inappropriate accounting practices and a dependency on opaque, unreliable BT cost models which undoubtedly have resulted (or will result) in Openreach's customers paying too much and competition and consumers being harmed as a result.

1.2 Ofcom's use of regulatory accounting remedies to improve the transparency and proprietary of BT's regulatory accounting data and other financial information have been insufficient to prevent these issues and, therefore, Ofcom will need to take additional steps going forward to ensure that consumers and competition are not harmed further. In Sky's view these steps will involve even greater levels of scrutiny than Ofcom already exercises, stronger and more frequent recourse to sanctioning BT for breaches of its obligations and a greater dependency on alternative non-BT data.

Given BT's market power, it has an incentive to exploit information asymmetry to harm competition and consumers

1.3 It is widely acknowledged that where a dominant provider has access to information that regulators and other providers do not, it will have an incentive to exploit this information asymmetry to its advantage which can be to the detriment to consumers and competition. This concept is uncontroversial and is merely a derivation of the principal-agent model whereby the agent (the dominant firm) has access to information which is not available to the principal (the regulator or the dominant firm's customers and competitors) and also has different objectives.

1.4 A profit-maximising strategy for the dominant firm is unlikely to match the objectives of the regulator or its competitors and the relevant information that could be exploited for the dominant firm's gain is most likely information that it holds and controls but which is not publicly available. The most obvious example of how a dominant firm may exploit information asymmetry is where the regulator is imposing a price control on the firm's service which is based on the costs of providing it. This cost information is held by the dominant firm and its strong incentive is to overstate these costs in order to extract a more favourable outcome from the price control i.e. a higher regulated price.

1.5 It is precisely for these reasons that a regulator's toolkit includes remedies aimed at addressing this information asymmetry – most notably in the context of the regulation of fixed communications markets, these are accounting separation and transparency obligations which give Ofcom access to more detailed information that is required to be prepared in accordance to objective accounting principles. During market reviews, Ofcom augments this data with further requests for information from BT and other market participants.

Ofcom's current approach to information asymmetry provides insufficient protection to competition and consumers

1.6 Despite Ofcom's extensive efforts, information asymmetry continues to blight the communications sector with little prospect of improvement without Ofcom re-thinking its approach. It is now 14 years since Ofcom was formed, BT has been required to prepare and publish regulatory accounting information for even longer and there have been numerous market reviews, complaints and investigations - yet, in 2017 Ofcom continues to discover highly irregular, inappropriate accounting practices which have led to consumers paying too much and BT earning excessive profits. These cases are the latest in a litany of accounting issues that have favoured BT and which show no sign of abating – both in terms of number or severity.

1.7 Specifically, in Ofcom's Further Charge Control Consultation[1], it has identified (yet again) instances of BT:

(a) unfairly attributing costs to regulated services that should have been allocated to competitive services (which necessitate Ofcom lowering charges at the start of the next charge control by more than proposed);

(b) recovering certain costs twice – once in upfront fees and then again in recurring charges (co-mingling, tie-cables and abortive visit charges, AVCs);

(c) charging excessive prices while providing limited cost data (AVCs and cablelink); and

(d) submitting unreliable information late in the consultation process (BT's Resource Allocation Model).

1.8 As a result of some of these, BT has significantly over-charged LLU operators over many years and, accordingly, it is profoundly disappointing that Ofcom and stakeholders have been unable to identify these issues until this time.

1.9 In Sky's view, it is safe to assume that, given BT's repeated transgressions in preparing its regulatory financial information, that other key BT information upon which Ofcom relies is also likely to over-estimate BT's costs systematically. For example, in relation to this review, we think Ofcom should not place too much weight on BT's Resource Allocation Model which aims to forecast the increase in costs to Openreach of meeting higher minimum service levels.[2] It appears that Ofcom's own consultants, Analysys Mason, also cast sufficient doubt over the reliability of the BT model, noting in the Further QoS Consultation[3] that it is:

> "*unlikely that Ofcom could use the model, in its current form, directly or in isolation to predict resource deltas for quality of service improvements*"[4], "*it would not be*

1 'Wholesale local access market review: Further consultation on proposed charge control for wholesale standard and superfast broadband', Ofcom consultation, 14 September 2017 (the "Further Charge Control Consultation").

2 Sky is also opposed to the principle of allowing BT to recover the costs of improving its service quality.

3 'Quality of Service for WLR, MPF and GEA: Further consultation on proposed quality of service remedies', Ofcom consultation, 14 September 2017 (the "Further QoS Consultation").

4 Paragraph 4.17, Further QoS Consultation.

appropriate to rely on the Allocation Model alone as an input to our regulatory charge control models"[5], and "*[Ofcom] should treat the results of the Openreach model with caution*"[6].

1.10 Additionally, Analysys Mason noted that given the complexity of the model and the late stage at which it was received, they were unable to verify the inputs. This is particularly concerning given Analysys Mason's findings that much of the detail that contributes to the complexity of the model does not materially affect the overall results, but does reduce transparency, results in a more problematic estimation process and in some cases generates counter-intuitive results.[7]

1.11 In the March 2017 WLA Charge Control consultation[8] while awaiting 'delivery' from BT of its Resource Allocation Model, Ofcom proposed cost increases from meeting higher service levels based upon its own modelling (supported by Analysys Mason). The outputs from this modelling showed lower cost increases than suggested by BT's unaudited model. Given the high risk that BT's approach over-estimates the real costs of meeting higher standards, we think Ofcom is justified in continuing to use its own modelling.

A step change is required in the way in which Ofcom addresses information asymmetry

1.12 Despite its extensive nature, Ofcom's approach to addressing BT's ability to exploit information asymmetry in its favour is insufficiently effective and shows no sign of improvement. Customers and competition continue to be harmed as a result. We think there needs to be a step change in the way that Ofcom approaches this issue.

1.13 First and foremost, there needs to be more jeopardy for BT when it prepares inappropriate accounts and models. At present, for the most part there is almost no situation where BT could be worse off for being 'found out' by Ofcom than it would have been if it had prepared its information correctly. At best, BT is required to fix things going forward and, less often, may be required to pay back what it has overcharged – but this can be a very long process and frequently the harm caused is irreversible.

1.14 Therefore, Ofcom should sanction BT strongly, quickly and uniformly for its transgressions, which are often of its regulatory obligations. An example of relatively strong action is Ofcom's sanctioning of BT over the 'deemed consent' issue[9]. However, even in that case action was too slow; the infringing practices had been going on for many years and CPs had to raise complaints with Ofcom before there was any regulatory intervention.

1.15 The second change required to bring a step change to Ofcom's approach to information asymmetry is a far greater level of proactive scrutiny of BT's regulatory financial information and associated data. In this regard, it is clear that BT has been able to engage in inappropriate accounting practices for an extended period. This practice even extends to practices that Ofcom had previously identified as being inappropriate.

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5 Paragraph 4.18, Further QoS Consultation.

6 Paragraph 1.10, Further QoS Consultation.

7 *Ibid.*

8 'Wholesale Local Access Market Review: Consultation on the proposed market, market power determinations and market remedies', Ofcom consultation, 31 March 2017 (the "March 2017 WLA Charge Control consultation").

9 'Confirmation Decision under section 96C of the Communications Act 2003 relating to a contravention of SMP Conditions: Confirmation Decision issued to British Telecommunications plc by the Office of Communications', 27 March 2017 (https://www.ofcom.org.uk/__data/assets/pdf_file/0017/102167/cw-01170-11-15-bt-confirmation-decision.pdf.)

1.16 For example, BT has been found to include the upfront costs of supplying services such as cablelink and tie-cables in its connection costs and hence regulated connection charges but has also capitalised these costs over several years such that they are also recovered from recurring charges. On its face, this is clear double-charging for the same costs and is plainly wrong. However, BT has engaged in this accounting practice before. At the BCMR in 2012/13, Ofcom found that it was charging customers upfront for the full cost of excess construction but then also capitalising those costs which would then be reflected in other charge controlled services.[10]

1.17 It is clear that, coupled with far more onerous sanctions on BT for transgressions, Ofcom needs to be significantly more rigorous in scrutinising the data which is supplied to it by BT. For the sake of consumers and competition, there needs to be a substantial change in the speed and frequency with which Ofcom identifies any inappropriate accounting practices by BT.

1.18 Third, we also think that Ofcom should be less dependent on unreliable new BT information such as the Resource Allocation Model and should instead rely on its own modelling. Given BT's incentives and its long track record of over-estimating its costs, Ofcom should exercise a high degree of circumspection over BT's data and be prepared to reject its use if there is sufficient doubt over its robustness.

SECTION 2: CHARGES FOR CO-MINGLING, CABLELINK, TIE-CABLES AND ABORTED VISITS SHOULD BE SIGNIFICANTLY LOWER

2.1 For several years, BT appears to have over-charged for certain important services related to LLU operators locating their equipment in BT's local exchanges - co-mingling, tie-cables and cablelink – and for aborted visit charges (AVCs). This over-charging stems from inappropriate cost accounting methods and the setting of charges significantly in excess of costs. The fact that cases of significant over-charging continue to occur 14 years after the formation of Ofcom and after numerous market reviews, investigations and complaints demonstrates that Ofcom's approach continues to fail consumers and competition. We have explained that a step change is necessary if BT's behaviour is to be improved materially and consumers harmed less.

2.2 In the narrower context of this market review however, it is essential and necessary for Ofcom to set significantly lower charges for these services. Therefore we support the 'direction of travel' in Ofcom latest consultation. It is difficult for Sky to comment fully on these proposals because, as with the rest of Ofcom's WLA charge control proposals, there is simply insufficient information available. However, we think these proposals can and should go further.

2.3 For instance, despite the recent large reductions in cablelink prices which were both prompted by and reflected in Ofcom's proposed charge controls, we think they are still too high. BT and Ofcom assert that there is uncertainty over future costs but Ofcom has received evidence from other stakeholders that show costs are lower. Ofcom is also not proposing any future efficiency in these costs – this is unjustified and Sky considers that costs should be forecast to be lower and to reduce over the course of the charge control period.

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10 Paragraph 19.131, 'Business Connectivity Market Review' 2012/13, Ofcom consultation. (https://www.ofcom.org.uk/__data/assets/pdf_file/0019/63028/sections17-24.pdf.)

2.4 We also consider that AVCs should be subject to a charge control and that Ofcom's reasoning against one is unconvincing. First, it is clear that the AVC of £90 is not cost-oriented. Openreach engineer charges (and, accordingly, its costs) when they actually conduct work are far lower[11]. Second, assessing these costs can be no more difficult than other engineering costs – which Ofcom does routinely.

2.5 Clearly, where an Openreach charge for a service which is an essential component of providing broadband services is substantially above its costs there is a serious risk of consumer harm. Typically, in accordance with Ofcom's duties such conditions would trigger the imposition of a charge control or cost orientation condition. In Sky's view, there are no extenuating circumstances to consider an alternative approach.

2.6 We acknowledge that the AVC can act as a useful disincentive to CPs and to consumers to ensure that they do not miss or abandon visits by engineers but this is likely to persist even where the charge is more reflective of costs.

2.7 Further, high profits on AVCs will incentivise Openreach to levy this charge excessively. Openreach has a long track record of abusing the use of key charges and processes for its financial gain – for example, through the use of deemed consent. This significant breach of BTs regulatory obligations went on for many years and required CPs to raise disputes – despite a dearth of information. It is not appropriate therefore for Ofcom suggest that the dispute route is the best option for preventing excessive AVCs.

2.8 We think it appropriate for Ofcom to set a cost-based AVC charge control.

2.9 For co-mingling and tie-cables there is a common cause of over-charging – the recovery of costs twice. In addition, for co-mingling BT under-reported service volumes and inappropriately allocated certain GEA costs – both of which have led to a further over-statement of co-mingling costs. Charges should be reduced to reflect the efficient level of costs.

SECTION 3: IT IS APPROPRIATE TO REDUCE STARTING CHARGES IN THE CHARGE CONTROLS

3.1 Sky considers that there should be immediate price reductions at the start of the charge control period in order to take account of BT's inappropriate cost attributions which have overstated the costs of BT's regulated WLA services. Failure to do so would mean that consumers would continue to pay higher prices than if BT had prepared its regulatory reporting in an appropriate and objective manner in accordance with its obligations.

Ofcom failed to address this important issue in the March 2017 WLA Charge Control consultation

3.2 In short, Openreach's WLA prices today are as high as they are because BT attributed costs to regulated WLA services in an inappropriate and non-causal manner – as concluded by Ofcom and its consultants (Cartesian) in the Cost Attribution Review (CAR, 2015). This was a big deal with hundreds of millions of pounds per annum over several years being allocated to regulated services when they should have allocated to non-regulated parts of BT operating in competitive markets. As a result, the issue of how to

[11] Ofcom previously found that Openreach's charges for special fault investigations were unduly high, and should be no more than £52.60. See further: 'Disputes between BT and each of TalkTalk and Sky in relation to BT's historical charges for SFIs and TRCs' Ofcom final determination in case CW/01185/07/16, 17 November 2016. (https://www.ofcom.org.uk/__data/assets/pdf_file/0016/94120/cw_01185-Disputes-between-BT-and-each-of-TalkTalk-and-Sky-in-relation-to-BTs-historical-charges-for-SFIs-and-TRCs.pdf.)

deal with effects of BT's discredited cost attributions was subject to significant focus in the last Business Connectivity Market Review with Ofcom giving over several pages of its consultations to deal with the topic.

3.3 However, in Ofcom's March 2017 WLA Charge Control consultation there was no discussion whatsoever of the CAR. In Sky's view, this was a clear error and, as such, is a failure of due process. In any event, we and other stakeholders raised the issue in our responses to that consultation and the adjacent consultation on a proposed direction specifying fair and reasonable MPF prices.

Ofcom's subsequent justification for not making one-off price reductions is without merit

3.4 In light of these responses, Ofcom is now seeking to justify not making a starting charge adjustment (SCA) in the next WLA charge control by arguing variously that:

(a) today's WLA prices appear to be similar to their costs;

(b) while using an appropriate cost allocation method would have lowered BT's WLA costs this would likely have been off-set by cost increases driven by cost re-allocations to WLA from business connectivity markets; and

(c) the cost impact of BT's inappropriate cost attributions on BT's current WLA charges is smaller than reported in the CAR.

3.5 These arguments for not imposing starting charge adjustments do not stand up to scrutiny.

3.6 First and foremost, whether current prices are close to their costs is irrelevant and to rely on this argument is a violation of the key principle that underpins all of Ofcom's setting of charge controls – namely, the 'fair bet' that allows BT the <u>opportunity</u> to recover its efficiently incurred costs. Ofcom forecasts the costs of providing regulated services and sets charge controls accordingly. If BT reduces its costs below the forecast level it keeps the additional returns. Equally, if its costs are higher than forecast it bears the losses (or reduced returns).

3.7 In this case, costs have been inappropriately overstated and, as a result, today's charges have been set too high. It is now fully justified for there to be a starting charge adjustment to ensure that when the new charge control starts prices no longer reflect any costs that Ofcom has found should not be included. If, as a result, prices at the start of the charge control fall below BT's current costs then this merely reflects the fair bet in action i.e. BT's actual costs of providing WLA services are higher than those forecast by Ofcom at the start of the charge control (after excluding inappropriate costs) and BT makes lower returns. This is exactly how a charge control should work.

3.8 Allowing charges to be higher to reflect costs that are not relevant to WLA services would effectively shelter BT from the fair bet and reward it for adopting cost allocations which have been found to be subjective and non-causal.

3.9 Second, it is incorrect to argue that if current WLA charges had been set on a fairer basis where certain costs that BT had allocated to WLA were instead appropriately allocated to non-regulated BT services, then any subsequent reduction to WLA charges would have been offset by the re-allocation of costs from regulated business connectivity markets. This is because regulated charges in business connectivity markets already reflected those costs and to re-allocate them to WLA and include them in WLA charges would result in double-recovery from each set of charge controls.

3.10 In contrast, it is entirely appropriate to purge WLA charges of costs that should have been allocated to unregulated markets because there is no risk of double-recovery from another regulated market. This is an uncontroversial point and was put forward by Ofcom in the business connectivity market review.

3.11 Third, Ofcom argues that the impact on current WLA charges of BT's cost allocations is smaller than reflected in the CAR but then presents evidence which shows that the impact may still be significant. This implies that an adjustment should be made.

3.12 Ofcom outlines that the earlier set of BT accounts (2011/12) upon which current WLA charges are based included less inappropriate cost allocations than the accounts reviewed in the CAR (2014/15). In Table 3.24 of the September 2017 consultation Ofcom presents evidence which shows that £400m to £500m of 2011/12 costs were subject to the inappropriate allocation method whereas this rose to £500m to £1,000m in 2014/15. It is clear that these lower 2011/12 costs are still significant and not materially lower than the lower bound of the 2014/15 figures.

3.13 In summary, starting charge adjustments at the next charge control are essential to ensure that consumers no longer pay excessive prices and BT is no longer rewarded for overstating the costs of regulated WLA service. Ofcom has not put forward any compelling reasons why such steps are not fully justified.

SECTION 4: OFCOM IS CORRECT TO FORECAST LOWER CUMULO COSTS

4.1 Sky agrees with Ofcom that it is justified to assume that BT's non-domestic rates (also known as cumulo) bill is likely to fall below the level indicated by the latest ratings list. While these ratings show significant increases in the rateable value of BT's network (and of other communications networks), it is also highly likely that BT's actual rates bill will fall substantially. This would be in keeping with previous ratings periods.

4.2 As such, it is entirely appropriate for Ofcom to draw upon contemporaneous evidence to forecast reductions in BT's cumulo costs and that these lower costs should be reflected the WLA charge controls. The non-domestic ratings regime and, more specifically, the unique approach that the Valuations Office Agency (VOA) adopts with BT are highly technical and opaque such that it is not easy to predict the future trajectory of BT's cumulo costs. However, the scale of these costs that are included in regulated charges and the differences between initial ratings and BT's subsequent rates bill are so significant that is vital that Ofcom takes reasonable steps to forecast how these costs may change.

4.3 The latest ratings list is relatively new and is now operating under a new process that may mean that previous reductions in BT's rates costs subsequent to previous ratings lists may not be a good indicator of future trends. It is not clear at this stage. Ofcom has chosen to rely on Virgin Media's recent reductions in its rateable value as a proxy for what BT may achieve. This appears reasonable – and certainly better than not forecasting any reduction in rates costs – but Ofcom should consider whether there are any differences between BT and Virgin Media that could justify a further adjustment to the forecast reduction. For instance, given its size and experience, it is possible that BT and its consultants will be at least, if not better, than Virgin Media at negotiating better outcomes from the VOA – this may be evident from previous rounds of ratings lists and appeals.

SECTION 5: OFCOM SHOULD INTRODUCE CHARGE CONTROLS FOR ALL GEA VARIANTS

5.1 Sky notes that the Secretary of State has written to Ofcom's Chief Executive, Sharon White, noting that "*price suppression could reduce demand for better services, such as fibre, and so will disincentivise investment in the network*"[12]. Plainly, the Secretary of State's view can have no bearing on Ofcom's decision, given that Government must ensure that Ofcom exercises its powers "*impartially*"[13].

5.2 Nevertheless, for completeness, Sky notes that imposing effective charge controls on Openreach is essential to ensure a competitive retail market. Properly imposed charge controls ensure that CPs that are dependent on Openreach's network are able to compete effectively with BT Retail, notwithstanding Openreach's SMP. As set out in Sky's GEA charge control submission, dated January 2017 (see Annex 1 to Sky's June 2017 submission), this is particularly important in relation to GEA services as:

(a) BT has enduring SMP in wholesale local access;

(b) as the broadband market moves to superfast broadband (and faster variants of superfast broadband), GEA has become an essential wholesale input;

(c) high GEA prices distort competition and harm consumers; and

(d) imposing a charge control would not materially lower the incentives to rollout FTTP networks and would in fact provide the scale needed to improve the potential for such networks.

5.3 BT has already taken advantage of the delayed introduction of a GEA charge control to grow its market share by promoting fibre in a way that competing CPs cannot replicate profitably. This will be partly addressed through the introduction of a charge control for BT's 40/10 Mbps service. However, it is not enough. Failing to impose a charge control on higher speed GEA variants (such as 55/10 Mbps and 80/20 Mbps) will undermine the effectiveness of the 40/10 charge control.

5.4 If Ofcom's WLA remedies are focused around the 40/10 Mbps service, BT will be incentivised to drive retail competition to higher speeds, where its wholesale inputs are not subject to charge controls. Indeed, BT is already doing this. BT Consumer recently announced that all of its Infinity 1 customers who can receive higher speeds will be moved to its Infinity 2, 76 Mbps service, without charge. If Sky were to follow BT by putting the same proportion of our superfast broadband base on a 76 Mbps service, it would cost Sky more than £[redacted] per annum. To match BT Consumer's proportion of its overall base on a 76 Mbps service would cost Sky nearly £[redacted] in one-off fees and close to £[redacted] per annum.[14]

5.5 To ensure that there is effective competition in relation to superfast broadband, Ofcom should extend its GEA charge controls to the 55/10 Mbps and 80/20 Mbps services.

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12 Letter from Rt Hon Karen Bradley MP to Sharon White, dated 15 August 2017. (https://www.ofcom.org.uk/__data/assets/pdf_file/0013/107140/dcms-letter.pdf.)

13 Article 3(3), Directive 2002/21/EC of the European Parliament and of the Council of 7 March 2002 on a common regulatory framework for electronic communications networks and services (Framework Directive).

14 Sky has written to Ms White regarding this issue. See letter from Stephen van Rooyen to Sharon White regarding 'BT Consumer', dated 18 October 2017.

SECTION 6: MINIMUM SERVICE LEVELS NEED TO BE HIGHER FOR NO EXTRA COST

6.1 Sky's strong focus on delivering the best customer service[15] provides Sky with the ability to differentiate itself from its competitors. Reliability and high quality customer service are important drivers for consumers when deciding whether to switch providers. Despite our extensive investment in customer service, however, Sky continues to be let down by poor quality of service from BT.

6.2 This is a concern apparently shared by Ofcom, which has placed great emphasis on improved quality of service. In April 2017, Sharon White emphasised the importance of quality of service, observing that "*success*" would mean "*Openreach, not Ofcom, setting its own stretching service standards*"[16]. In July 2017, Sharon White built on this sentiment, noting that greater emphasis was being given to "*getting it right first time*" and that Ofcom were "*planning tougher rules for Openreach to repair faults and install new lines more quickly*"[17]. This was presumably a reference to Ofcom's proposals in its March 2017 WLA QoS Consultation[18].

6.3 Sky considers that it is essential that BT improves its service quality significantly and, as such, supports Ofcom's efforts to raise the minimum service levels for repairs and provisioning by Openreach at this market review. However, Ofcom now proposes to row back significantly from its original proposals for the minimum service levels for repair. This is a retrograde step which will result in many consumers continuing to suffer from unacceptably low service levels for many years to come.

Openreach's unacceptably low service quality harms consumers and competition

6.4 Which? recently published the results of a survey that found that 53% of people had a problem with their broadband in the last year, ranging from slow speeds to connection drop outs and losing service entirely.[19] Poor Openreach service quality for repair and provisioning undermines consumer confidence in the fixed communications sector and, as such, acts as a brake on consumers engaging with the market and switching their services. The biggest beneficiary of reduced switching is the retailer with the largest subscriber base – namely, BT Consumer – which is able to retain its customers more easily as a result. Moreover, rightly or wrongly, some consumers also consider that as BT controls the access network via Openreach, purchasing communication services from BT Consumer will mean that they will be less exposed to the risks arising from low service quality than other Openreach-based communication providers.

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15 Sky has the lowest number of complaints for broadband and landline services and has the highest overall satisfaction and satisfaction with reliability of all CPs on the Openreach network (Pages 9 – 10, Ofcom 'Comparing Service Quality: The performance of broadband, landline and mobile providers' (12 April 2017).

16 'Delivering for consumers and citizens', speech by Sharon White at Which?, 12 April 2017. (https://www.ofcom.org.uk/about-ofcom/latest/media/speeches/2017/delivering-consumers-citizens-sharon-white.)

17 'Driving investment in our digital economy', speech by Sharon White to the Parliamentary Internet, Communications and Technology Forum, 10 July 2017. (https://www.ofcom.org.uk/about-ofcom/latest/media/speeches/2017/investment-digital-economy-sharon-white.)

18 'Quality of Service for WLR, MPF and FEA: Consultation on proposed quality of services remedies', Ofcom consultation, 31 March 2017 (the "March 2017 WLA QoS consultation").

19 'More than half of households experience problems with broadband', Which? press release, 21 October 2017. (https://press.which.co.uk/whichpressreleases/more-than-half-of-households-experience-problems-with-broadband/.)

Ofcom should not lower repair minimum service levels from its original proposal

6.5 In this latest consultation, Ofcom has lowered its proposed minimum service levels for repair. The table below sets out Ofcom's proposals and Sky's position on on-time repairs.

	Current level	First year (2018/2019)	Second year (2019/2020)	Third year (2020/2021)
Ofcom's proposal - March 2017	80%	83%	90%	93%
Sky's response – June 2017[20]	80%	85% - 87%	90%	93%
Ofcom's proposal – September 2017	80%	83%	86%	88%

6.6 Ofcom's latest position is profoundly disappointing and does not serve consumers well. Ofcom has proposed reducing BT's minimum service levels to the point that for the first two years they would be below the levels that BT presently achieves (as set out in Sky's June 2017 response, BT was meeting its LLU repair target approximately 85% of the time for MPF SML1 and approximately 87% of the time for MPF SML2), and there would only be marginal improvements in the third year.

6.7 If Ofcom were to implement these proposals, it would be a retrograde step that would signal to Openreach that it can reduce its service quality over the next two years and it is not expected to improve materially its service quality further during the market review period.

6.8 In coming to its current proposal, it appears that Ofcom has accepted – without challenge – BT's proposed level of the 'glass ceiling' to the achievable level of repairs and selected historical data from the worst performing region and year to inform its minimum service level.

6.9 It is plainly wrong to take such an unambitious view when repair performance – as recognised by Ofcom – is a long way below where it needs to be. The purpose of setting increasing minimum service levels is to raise the performance of Openreach such that consumers experience significantly higher levels of service quality. Minimum standards for repair set on the basis of what has been achieved by BT's worst performing region (88%) is already well below what BT has achieved in aggregate (89.5%) and clearly does not sufficiently incentivise BT to improve its performance.

6.10 Moreover, reducing BT's minimum service levels further exposes CPs when considering Ofcom's proposed automatic compensation arrangements (whether introduced via a general condition or a voluntary industry code of practice). At present, SLGs do not cover the average costs incurred by CPs when there is an unresolved fault or late provision. Following the introduction of automated end-user compensation payments, and taking the current levels of SLGs, CPs will be financially worse off each time Openreach failed to meet its SLAs. Reducing the minimum service levels would increase CPs' exposure until such time as BT's SLGs are increased to cover appropriately CPs' related costs.

6.11 We think Ofcom should re-instate its proposed higher repair service levels – or at least increase them compared to its latest proposals – without raising the level of the latest proposed charge controls. Given the considerable harm caused by Openreach's repair

20 See further Sky's response to the March 2017 WLA QoS consultation.

performance and the only modest improvements targeted by Ofcom's amended minimum service level proposals, we think this is an essential step.

6.12 Sky has consistently argued that BT should not be entitled to recover any costs of improved Openreach service quality through regulated charges because this does not reflect normal commercial practice. Here, it is typical for service improvements to come at no (or less) cost.

Ofcom should assess Openreach's capabilities based on its most recent performance

6.13 Ofcom notes that Openreach's new analysis of SLA failures covers the period 2014/15 to 2016/17.[21] Whilst Openreach's service has improved over the last 12 months, its performance in those earlier years was particularly bad. Including data from these years results in an artificially low baseline for service completion and would allow Openreach to profit from its historic poor service levels. A far more appropriate starting point for analysing Openreach's potential performance is to consider its on time completion rates over the last 12 months.

6.14 Notwithstanding the inclusion of repair data from earlier years, Ofcom's proposal that Openreach's should only be required to repair failures on time 88% of the time is incongruous with Openreach's acceptance of the fact that it could make improvements on its side to improve its operational capabilities to 90.8%[22]. Indeed, Ofcom appears to have simply accepted Openreach's assertions on the practical operational limit to its performance and proposed an on-time completion requirement that is at the lowest end of Openreach's current estimate of the operational limit to its performance[23].

Ofcom must not accept Openreach's failings when determining its operational capabilities

6.15 Openreach asserts that its operational capabilities could be improved by 2% by:

(a) including an exemption for instances where the telecoms provider does not explicitly make an appointment with the end customer to ensure that the customer provides access to an Openreach engineer; and

(b) preventing telecoms providers from rejecting an Openreach fault clear within a 48-hour window should the end customer advise them that the fault has not been resolved to their satisfaction.

6.16 Whilst Ofcom does not intend to implement these changes proposed by Openreach,[24] it is concerning that Ofcom accepts that the glass ceiling for Openreach's operational capabilities should be lowered to take account of these issues[25]. This implies that Ofcom accepts that Openreach's current approach to faults that are either identified as requiring access to the customer's premises or faults that persist within 48 hours of apparently being repaired.

6.17 With regards to the first point, Sky agrees that Openreach should not be granted an exemption from meeting its commitment to on-time repairs due to being unable to access

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21 Paragraph 3.12, Further QoS Consultation.

22 Paragraph 3.14, Further QoS Consultation.

23 Paragraph 3.13, Further QoS Consultation. Openreach asserts that the practical operational limit to its performance lies within the range 88.7% to 92.6%.

24 Paragraphs 3.21 and 3.23, Further QoS Consultation.

25 Paragraph 3.24, Further QoS Consultation.

a customer's premises where the fault is classified as non-appointed. This issue arises due to the ineffectiveness of the diagnostic tools provided by Openreach, which do not enable CPs to ascertain whether access to the customer premises is required. In these circumstances, faults are classified as non-appointed to minimise inconvenience to consumers.

6.18 Openreach disingenuously suggests that, "*telecoms providers have resisted its efforts to appoint more orders and are happy to forego greater on-time success if it avoids increasing the possible inconvenience faced by their customers*."[26] The only attempt that Openreach has made to increase the number of appointed orders was in November 2016, where Openreach wanted CPs to appoint on the basis of 'T-Codes' that were only 30% accurate. Implementing this request would have meant that 70% of the time, customers would have been required to be at home for appointed repairs where this was not necessary. Ofcom itself recognises that appointing faults where appointments are not necessary causes inconvenience to consumers, who must ensure that access to their premises is available.[27]

6.19 Granting an exemption for Openreach for these repairs would remove the incentive from Openreach to address the underlying issue by improving the poor quality of their diagnostic tools. If Openreach delivers diagnostic tools that are fit for purpose, CPs would be better placed to determine whether a fault should be appointed. Ofcom recognises that appointing a greater proportion of faults in this way could provide efficiency benefits for Openreach.[28] Moreover, this would result in a much better consumer experience, with faults being repaired more quickly.

6.20 With regards to the second point, 'reject clear', this issue can only relate to GEA repairs as there is no 'reject clear' process for MPF services. Sky would have concerns if BT were allowed to circumvent its obligation to repair GEA faults on time where it has attempted a repair but failed to undertake that repair effectively. A consumer pays for a broadband or fibre service and expects it to work. SLAs are in place to ensure that Openreach minimises interruptions to that consumer's service when there is a fault. Consumers will not be satisfied if Openreach attempts to repair a fault if the fault then persists. This does not constitute an effective repair and Openreach must be held to its commitment to repair faults on time.

Openreach's national capabilities should not be determined according to the worst performing region

6.21 BT has 10 UK geographic operational regions. BT accepts that 92.2% is a "*reasonable representation of its operational capabilities at the UK level*". However, due to the fact that the proposed repair standards would apply to each of 10 geographic regions, BT has lowered the glass ceiling of its operational capabilities to 90.9%. This reflects BT's performance in its "*most challenging region*".

6.22 As Ofcom states, Openreach's performance does vary from region to region for a variety of reasons, such as geographical difficulties. As a preliminary point, Sky observes that this indicates that BT should be able to exceed 92.2% in geographic regions where the conditions are favourable. Bringing down BT's national obligations to the lowest level allegedly achievable in the country would undermine the regulatory regime if Ofcom given the importance of quality of service to consumers. Doing so results in a disproportionate negative impact on consumers in the nine other geographic regions. It would undermine the incentive for BT to improve its quality of service across the country if it only needs to

26 Paragraph 3.20, Further QoS Consultation.

27 *Ibid.*

28 *Ibid.*

provide a standard of care that reflects its capabilities in particularly difficult conditions, i.e. servicing the 'islands and highlands' where it can be more challenging to send engineers in a timely way.

6.23 A far more proportionate approach would be to vary the requirements in particularly challenging regions (or to exclude those regions, as is presently the case for Northern Ireland), or to set the average on a national basis.

MBORCs

6.24 In setting an allowance of 3% for repairs that occur during MBORCs ('matters beyond our reasonable control' – intended to be similar to *force majeure* events) in order to lower the minimum service level further (to 85%), Ofcom has selected a particularly bad year from 6 years ago (2011/12) which is unlikely to still be a robust basis upon which to set the allowance. We recommend that Ofcom updates this allowance with more contemporaneous data.

Ofcom's reliance on Openreach's "*new evidence*" is flawed

6.25 As outlined above, Sky considers it inappropriate for Ofcom to rely too heavily on BT's data such as its Resource Allocation Model or arguments regarding the 'glass ceiling'. Ofcom's own consultants have raised doubts over the reliability of the model and BT has a long track record of exploiting information asymmetry in order to overstate its costs and get a more favourable outcome when Ofcom sets charge controls on its regulated services. Sky considers it more appropriate to continue to rely on Ofcom's modelling commissioned from Analysys Mason as this is likely to be more robust and objective (although there may still be weaknesses).

6.26 Ofcom states that it obtained a random sample of 25 repair jobs from a larger data set to understand the failures in Openreach's operational capabilities and to "*scrutinise the integrity of the methodology*".[29] Openreach undertook around [redacted] repairs for Sky consumers in 2016/2017. A sample of 25 is not statistically significant and cannot reasonably be considered to provide any insight into the integrity of Openreach's methodology.

6.27 Relying on this "*new evidence*", Ofcom has proposed reducing the proportion of on-time repairs that Openreach must meet from 93% to 88%. This is a drastic drop that is not supported by evidence and is only marginally better than Openreach's performance today. This cannot be seen as a "*challenging standard*"[30]. Rather, it signals to Openreach that it does not need to undertake any material investment in its repair systems but should simply carry on as they do today.

6.28 As set out in Sky's June 2017 Response, Openreach is achieving its 87% SLA for on-time repairs for MPF SML2. As such, Ofcom's proposal that Openreach should only be required to achieve 83% in Year 1, 86% in Year 2 and 88% in the final year of the market review period falls significantly short of what should be expected by Openreach. In a competitive environment, one would expect to see stretching targets that deliver tangible benefits to customers and consumers. At the very least, Ofcom should:

(a) increase the Year 1 and Year 2 requirements to levels that are commensurate with Openreach's current performance and deliver improvements over time;

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29 Paragraph 3.17, Further QoS Consultation.

30 Paragraph 3.28, Further QoS Consultation.

(b) increase the requirements to take account of the fact that its national operational capability is 1.5% greater than its capability in its worst performing geographic region, and in many more regions, Sky assumes, it is performing significantly better.

(c) increase the Year 3 requirement to take account of the 2% improvement that Openreach could achieve if it rolled out effective diagnostic tools and adopted a 'right first time' approach to repairs.

Under Ofcom's approach, it will need to take account of the new, lower automatic compensation levels

6.29 Ofcom has outlined plans to include in its estimates of service level guarantee (SLG) costs the costs to Openreach of passing through to its wholesale customers increased compensation payments that reflect their need to make automatic payments of fixed compensation to consumers.

6.30 It now appears likely that the levels of automatic compensation payments to consumers will be lower than Ofcom's proposals. Ofcom has relied on figures from its automatic compensation consultation which contemplated consumers receiving £10 for loss of service and £6 for delayed provisioning for each day beyond committed service levels. They would also receive £30 for missed appointments.

6.31 However, industry is currently concluding arrangements for a voluntary industry code of practice (VICOP) for an automatic compensation scheme and the planned compensation payments are somewhat lower - £8 for loss of service, £5 for delayed provisioning and £25 for missed appointments. Even if Ofcom proceeds in including into its charge control calculations the increased SLG costs to Openreach associated with CPs automatic compensation payments to consumers, it will need to reflect these lower payment levels.

SECTION 7: ONGOING CONCERNS WITH OPENREACH'S QUALITY OF SERVICE THAT HAVE NOT BEEN ADDRESSED

7.1 As set out in Sky's June 2017 Response, the three most significant causes of consumer harm for Sky are:

(a) Dead on Arrivals ("**DOAs**") – when a fault develops within 8 calendar days of installation;

(b) Early Life Failures ("**ELFs**") – where a fault develops within 28 days of installation; and

(c) **repeat faults** – where a second fault develops within 28 or 30 days of a previously closed fault repair.

7.2 These concerns are not addressed in the Further QoS Consultation. Nevertheless, Sky continues to urge Ofcom to introduce new specific minimum service levels which set out the number of DoAs, ELFs and repeat faults which BT is allowed to incur within each period of the market review. Failure to address these concerns, will continue to have a detrimental impact on consumers and their propensity to switch suppliers. This will result in BT's entrenching its market leading position in the supply of broadband services and will stifle competition.

7.3 Similarly, Sky reiterates that:

(a) the remedies for **installations** do not go far enough. From April 2016 to March 2017, close to 3,000 'New Line Provide' orders per month had a different contractually committed date ("CCD") to the customer request date ("CRD"). This poor service is unacceptable and causes significant consumer harm. It results in long delays between the date on which a sale is made and the eventual date the service is delivered. As such, Sky proposes that Openreach is required to satisfy a KPI which tracks the CRD against CCD;

(b) **appointment availability** should be increased to 90% over the review period and **lead times** should be shortened to 8 working days; and

(c) the circumstances where BT can declare **matters beyond its reasonable control** ("MBROCs") should be more closely prescribed.

7.4 Given that Ofcom has not raised these points in the current Consultation, Sky has not repeated its submission in full, but refers Ofcom to Annex 6 of Sky's June 2017 Response.

Sky **October 2017**

ANNEX 1: RESPONSES TO OFCOM'S SPECIFIC QUESTIONS IN THE FURTHER QOS CONSULTATION

Question 3.1: Do you agree with our revised position on Openreach's operational capabilities for on-time repair? Please provide reasons and evidence in support of your views.

A1.1 No, Sky does not agree with Ofcom's revised position on Openreach's operational capabilities for on-time repair. As set out in section 2 of this response, Sky notes that Openreach is currently performing 87% of repairs on-time, which indicates that its operational capabilities are higher than 88%, and should continue to improve during the market review period.

A1.2 Further, Ofcom appears to have accepted that Openreach cannot improve its operational performance by a further 2% due to inefficient diagnostic tests and faults being mischaracterised as closed where the issue manifests itself again within the following 48 hours. This removes the incentive for Openreach to improve its own tests and fault resolution.

Question 3.2: Do you agree with the proposed levels of the repair standards? Please provide reasons and evidence in support of your views.

A1.3 No, Sky does not agree with Ofcom's proposed levels of the repair standards. As set out in section 2 of this response, Sky considers that Ofcom should:

(a) increase the requirements to take account of the fact that its national operational capability is 1.5% greater than its capability in its worst performing geographic region, and in many more regions, Sky assumes, it is performing significantly better.

(b) increase the Year 3 requirement to take account of the 2% improvement that Openreach could achieve if it rolled out effective diagnostic tools and adopted a 'right first time' approach to repairs.

Question 3.3: Do you agree with our proposed glidepath? Please provide reasons and evidence in support of your views.

A1.4 No, Sky does not agree with Ofcom's proposed glidepath. As set out in section 2 of this response, Openreach is currently capable of repairing 87% of repairs on-time. The proposed glidepath is a retrograde step, allowing Openreach's performance to deteriorate. Sky considers that Ofcom should increase the Year 1 and Year 2 requirements to levels that are commensurate with Openreach's current performance and deliver improvements over time.

Question 3.4: Do you have any further comments on our proposals for regulating BT's service performance for repairs? Please provide reasons and evidence in support of your views.

A1.5 Sky has set out its further comments in section 4 of this response.

Question 4.1: Do you agree with our resource uplift estimates as modified from our March proposals? Please provide reasons and evidence in support of your views.

A1.6 No, Sky does not agree with the resource uplift estimates. These figures appear to be based on Openreach's Allocation model and the RPM. Analysys Mason identified serious concerns with the former and concluded that, "*it would not be appropriate to rely on the Allocation Model alone as an input to our regulatory charge control models*".[31]

Question 5.1: Do you agree with our forecast as modified from our March proposals? Please provide reasons and evidence in support of your views.

A1.7 Sky cannot comment on Ofcom's revised forecasts due to the material redactions in section 5 of the September 2017 Consultation.

Question 6.1: Do you agree with the package of quality of service remedies we are proposing? Please provide reasons and evidence in support of your views.

A1.8 No, as set out above, Sky has material concerns about the proposed remedies for on-time repairs, and seeks:

(a) new specific minimum service levels which set out the number of DoAs, ELFs and repeat faults which BT is allowed to incur within each period of the market review;

(b) a requirement for Openreach to satisfy a KPI which tracks the CRD against CCD;

(c) appointment availability to be increased to 90% over the review period and lead times to be shortened to 8 working days; and

(d) the circumstances where BT can declare MBORCs should be more closely prescribed.

Question 6.2: Do you agree that our proposed quality of services remedies (as revised) are objectively justifiable, not unduly discriminatory, proportionate and transparent? Please provide reasons and evidence in support of your views.

A1.9 No; for the reasons set out in this response, Sky does not agree that the proposed quality of services remedies (as revised) are objectively justifiable, not unduly discriminatory, proportionate and transparent.

[31] Paragraph 4.18, Further QoS Consultation.