

Changes to BT and KCOM's regulatory and financial reporting 2012/13 update

Submission by BT

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Comments should be addressed to:

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Summary of our position

1. We note that Ofcom is currently conducting the 'Regulatory Financial Reporting Review' which will address fundamental issues in regulatory reporting. We responded to the first consultation of that process on 2 November 2012.
2. As we stated in our response to that consultation we believe that the review is appropriate and timely given that we are still required to produce and publish annually large amounts of revenue, cost and volume information at a granular level. Our view is that the current level of reporting goes far beyond what is legitimate or proportionate in light of the defined purpose of regulatory reporting and the identified attributes. Overall, we consider the detail we publish falls more into the category of data that is "useful and interesting" to Communication Providers ("CPs") rather than data that is required to answer an appropriately defined set of necessary regulatory questions.
3. For instance, and leaving aside the legitimacy of the requirement, in many cases Ofcom requires us to produce separate data on revenues and costs against connections and rentals for the same services. We have to therefore design our systems and establish allocation bases that are capable of fully allocating costs in this way. However, accounting allocations are increasingly subjective at this level of granularity and such allocations say very little about the 'right' way to structure prices across upfront and recurring charges for a particular service. The concern we have – reflecting recent history – is that the production and availability of the subjective cost data drives the regulatory decision making, rather than clear regulatory assessments of markets and the potential scope for anti-competitive activity driving the requirements to publish specific granular data.
4. Therefore, whilst we welcome the proposal in Ofcom's consultation "Changes to BT and KCOM's regulatory and financial reporting 2012/13 update" published on 23 January 2013 ("the Consultation"), to remove the requirement for us to publish Distributed Long Run Incremental Cost ("DLRIC") and Distributed Stand Alone Cost ("DSAC") information for certain services¹ in the LLU/WLR markets we are disappointed at Ofcom's proposals to retain other detailed cost reporting obligations. Reporting at a level more granular than the market, or even basket, level is disproportionate where cost orientation is not imposed.
5. Without prejudice to our position on the legitimacy of the reporting obligations imposed on us by Ofcom, should Ofcom impose the proposed changes on us:
 - We anticipate being able to make the necessary changes to our reporting systems and processes to enable publication of the 2012-13 RFS on or before 31 July 2013. However, should Ofcom impose additional requirements or alternative obligations, this may lead to a publication delay; and
 - Our concerns in response to the Consultation must be considered within the context of the wider 'Regulatory Financial Reporting Review'.

¹ MPF rentals, MPF ceases, SMPF ceases, Enhanced Service Level Care Services, analogue core WLR rentals and WLR transfers

Ofcom's consultation questions

Question 1 – Do you agree with Ofcom's proposed amalgamation of certain low revenue disclosed services in the AISBO, WBA, Call Origination, Call Termination and Point of Handover markets?

6. The current level of granularity in the Regulatory Financial Statements ("RFS") is excessive and disproportionate. For example, in the 2011-12 RFS we were required to publish details of 202 services, of which 120 have revenue of less than £10m. Therefore, Ofcom's proposals to amalgamate some low revenue services do not go far enough to address the excessive information we are required to publish in the RFS. Our comments on the specific proposals are below.

Proposal: Amalgamate Backhaul Extension Service ("BES") and Wholesale Extension Services ("WES") connections into 'Other Ethernet connections' reporting

7. Subject to paragraph 8 below, we agree that BES connections and WES connections should be amalgamated and reported within other internal and external Ethernet connections. New supplies of the service, of which the connection price is a part, ceased in June 2012 so the associated revenue will be immaterial for 2012-13.
8. However, for the purpose of demonstrating compliance with our cost orientation obligations, it is sufficient that BES and WES services are amalgamated and reported, at most, at no greater detail than the service level (i.e. by bandwidth). It is neither appropriate nor proportionate to require connections and rentals to be reported separately.

Proposal: Amalgamate Datastream services into 'Ancillary services' reporting

9. Revenue from Datastream services is immaterial for Wholesale Broadband Access ("WBA") Markets 1 and 2 and is not forecast to grow and we therefore agree these services should be amalgamated within Ancillary services.

Proposal: In the Call Origination Market amalgamate 'Internal Wholesale call origination local exchange Stick' and 'Internal Wholesale call origination local exchange Stick (ISDN)'

10. The revenue for both services is immaterial and is not forecast to grow and we therefore agree these services should be amalgamated into one service called 'Internal Wholesale call origination local exchange Stick (PSTN & ISDN)'.

Proposal: In the Call Termination Market amalgamate 'Internal Wholesale call origination local exchange Stick' and 'Internal Wholesale call origination local exchange Stick (ISDN)'

11. The revenue for both services is immaterial and is not forecast to grow and we therefore agree these services should be amalgamated into one service called 'Internal Wholesale call termination local exchange Stick (PSTN & ISDN)'.

Proposal: Split External 3rd Party Rentals services between charges for equipment and charges for circuits

12. In Ofcom's 'Points of Handover pricing review'² Ofcom required us to implement a charging structure incentivising migration from Type II to Type I Points of Handover ("POHs"), on the basis that the latter allowed more efficient POHs utilisation.
13. The current presentation of External 3rd Party POHs Rentals services in the RFS does not reflect the revised charging structure as Type I equipment is not sold by bandwidth. Therefore, we agree that it is appropriate to only publish one service for Type I equipment, as this is how the service is sold to customers.
14. For Type II POHs we agree that we should only separately publish details of services by bandwidth where revenue for a bandwidth is greater than £1m. We note that the total revenue for POHs is only c£6m.

Question 2 – Do you agree with Ofcom's proposal for separate disclosure of EAD Local Access and Wholesale Broadband Connect services?

Proposal: Report separately external and internal Ethernet Access Direct ("EAD") Local Access connections and rentals across 10Mb, 100Mb and 100Mb bandwidths

15. The EAD local access services are a growing proportion of total EAD services and we therefore agree these should be separately reported in the RFS.
16. However, for the purpose of demonstrating compliance with our cost orientation obligations, it is sufficient that EAD services are reported, at most, at no greater detail than the service level (i.e. by bandwidth). It is neither appropriate nor proportionate to require connections and rentals to be reported separately.

Proposal: Report separately Wholesale Broadband Connect ("WBC") revenues across WBA Markets 1 and 2

17. Revenue from WBC services has grown and we therefore agree these should be separately reported in the RFS.

Question 3 – Do you agree with the proposed changes to the presentation of the RFS?

Proposal: Publish the RFS online in an Excel format

18. We agree that the published RFS could also be presented in spreadsheet format to make them easier to access, interpret and use. We plan to make the 2012-13 RFS available on our website in spreadsheet format on the date that the RFS is published.

² Ofcom's 'LLCC PPC Points of Handover pricing review Final Statement on modification of SMP Conditions' published 21 September 2011

Proposal: Remove the average price/FAC column from market summaries

19. We agree this column in the RFS should be removed as this information is unnecessary to show our compliance with regulatory obligations and is only of general interest to CPs.
20. As we shall be publishing an Excel version of the RFS for 2012-13, this calculation can be easily reproduced by users if required.

Proposal: Re-ordering of some of the reported information

21. In order to make the RFS easier to read and use by the user we have proposed changes to the structure of the RFS. The changes only relate to the order of information and no information that was previously included in the RFS (other than information excluded as a result of this Consultation) will be excluded in the new format.
22. We shall also include a table in the 2012-13 RFS mapping the structure between the 2011-12 and 2012-13 RFS to make it easier for the reader to understand the changes.

Question 4 – Do you think we have fairly reflected the decisions of the relevant market review in the scope, form and content of the RFS?

23. Whilst we welcome the removal of the requirement to publish DLRIC and DSAC information for certain services we are disappointed at Ofcom's proposals to retain other detailed cost reporting obligations. Reporting at a detailed level greater than the market or even basket level is disproportionate where cost orientation obligations do not apply.
24. Ofcom's proposals mean we will still be required to produce and, with the exception of DLRIC and DSAC information, publish on an annual basis a large amount of revenue, cost and volume information at the same high degree of component/service granularity.
25. We have a number of concerns with Ofcom's rationale for maintaining these obligations and set these out in detail in our response³ to Ofcom's "Business Connectivity Market Review: Further Consultation" published on 15 November 2012 ("the BCMR Consultation"). We have summarised our concerns below:
 - In terms of monitoring compliance with **charge controls**, the only relevant issues for consideration are year on year movements in prices and volumes across the relevant charge control baskets or sub-baskets. This enables weights to be applied to different prices and the overall level of achieved X to be revealed, providing the necessary transparency on compliance. Therefore, publication of cost information is not relevant to any assessment of compliance in this area as it does not help with identifying year on year movements in prices and volumes.

³Available at <http://stakeholders.ofcom.org.uk/consultations/bcmr-reconsultation/?showResponses=true>

- In terms of monitoring compliance with **non-discrimination obligations**, regulatory reporting can only focus on price discrimination and, here, compliance is shown by simply confirming that internal and external customers face the same prices for the same regulated services. This does not require publication of cost information at a level of granularity below that of the defined markets.
- In relation to **information required to support Ofcom in conducting investigations** Ofcom has specific information gathering powers which it can rely on to request the information it requires for that purpose. However, the fact that Ofcom may require such information if it has to conduct a compliance investigation is not of itself a valid reason for requiring the routine provision to Ofcom or, in particular, the publication of a wider range of financial information such as that now proposed. Indeed, the fact that there are formal information gathering powers to be used in such circumstances suggests exactly the opposite.
- We understand that **in conducting market reviews**, Ofcom will want to assess – among other things – evidence on profitability of services within certain defined markets. However, we do not consider that such granular data needs to be published on an annual basis to meet Ofcom’s requirements. Such data would only be required during the market review process conducted once every three years – and Ofcom has the powers it needs to request that information at that time. We consider that it would be wholly inappropriate for Ofcom to base an obligation to report and publish information during the course of one market review because it needs that information to decide what obligations should be imposed in the next market review.
- Where **charge controls are set** Ofcom has more recently used DLRIC and DSAC information as a reference point for considering whether start charge adjustments for individual services may be necessary. We do not believe that DLRIC and DSAC data can be used in a deterministic way to assess whether individual prices may need to be increased or decreased. A broader range of factors should be considered particularly in relation to the balance of upfront and recurring charges for individual services. Nevertheless, to the extent that Ofcom considers them a useful reference point, we would again note that Ofcom can request such information when required for the purposes of setting specific price controls and therefore such data does not need to be published.
- In relation to **information required to support monitoring of effectiveness of remedies** our main concern here is that it is not clear what level of detail this requirement justifies especially given that remedies are reviewed every three years. For instance, even if it were appropriate to monitor the “effectiveness” of a charge control – as distinct from simply monitoring compliance with the control – during the charge control period, publishing costs and revenues at the level of the basket would be sufficient.
- For **information required to provide general transparency and assurance to stakeholders about our cost information** we would question whether CPs are better able to “assess accuracy” of our cost information and the extent to which

the need for transparency of detail can solely be justified by reference to the benefits of such transparency in providing general assurance to stakeholders around consistency and accuracy. However, even if there is benefit in providing some level of transparency through the annual publication of data, it is by no means clear what level of information and granularity of reporting is justified. We would argue that this cannot be a justification in itself to publish a high level of detail and publication should be justified by other requirements.

26. There are many instances of inappropriate and disproportionate levels of reporting that are not required for compliance purposes but which have not been addressed as part of this Consultation. Ofcom must consider these within the context of the wider 'Regulatory Financial Reporting Review'.

Glossary of terms

BCMR	Business Connectivity Market Review
the BCMR consultation	“Business Connectivity Market Review: Further Consultation” published on 15 November 2012
BES	Backhaul Extension Services
the Consultation	“Changes to BT and KCOM’s regulatory and financial reporting 2012/13 update” published on 23 January 2013
CPs	Communication Providers
DLRIC	Distributed Long Run Incremental Cost
DSAC	Distributed Stand Alone Cost
EAD	Ethernet Access Direct
POH	Points of Handover
RFS	Regulatory Financial Statements
WBA	Wholesale Broadband Access
WBC	Wholesale Broadband Connect
WES	Wholesale Extension Services