



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

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EE Response to Ofcom Consultation

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## 1 Table of contents

1.	Table of contents .....	2
2.	Introduction and summary .....	3
3.	Publication of cost information.....	3
4.	Answers to specific consultation questions .....	5

## 2 Introduction and summary

As Everything Everywhere (EE) has previously argued<sup>1</sup>, reliable and transparent regulatory reporting information is an important complement to the other remedies imposed on communications providers such as BT found to have Significant Market Power (SMP). This is especially the case where such communications providers have SMP in a range of inter-related markets. This information needs to be useful both to purchasing Communications Providers (CPs) and Ofcom.

The information available in the Regulated Financial Statements (RFS) is therefore important to other CPs to ensure that they can meaningfully negotiate with BT, understand that the services they are purchasing are being provided in a way consistent with BT's SMP and other obligations and for such CPs to be able properly to engage in processes such as market reviews.

This paper provides EE's comments on the proposals to amend the obligations on BT and KCOM in the RFS which they are required to publish as set out in "Changes to BT and KCOM's regulatory and financial reporting 2012/13 update" (The Consultation).<sup>2</sup>

In summary:

- EE supports changes which improve the usability and practicality of the RFS: in particular, the proposal to require the RFS to be provided in Excel format is welcome;
- allowing further aggregation of data between individual products needs to be undertaken with great care and there is a danger of Ofcom developing policy on a piecemeal basis – issues such as this should be addressed through the wider review of regulatory financial reporting which Ofcom is currently undertaking to ensure a consistent long term approach; and
- the proposal to remove the obligation to publish cost information, where cost orientation obligations have been removed in market reviews, is a retrograde step which reduces transparency and the ability of CPs to protect their commercial and regulatory positions; given the low cost of publishing data which Ofcom considers BT should anyway collate, the significant benefits of making this information available should see it continue to be published.

## 3 Publication of cost information

Section 4 of the Consultation proposes changes to the RFS as a result of the 2012 LLU/WLR charge control review. In particular, Ofcom is proposing that BT no longer is required to publish cost information (DLRIC and DSAC information) where cost orientation SMP obligations have been removed from

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<sup>1</sup> See, for example, EE's response of 1 November 2012 to "Regulatory financial reporting: an overview" Ofcom Consultation of 6 September 2012.

<sup>2</sup> Published 23 January 2013.

BT in relation to a number of services.<sup>3</sup> EE notes that this is the same approach which Ofcom is proposing to take in respect of the publication of equivalent cost information in the context of the Business Connectivity Market Review (BCMR). Both in relation to WLR/LLU services and the services covered by the BCMR, EE disagrees that the removal of SMP basis of charges conditions means that it is also appropriate to remove the obligation to publish such cost information. As a matter of principle EE considers that this is wrong.

The additional cost to BT of publishing such information is negligible as Ofcom is still proposing that BT is required to collect and calculate the relevant cost measures and provide them to Ofcom. Any arguments that publication of such information harms BT's competitive position should be treated with a significant degree of scepticism. It is not clear that this has been the case to date and therefore it is unclear why this should be the case going forward.

Set against this, no longer publishing these cost benchmarks will remove a significant benefit. The starting point is that these are services provided in markets where BT has been found to have SMP. These are generally inputs to other CPs, including BT Wholesale. Many CPs purchase managed services from BT Wholesale combining regulated inputs with other additional services. EE is in this position a range of circumstances, which include where EE purchases the WLR/LLU based products specifically mentioned in the Consultation. Further, the provision of these regulated inputs can influence the competitive environment in a range of ways. Against this background, EE does not consider that it is appropriate that the relevant cost benchmarks are no longer published.

- Where charges are regulated within a basket, BT is not constrained on the charges it makes for individual services within the basket. In some circumstances, this may be dealt with through sub-caps within the baskets, but competing and purchasing CPs will lose their ability to understand how effective any such sub-caps are over time without access to the relevant cost benchmarks. Where products are basket rather than individually price controlled, we consider that publication of cost information for the individual products is the minimum necessary to ensure the ongoing effectiveness of this remedy and avoid gaming by BT.
- Given that these are products supplied in markets where BT has been found to have SMP, publication of such cost information would also enable purchasing and competing CPs to understand the extent to which individual charges are consistent with competition law. Not having access to such information will make it much harder for such CPs properly to assess this and, if deciding to make a complaint, properly to formulate such a complaint. Greater transparency is also likely to enable CPs to avoid having to make competition complaints in some circumstances. The absence of such information will lead to longer administrative processes in such cases and potentially more such complaints (or worse, an absence of private enforcement where

<sup>3</sup> As set out in paragraph 4.5 of the Consultation.

this should be operating as an important constraint on abusive conduct by BT).

- The availability of such cost benchmarks over time, at a reasonably disaggregated level, allows competing and purchasing CPs to make more meaningful inputs into charge control and market reviews. Loss of this information being available over time will make it harder for such CPs properly to engage with market reviews (especially in the early stages). Ofcom's tendency to reduce the consultation periods will also exacerbate this (as CPs will have a greater analytical task in each individual market review consultation without having had any prior access to cost information and therefore the ability to know on which areas to concentrate). It is also important to note that much of the cost information provided and analysed by Ofcom as part of market review processes is essentially **forecast** cost information whereas the cost information being considered here is **actual** cost data. Any forecast data is subject to forecasting errors and understanding what costs have actually done historically is important in being able to assess the reliability of such forecast data.
- Where downstream managed services are purchased (which include regulated inputs) the availability of this cost information allows CPs to better understand and negotiate with BT (where the managed service includes the provision of services where it has SMP). Knowing the fully allocated cost (price of regulated inputs alone) only provides purchasers with information on whether any undue discrimination is taking place. Availability of DLRIC and DSAC measures as well aids CPs in negotiating with BT as an SMP provider to understand the extent to which the prices for these important inputs could vary. Without this information, SMP providers effectively are able to avoid any negotiation on regulated parts of managed services (inter alia this potentially has the impact of making charge caps also charge floors). Removing access to this cost information will therefore place BT in a stronger negotiating position – in relation to products where Ofcom has found it has SMP. Continuing the publication of such cost information would allow purchasing CPs to understand overall from which products BT is recovering its costs and level the negotiating playing field to some extent.

Combining all these factors, Ofcom should reconsider its position that the publication of such cost information should cease (and similar arguments apply to other markets where Ofcom is making similar proposals such as in relation to the BCMR). The additional cost of publishing this data, which Ofcom is still proposing BT should collate, is minimal compared to the benefits it creates.

## 4 Answers to specific 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?

In its response to the equivalent consultation on last year's RFS<sup>4</sup>, EE noted that regulatory financial information needs to align with other SMP remedies, being an important source of information for other stakeholders (including purchasing CPs) to be able to understand the extent to which specific charges align with SMP remedies. In this context, greater transparency and disaggregation of information will always be more useful. EE recognises that Ofcom needs to assess materiality, however, and the level of disaggregation needs to be proportionate and appropriate. Nonetheless EE considers that Ofcom should conclude its wider review of regulatory reporting: and use it to establish the principles on the relevant degree of materiality it intends to apply across all markets rather than make piecemeal changes year to year. Such principles would establish a consistent approach to assessing materiality, which could then be consistently applied to the individual circumstances of specific markets. Making ad hoc changes as a result of this consultation (or similar consultations in future) before setting the wider principles does not seem appropriate. The impacts of removing the transparency resulting from disaggregation cannot be reversed.

The main reason given in this Consultation for allowing BT to aggregate these services in its regulatory financial reporting is "to ensure that the RFS focuses on the main regulated services produced by BT and these are not obscured by the reporting of many small services".<sup>5</sup> This is a point of general principles which would be better addressed through the wider review on financial reporting and in the context of Ofcom's developing views on cost orientation obligations (on which Ofcom is still due to consult). It is not immediately clear how ensuring disaggregated reporting "obscures" any information and this is not explained in the Consultation (nor is it a major theme in previous consultations on regulatory reporting). EE considers that Ofcom needs to ensure that a consistent approach is taken, based on a clearly articulated set of principles. Ofcom's approach here appears to be developing policy piecemeal, which does not promote regulatory certainty.

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

Notwithstanding the response to the previous question, EE agrees that, in the interests of transparency it would be beneficial to report Wholesale Broadband Connect ("WBC") revenues separately across markets 1 and 2. Given the evolution of the markets, as described in the Consultation, this seems a proportionate response. Presumably any such changes would need to be amended in line with any conclusions on the relevant market definitions in the current Fixed Access Market Reviews.

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

The main proposal in terms of changing the presentation of the RFS is to require BT to provide an Excel version of the various accounts. This is

<sup>4</sup> "Changes to BT and KCOM's regulatory and financial reporting 2011/12 update", EE Response of 5 March 2012

<sup>5</sup> See, for example, paragraph 3.14 of the Consultation.

something which EE had understood BT to be considering anyway. It would greatly enhance the practicability of the RFS and EE supports this proposal. The only proviso to this would be to ensure that both Ofcom and other stakeholders retain an ability to readily identify and **track any changes** to the RFS from one version to the next.

So long as this requirement can be suitably met, an appropriately laid out spreadsheet would improve both the ease with which the accounts can be navigated by external parties, as well as make it easier to undertake appropriate analysis of the accounts. EE also does not object to any resulting simplifications removing the obligation to provide columns, where stakeholders are able easily to replicate calculations and reproduce such columns for themselves. Indeed one significant benefit of this approach is that it will make it easier for stakeholders to undertake more detailed analysis of the RFS without relying mainly on the particular ratios / columns which Ofcom requires BT to provide (and which can therefore be tailored to the particular issue in question).

**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?

See section 3 of this response. EE disagrees on principle that the removal of a cost orientation obligation should lead to the removal of cost reporting.