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# **Consent for KCOM to defer its 2018/19 Regulatory Financial Statements**

Explanatory statement and Consent

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# 1. Explanatory statement

## Consent to defer the 2018/19 Regulatory Financial Statements

### Background and summary

- 1.1 Since 2004, KCOM has been subject to regulatory financial reporting requirements across all of the fixed telecoms markets in which it is regulated, these currently comprise:
- wholesale local access market;
  - business connectivity markets;
  - narrowband markets; and
  - wholesale broadband access markets.
- 1.2 As part of these requirements, each year KCOM prepares Regulatory Financial Statements ("RFS"). These are prepared according to a defined framework and methodology and include published statements as well as information that is submitted to Ofcom privately.
- 1.3 These requirements are designed to provide us with the information that we need to make informed regulatory decisions, monitor compliance with regulatory obligations, ensure that obligations address underlying competition issues, and investigate potential breaches of obligations. They should also provide reasonable confidence to stakeholders that KCOM has complied with its SMP conditions and add credibility to the reporting regime.
- 1.4 These requirements are imposed on KCOM by way of an SMP condition set in each regulated market and a suite of directions imposed in each market pursuant to that SMP condition. The SMP condition sets out our general regulatory financial reporting requirements, including any accounting separation and cost accounting obligations. The directions then set out our detailed financial reporting requirements.
- 1.5 In all the markets in which KCOM is regulated (set out in paragraph 1.1), KCOM is required to publish and deliver to Ofcom the RFS and the corresponding audit opinion by 31 July (i.e. within four months after the end of the financial year to which the RFS relate).
- 1.6 On 13 June 2019, KCOM wrote to Ofcom to explain that the 31 July deadline for submitting its 2018/19 RFS was impracticable in the circumstances and requested an extension of two months, with a new deadline of 30 September 2019.
- 1.7 KCOM set out in its letter that the requested extension would be necessary due to the proposed acquisition of KCOM by MEIF6 Fibre Limited.<sup>1</sup> KCOM explained the manner in which the process for producing the audited RFS relates to its audited statutory accounts and how this process has been delayed in light of the proposed transaction that would see KCOM become a private entity. KCOM also explained that finalisation of the 2018/19 RFS had been delayed due to deployment of resource and time from the finance team towards executing the prospective transaction.

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<sup>1</sup> See: <https://www.londonstockexchange.com/exchange/news/market-news/market-news-detail/other/14095189.html>

- 1.8 On 26 July 2019, KCOM wrote to Ofcom to explain how the circumstances had developed. It explained that the proposed acquisition had been delayed due to the auction process established by the Takeover Panel,<sup>2</sup> and how this delay had put additional time and resource constraints on the Group's finance team. KCOM noted that it continued to expect to file the 2018/19 RFS by the proposed new deadline of 30 September 2019.
- 1.9 We consider that the prompt publication of the 2018/19 RFS is important because it provides Ofcom with the information necessary to make informed regulatory decisions. It also provides transparency and reasonable confidence to stakeholders that KCOM has complied with its SMP obligations. Nevertheless, we recognise that the prospect of the proposed acquisition of KCOM by MEIF6 Fibre Limited and related processes and being taken into private ownership constitutes an exceptional circumstance and it is thus reasonable on this occasion to accept a two-month delay to the publication of KCOM's RFS due to the changes in process and resourcing identified to us in KCOM's letter of 13 June 2019.
- 1.10 We have therefore decided to consent to KCOM's 2018/19 RFS being published and delivered to Ofcom no later than six months after the end of the financial year to which they relate, on 30 September 2019.
- 1.11 This consent relates only to the publication deadlines for KCOM's 2018/19 RFS and any corresponding audit opinion.

## Legal tests

- 1.12 We have considered our decision to grant the consent against the tests set out in section 49(2) of the Communications Act 2003 (the "Act") and have concluded that it is:
- a) objectively justifiable as it allows KCOM sufficient time in which to prepare its 2018/19 RFS in the context of the proposed acquisition;
  - b) not unduly discriminatory because BT is the only other SMP provider which has regulatory accounting obligations and, given the context of the proposed acquisition of KCOM which would take it into private ownership, it is not facing the same resource and process considerations in preparing its 2018/19 RFS;
  - c) proportionate, as it does not grant more additional time than is necessary for KCOM to prepare its 2018/19 RFS; and
  - d) transparent, in that it is clear that Ofcom's intention is to ensure that KCOM has sufficient time in which to prepare its 2018/19 RFS in the context of the proposed acquisition and KCOM's obligations following this consent are clear.
- 1.13 We do not consider that the granting of this consent will have a significant impact on a market for any of the services, facilities, apparatus or directories in relation to which we

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<sup>2</sup> See: <https://www.londonstockexchange.com/exchange/news/market-news/market-news-detail/other/14155214.html>

have functions under Section 1 of the Act.<sup>3</sup> We have therefore decided not to carry out a domestic consultation. We also consider that the granting of this consent is not of EU significance as in Ofcom's opinion it would not affect trade between Member States.<sup>4</sup>

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<sup>3</sup> As set out in section 49A(1)(b) of the Act.

<sup>4</sup> The cumulative criteria that must be satisfied in order for a proposal to be of EU significance include the criterion that the proposal would, in Ofcom's opinion, affect trade between Member States (please see section 150A(2)(d) of the Act).

# A1. The Consent

## **Consent under section 49 of the Communications Act 2003 and SMP services condition OA1 set out at Annex 2 of the 2004 Statement, SMP services condition 13A.3 set out at Annex 29 of the FAMR Statement, SMP services condition 8A3 set out at Annex 2 of the WBA Statement and SMP services condition 7.6 of the 2019 BCMR Statement**

### **Background**

- A1.1 On 22 July 2004, Ofcom published a statement entitled “The regulatory financial reporting obligations on BT and Kingston Communications Final statement and notification – Accounting separation and cost accounting: Final Statement and notification” (“July 2004 Statement”).<sup>5</sup> At Annex 3 of that statement, Ofcom imposed SMP conditions with respect to regulatory accounting (Conditions OB1 to OB33) on KCOM in markets in which KCOM had been found to have significant market power in previously concluded market reviews.
- A1.2 At Annex 5 of the July 2004 Statement, Ofcom published various directions for KCOM given under the SMP conditions. These included directions (“2004 Regulatory Financial Reporting Directions”) specifying network components (“Direction 1”), Transparency (“Direction 2”), Preparation, audit, delivery and publication of regulatory financial statements (“Direction 3”), Form and content of Regulatory Financial Statement (“Direction 4”), Form of the ‘FPIA’ opinion for financial statements (“Direction 5”) and Form of the ‘PPIA’ opinion for financial statements (“Direction 6”) for the purposes of, among others, SMP Conditions OB1 to OB33. The 2004 Regulatory Reporting Direction have been subsequently amended on various occasions.
- A1.3 On 28 April 2016, Ofcom published a statement “Business Connectivity Market Review: Review of competition in the provision of leased lines” (“2016 BCMR Statement”).<sup>6</sup> The 2016 BCMR Statement found that KCOM continues to have significant market power in each of the markets covered by the review in the Hull Area. Ofcom decided to set on KCOM SMP conditions under section 45 of the Act designed to encourage greater competition in leased lines in the Hull Area. These included SMP conditions OB1 to OB33 in respect of regulatory financial reporting. Ofcom also amended, where necessary the 2004 Regulatory Financial Reporting Directions. As set out at section 4 of Annex 35 of the 2016 BCMR Statement, Ofcom modified Direction 1.
- A1.4 On 30 November 2017, Ofcom published a statement “Narrowband Market Review: Statement” (“2017 NMR Statement”).<sup>7</sup> The 2017 NMR Statement found that KCOM

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<sup>5</sup> Ofcom, [The regulatory financial reporting obligations on BT and Kingston Communications](#), 22 July 2004.

<sup>6</sup> Ofcom, [Business Connectivity Market Review](#), 28 April 2016.

<sup>7</sup> Ofcom, [Narrowband Market Review Statement](#), 30 November 2017.

continues to have significant market power in each of the markets covered by the review in the Hull Area. Ofcom decided to set on KCOM SMP conditions under section 45 of the Act designed to encourage greater competition for Narrowband services in the Hull Area. These included SMP conditions OB1 to OB33 in respect to regulatory financial reporting. Ofcom also amended, where necessary the 2004 Regulatory Financial Reporting Directions. As set out at section 2 of Annex 9 of the 2017 NMR Statement, Ofcom modified Direction 1.

- A1.5 On 31 July 2018, Ofcom published a statement entitled “Wholesale Local Access and Wholesale Broadband Access Market Reviews: Review of competition in the Hull Area” (the “2018 WLA and WBA Statement”).<sup>8</sup> The 2018 WLA and WBA Statement presents Ofcom’s conclusion that KCOM continues to have significant market power in each of the markets for wholesale local access and wholesale broadband access in the Hull Area. Ofcom decided to set on KCOM SMP conditions under section 45 of the Act designed to encourage greater competition in the provision of fixed telecoms services for consumers in the Hull Area. At Annex 6 of that Statement, Ofcom revoked Conditions OB1 to OB33 from the July 2004 Statement insofar as they applied to the WLA and WBA markets and in their place imposed SMP Condition 8 with respect to regulatory accounting on KCOM in the WLA and WBA markets. This did not represent a change to the substance of the accounting separation and cost accounting conditions as set out in the July 2004 Statement but was a ‘structural’ change to the way in which the financial reporting obligations are imposed, aimed at clarifying KCOM’s obligations.
- A1.6 On 6 February 2019, Ofcom published a statement entitled “KCOM Regulatory Financial Reporting: Statement on new regulatory financial reporting directions covering all regulated fixed telecoms markets” (the “2019 KCOM RFR Statement”).<sup>9</sup> This statement set out Ofcom’s decision to revoke the existing SMP directions which apply to KCOM and impose fresh directions across all markets in which KCOM is regulated for the purposes of KCOM’s 2018/19 RFS and subsequent RFS. The changes were as follows:
- a) Direction 1 was revoked and replaced with the Network Component Direction. The list of network components in this direction is the same as that used by Ofcom in its 2016 BCMR Statement and 2017 NMR Statement, but applies to all of the markets in which KCOM is regulated.
  - b) Direction 2 was revoked and replaced with the Transparency Direction. There were no substantive changes to the existing requirements imposed by the new direction.
  - c) Direction 3 was revoked and replaced with the Direction for the preparation, audit, delivery and publication of the Regulatory Financial Statements. This amended some of the schedules and, in some cases, no longer requires KCOM to publish or provide them. It also requires KCOM to produce and publish the same level of information for the WLA market as for other regulated markets.

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<sup>8</sup> Ofcom, [Wholesale Local Access and Wholesale Broadband Access Market Reviews](#), 31 July 2018.

<sup>9</sup> Ofcom, [KCOM Regulatory Financial Reporting Statement](#), 6 February 2019.

- d) Direction 4 was revoked and replaced with the Direction for the form and content of Regulatory Financial Statements. The new direction set out that KCOM should update the cost categorisations used within some published schedules of its RFS, and that KCOM should report an actual ROCE across all relevant markets, rather than fixing it at 13%.
- e) Directions 5 and 6 were revoked and replaced with the Direction for the form of the 'PPIA' opinion for Regulatory Financial Statements. This changed the type of opinion required for the regulatory audit from 'FPIA' to 'PPIA'. Ofcom recognised that it was no longer appropriate and proportionate to require KCOM to obtain a 'FPIA' opinion on its RFS from its regulatory auditors.

- A1.7 On 28 June 2019, Ofcom published a statement entitled "Promoting competition and investment in fibre networks: review of the physical infrastructure and business connectivity markets" ("2019 BCMR Statement"). The 2019 BCMR Statement found that KCOM continues to have significant market power in the market for wholesale CI Access services in the Hull Area. Ofcom decided to set on KCOM SMP conditions under section 45 of the Act designed to encourage greater competition in this market in the Hull Area. These included SMP conditions 7.1 to 7.30 in respect of regulatory financial reporting. Specifically, Condition 7.6(b) requires dominant providers to publish their RFS and any corresponding audit opinions within 4 months after the end of the period to which they relate.
- A1.8 KCOM has requested that Ofcom consent to deferment of the 2018/19 RFS. It has requested that the RFS can be published and delivered to Ofcom on 30 September 2019, a two-month deferment with respect to the existing deadline, with the pre-publication RFS sent to Ofcom by 16 September 2019.

## **Decision to grant consent**

- A1.9 Ofcom has decided to consent to KCOM's request set out in paragraph A1.8 above. This consent shall take effect on the day it is published.
- A1.10 The effect of and reasons for granting the consent are set out in the accompanying explanatory statement.

## **Ofcom's duties and legal tests**

- A1.11 Ofcom considers that the consent referred to in paragraph A1.9 complies with the requirements of section 49(2) of the Communications Act 2003 (the "Act").
- A1.12 In granting the consent referred to in paragraph A1.9, Ofcom has considered and acted in accordance with its general duties set out in section 3 of the Act, the six community requirements in section 4 of the Act and the duty to take account of all applicable recommendations for harmonisation issued by the European Union in section 4A of the Act.



## **Interpretation**

A1.13 Except as otherwise defined, words or expressions used shall have the same meaning as they have been ascribed in the SMP services conditions set out in Annex 3 of the 2004 Statement, Annex 9 of the 2017 NMR Statement, Annex 6 of the 2018 WLA and WBA Statement and Annex 26 of the 2019 BCMR Statement. Otherwise any word or expression shall have the same meaning as it has in the Act.

**David Brown**

**Director of Regulatory Finance, Ofcom**

**A person authorised by Ofcom under paragraph 18 of the Schedule to the Office of Communications Act 2002**

26 July 2019