

INTRODUCTION

The regulatory financial reporting provided by BT is a fundamental part of the current regulatory regime. The reports provide one of the ways by which BT demonstrate their compliance with some of their most important regulatory obligations. In particular the obligations relating to cost orientation, charge controls and no undue discrimination.

Compliance with these obligations is not black and white, different stakeholders will have different views as to what constitutes compliance and what does not. Concerns over discrimination may be completely unfounded when viewed in the light of one particular competitor but of material impact when considered against another operating to a different business model. Therefore the reports are not simply a statement by BT that they have complied; they must provide the detail of their relevant trading in order that stakeholders can assess this for themselves.

The current reports are not fit for purpose in some areas. Ofcom's work on replicability over the past two years has highlighted particular problems in the markets that cover private circuits. The reports covering broadband access fail to properly identify external supply from internal supply making compliance with no undue discrimination obligations impossible to consider. The growing and very important market for Ethernet services (AISBO) fails to accurately capture all sales or differences between internal and external supply. These are not new issues, they should have been corrected already but the improvements made to the format of the reports have diverted attention from the content.

These proposals made by Ofcom are a significant step towards addressing problems with the reports published over the last few years. They do not yet solve the problems; but they do propose some improvements for the next set of reports and most importantly they put in place a plan to address them more fully in time for the publication of the 2008/9 reports. Cable&Wireless believes that improvements to the reports are an essential part of effective regulation and supports these proposals from Ofcom.

Cable&Wireless believes that the issues in the business connectivity and broadband markets are the most important and the first step is to ensure that the reports capture revenues accurately and cover all relevant products with each market. This is the focus of these proposals. Showing any differences between internal and external supply clearly is also essential if the reports are going to be useful for assessing compliance with no undue discrimination and Ofcom correctly identifies that it is often necessary to look closely at the different downstream uses of the wholesale inputs in order to properly assess this.

Although the proposals address many of the important issues a number of them are proposed to be address through information that will only be supplied to Ofcom and not published. Publishing information is important, different issues will impact different businesses in different ways and therefore can only be properly understood through

publication to a range of stakeholders. There are issues of commercial confidentiality however some of the information that is proposed to be supplied only to Ofcom is a basic part of effective reporting. Cable&Wireless urge Ofcom to assess the information provided only to them and, where appropriate, require it to be published in a form that avoids overriding issues of commercial confidentiality. It should be recognised that the majority of information published in the regulatory reports is confidential, but there is an over-riding need to make it available to stakeholders.

Our comments above relate specifically to addressing the current problems that exist within BT's regulatory financial reports. These are the priority; but the reports must also be developed to address the changing nature of telecoms networks and regulation. These include the investment in next generation networks and geographic regulation in broadband. Ofcom has started to address the 21CN issue through the introduction of some 21CN components. Cable&Wireless welcome this but think these significant developments require a wide ranging debate between BT, Ofcom and other industry stakeholders. Ofcom should facilitate this debate over the next six to nine months in order that detailed proposals can be developed in good time for inclusion within the 2008/9 regulatory financial reports.

In summary Cable&Wireless believe these are a good set of proposals from Ofcom, in our view Ofcom is focusing attention in the correct areas. There is much more to do, and Cable&Wireless would like to see that happen more quickly, but these proposals will result in material improvements for the 2007/8 reports. In the remainder of this document we provide answers to Ofcom's specific questions.

ANSWERS TO OFCOM'S QUESTIONS

Question 1: Do you agree with Ofcom's proposal that BT provides an AFI that explains the difference between the revenue reported in the regulatory financial statements compared to the revenue recognised in BT's general ledger for 2007/08 for the markets covered by the replicability review?

During the replicability review Ofcom identified that there is a significant difference between the revenues reported in BT's regulatory financial statements and those actually generated by BT. In particular the regulatory reports miss out some types of revenue altogether and these account for nearly 20% of BT's external revenue from Partial Private

Circuits (PPCs). This is a serious issue; with omissions of this magnitude the regulatory reports cannot be considered to be fit for purpose.

Ofcom's proposals to resolve the problem are a welcome step forward. Clearly problems with the 'price x quality' calculation will extend to internal as well as external sales and in this case there is no general ledger value with which the results can be crosschecked. Therefore it is vital that the reasons for the differences are fully understood in order that the calculation of revenue can be improved giving users of the document confidence that the reported revenues are accurate.

This issue has highlighted a more general issue, it is not just in the markets that were subject to the replicability review where this type of issue exists, it could be true for all markets. The AISBO market, for example, fail to accurately report revenue – there is no mention of the various one-off charges associated with excess construction, resilience and moves and changes. Although these ancillary charges are often small in relation to total revenues they are very important both from the point of view of assessing compliance with cost orientation and no undue discrimination obligations.

Cable&Wireless believe that there are four steps required to address these issues:

1. Where issues have already been highlighted, such as those from the replicability review, the 2007/8 financial reports should address them – we note that this is the intention;
2. In **all** markets a balancing item should be reported for external sales that shows the difference between the actual revenues and the figures reported;
3. Ofcom should obtain, **for all markets**, a detailed reconciliation between the revenues derived from the price x quantity calculation and published in the accounts and the actual volumes and associated revenues from BT's external sales. While the full extent of this information may need to remain confidential between BT and Ofcom it may be necessary for Ofcom to share with CPs some of this information in order to ensure any differences are properly understood and addressed;
4. Where material differences exist a new methodology should be established in good time for inclusion within 2008/9 regulatory reports.

Question 2: Do you agree with Ofcom's proposal for BT to report OSPs, resilience and third party equipment charges separately in the relevant markets within the regulatory financial statements?

Yes, please see answer to question 1 above. With respect to OSPs and resilience charges these should also be provided in the AISBO market.

Cable&Wireless has argued for some time that it is the detail within the regulatory reports that is valuable and it is important that detail is published. Clearly there has to be a balance, it will not be practical to show volumes, revenues, costs for all individual elements sold within a regulated market. What is most important is that all those items that drive significant revenues, or where there are differences in the relative use between internal and external supply are fully identified. For other balancing items, it may be sufficient just to identify the revenues and not consider cost orientation specifically on those items but just at the aggregate level (as far as the published reports are concerned). This is something that Ofcom can explore further for the 2008/9 reports, with the benefit of the experience gained from these changes.

Question 3: Do you agree that BT should calculate and disclose service revenues on the CLZ and non-CLZ based prices in the relevant market statements?

Yes, please see answers to questions 1 and 2 above.

Question 4: Do you agree that BT should update its Accounting Documents to transparently describe how the transfer charges and external revenues are calculated?

Yes. In 2004/5 BT produced a reconciliation between the Carrier Price List and the prices used within the regulatory financial reports. This was published as part of the PPC internal reference offer. This document enabled the reader to understand exactly how the figures in the regulatory reports were calculated and in fact helped identify many of the weaknesses within the reports that are being considered today. Although on its own it did not fully explain all the calculations (in particular the rationale behind some of the constants used as Ofcom has identified) it does represent the simplest and best way to understand the calculations undertaken.

As part of the provision of a transparent explanation of internal and external reported revenues Ofcom should require BT to provide a similar spreadsheet based reconciliation in any market where the calculation is non trivial.

Question 5: Do you agree with Ofcom's proposal for BT to amend their current calculation of debtor days which is used to calculate notional debtors?

Yes, Cable&Wireless support Ofcom's proposal.

Question 6: Do you agree with Ofcom's proposals to amend the list of Network Components?

The list of network components does require regular review and BT's investment in 21CN makes this particularly important at this time.

The selection of the most relevant set of 21CN components is an important decision, ideally the components selected will stay relatively constant over a period of some years. The list of components proposed here is a start but it comes with very little explanation and there has been no dialogue with other Communications Providers to discuss the most appropriate items. Cable&Wireless believe that a more comprehensive debate should occur over the choice of 21CN components and urge Ofcom to facilitate that debate over the next nine months in order that an agreed list of 21CN components can be established in good time for the 2008/9 regulatory reports.

In the meantime we offer some simple comments on the list proposed:

- Access cards (for other services) should be split into at least two components, one covering legacy cards (TDM and ISDN) and the other(s) covering Ethernet, possibly splitting that between low speed and high speed;
- A separate MSAN-Metro component is proposed for 'dense' and 'non dense' but is not clear that these are really different components. A better choice of components might be the connectivity links themselves, one type makes use of DWDM and the other does not. For any given MSAN the connectivity will sometimes be provided by one type of link, sometimes by the other, and sometimes by a combination of both. As they stand the proposed connectivity components are likely to lead to confusion, a risk of double counting and a lack of transparency;
- It is not clear exactly what falls under MSAN-Metro compared with MSAN-BRAS and MSAN-POSI, are these latter two in addition to the first, or instead of the first? If they are in addition then there seems little reason to split them between 'dense' and 'non dense' and if they are instead of then the point above applies;

- There are two different components for the combi card – one for voice and one for broadband – but as it is, by its very name, one card that will do with voice, or broadband, or both, is it really possible to split it into two components?
- A key consideration in deciding whether to separate out components into greater numbers is the expected overall cost of those components and way they are used by different products – the lack of this information at this stage makes it hard to form views. For example, if the I-node costs are large it may be appropriate to break that down into origination, termination and transit.

Question 7: Do you agree with Ofcom's proposal requiring BT to provide Ofcom with the details of the cost stack underlying the regulated PPC and technical area services?

The reporting of the underlying costs in the business connectivity markets currently suffer from a number of issues. Cable&Wireless supports Ofcom's efforts to better understand these issues and the underlying costs in order to improve the reporting going forward. However, these issues are not new, they first came to light during the replicability work several years ago. The justification for yet another year of delay does not exist, there is certainly no reason for this information to be provided only to Ofcom and it should be published along with the rest. BT's regulatory reporting should not be optional.

Question 8: Do you agree with Ofcom's proposal for additional disclosure of non matched sales and costs in the RFR to assist users understanding of the underlying return for that market?

Yes, where the accounting treatment of sales does not match that used for the costs driven by those sales it should be clearly identified within the reports.

Question 9: Do you agree with Ofcom's proposal to expand the list of services reported in the ASBO market?

The 2006/7 reports for the ASBO market completely fail to address the issue of BT's compliance with its obligation not to unduly discriminate as they provide so little detail and don't identify internal and external sales properly. A radical overhaul of this part of the regulatory reports is required to make the regulatory reports fit for purpose.

The next challenge in this area will be dealing with the different geographic markets found by Ofcom in its recent market review. In the future BT will clearly expect reduced reporting

obligations in this market due to the fact that it no longer has SMP within market 3. However, importantly this does not mean no reporting obligations; it is essential that adequate reporting remains in the areas where BT does have SMP and to the extent that costs are shared between the different broadband markets clear and transparent details of the allocation of those costs between SMP and non SMP markets is required. Cable&Wireless look forward to the debate on regulatory reporting requirements in geographic markets and urge Ofcom to commence this sooner rather than later as the issues are clearly complex.

Question 10: Do you agree with Ofcom's proposal to expand the list of disclosed services in the AISBO market?

Yes. The 2006/7 reports did not adequately address the AISBO market. It is very likely that some revenues were missed out in the reports and furthermore the reports failed to identify any difference in main link charges between internal and external supply; differences that almost inevitably exist.

Cable&Wireless welcomes the improvements proposed by Ofcom. However, it is not clear that these improvements go far enough, for example how are the sales of WES Local Access identified. Clearly it is not possible to publish full detail on each product variant individually but all sales must be included within the reports, our preference is to see the main services broken out in detail, showing detail of costs against revenues. Other, lower value services should be shown in aggregate, along with relevant cost information at the aggregate level. However, where such aggregates are shown a further breakdown on revenues and volumes, shown separately for internal and external supply, should be identified in order to demonstrate compliance with non-discrimination obligations. This additional information is fundamental; it should not be optional for BT to provide it, or to limit it only to Ofcom.

Question 11: Do you agree with Ofcom's conclusion that the attribution treatment of LUS costs is currently inappropriate in the context of BT's USO obligations and therefore the Accounting Documents and in turn the Regulatory Financial Statements should be amended?

Yes. The costs associated with BT Retail's Light User Scheme have no place in the regulatory financial reports of products sold by Openreach.