Virgin Media's response to Ofcom's Consultation : Changes to BT and KCOM's regulatory and financial reporting 2012/13 update

6th March 2013

Introduction

The obligation on BT to publish key financial data under its SMP obligation in various markets is key to the wider industry in being able to understand BT's position in dominant markets, and to ensure that it can bring to the attention of Ofcom any concerns identified by pricing and cost trends.

The annual review of direction 4 ('the reporting direction') made under SMP condition OA2 provides an important reference point to ensure that any amendments to the direction are fully understood and commented upon by industry.

Virgin Media therefore, welcomes this opportunity to comment on the proposals made by Ofcom to amend the reporting direction.

Virgin Media does have a number of concerns over Ofcom's position in relation to this consultation, both in the manner of approach and the specific proposals it seeks to put forward. Our concerns are as follows:

- **Ofcom's Approach to Consultation** : Ofcom appear to not to be consulting in relation to certain aspects of changes to cost accounting obligations suggesting that decisions that have already been taken in market reviews, when this is not the case;

- **Failure to consult on ISDN30 policy** : Ofcom have failed to consult on changes in the ISDN30 market to follow through on their regulatory statements in the market review and charge control review; and

- **Specific Proposals for LLU/WLR services** : The proposals made in relation the WLR/LLU market are not, as suggested, exclusively made as a consequence of last years charge control review, and in any event the proposals made in relation to WLR/LLU rentals are not appropriate, and other proposals lack coherent reasoning.

We now discuss each of our concerns in turn, following which we provide our responses to the individual consultation questions.

Ofcom's Approach to Consultation

It is a fundamental basis for any consultation that the authority undertaking the consultation does so with an open mind. In this case, Ofcom state that the:

"*decision in the LLU/WLR charge control review to remove cost orientation for certain services was a decision which required consultation as it had a significant* *impact on the relevant market, the proposal in this review is simply a consequence of that decision and does not by itself have a significant impact*"[1]

The purpose of the consultation appears to be in order to allow stakeholders a short opportunity to comment on the "technical aspects" of the amendments, rather on a proper basis that the amendments may not be appropriate in themselves.

This position is then not further expanded upon in Section 4 that purports to set out the detail of the consultation, including how the proposal meets the relevant tests under section 49. Ofcom's sole justification appears to be based on a flawed assumption that the removal of a cost orientation obligation should automatically result in the removal of a requirement to publish LRIC data.

Virgin Media considers that this cannot be the case. There are a number of reasons that may justify the continued publication of LRIC data beyond the removal of a cost orientation obligation. We discuss below, the reasons why we consider that the continuation of this obligation for WLR/MPF Rental charges should be continued, and we would also refer Ofcom to our comment in relation to the BCMR Further Consultation[2] when responding to a revised proposal for requiring BT to deliver LRIC data to Ofcom.

It is also of note that Ofcom is currently reviewing its approach to cost orientation as a policy project related to the substantive review of regulatory financial reporting, however, as of today no document as been published as to Ofcom's revised thoughts on how this remedy should be applied, or its interrelationship with other remedies including financial reporting obligations. If a policy shift is proposed that affects the application of not only cost orientation as a remedy, but also the continuation of financial reporting obligations, this would further suggest that this is a policy change that should be the subject of a consultation with stakeholders.

It is of note that the utility of the data does not appear to be in dispute, as the proposal is to require BT to continue to deliver the data to Ofcom, it is solely the issue of whether the data should be published.

Ofcom must ensure that they fully consider the fundamental question of whether an amendment of this nature, reducing the reporting requirements is an appropriate step. The existence of an underlying cost orientation obligation is a factor to be considered, but it certainly does not justify the amendment of the cost accounting regime and consequent reporting obligations in its own right.

Failure to consult on ISDN30 policy

[1] Paragraph 1.9 Ofcom Consultation

[2] Virgin Media's response to the BCMR Further Consultation dated 17 December 2012

In the ISDN30 statement Ofcom stated:

"*We believe that it is appropriate that any price controls for ISDN30 services would need to be supplemented by an appropriate reporting framework, and that this should be transparent to stakeholders. We have therefore concluded that a new cost accounting obligation is needed, subject to the setting of an appropriate price control.*

It is important to understand how the cost accounting requirement would work in practice. In this review we are imposing SMP conditions (OA1 to OA33) that require Openreach to comply with appropriate financial reporting obligations. We have concluded that Openreach should provide appropriate cost accounting information in order to ensure that any price control could be effectively monitored. Any specific obligations would be imposed by a direction made under the SMP conditions ("the financial reporting direction"). We are not setting this direction in this review.

Firstly, we will need to conclude our ISDN30 price control review. This will determine the nature of any control applied to Openreach. The nature of any control may have a bearing on the data that would be required to be produced under the cost accounting obligation.

Secondly, we intend to undertake a review of BT's regulated financial statements next year ("the RFS review"). The RFS review will take account of regulatory changes made that need to be reflected in the reporting requirements imposed on BT by the financial reporting direction. The RFS review will therefore take into account the conclusions of this review and the conclusions of the ISDN30 price control review before proposing any amendments or additions to the financial reporting direction. Stakeholders will therefore, have two further opportunities to respond to consultations related to the price control and the detail of the cost accounting obligations to be associated with that control."[3]

Further, in the ISDN30 Price Control statement Ofcom stated:

"*As we have explained in Section 5 above, the ISDN30 2010 Market Review Statement decided that cost accounting information should be reported by Openreach in relation to ISDN30 in order to support any price control imposed by this review. As the control imposed as a result of this review only comes into force on [date], and therefore part way through the 2012/2013 financial year, any amendment to the financial reporting direction would be made in the review that we anticipate conducting next year. SMP condition*

[3] Paragraph 8.28-8.31 ISDN30 2010 Market Review Statement dated 20 August 2010

AAA(IS)4A, imposed under this review, will therefore provide the authority and scope for any proposal made to amend the financial reporting direction next year, where stakeholders will get a further opportunity to comment."[4]

Virgin Media agrees with the process outlined by Ofcom in the ISDN30 statements as to how market review decisions and reviews of the RFS obligations should proceed. We do not think that Ofcom have followed through with their statements by not consulting on any changes to the ISDN30 reporting framework in this review.

The introduction of a charge control in this market obliged BT to ensure that relevant ISDN30 products and services were charged at rates that ensured compliance with the imposed control. Such price controls will be monitored primarily by BT, but will also be of interest to stakeholders and it is of note that Ofcom, in relation to its comments on the changes in the WLR/LLU markets comment that

> "*Stakeholders will be able to monitor BT's compliance with the applicable charge control by reference to average prices in the accounts. Stakeholders will also have access to the published Fully Allocated Cost data, which will enable them to see if prices are out of line with costs*"[5]

This suggests that there is an acceptance that it is important for stakeholder to see that BT is complying with imposed controls, and that the publication of average prices and FAC data provide the necessary transparency in order to do this.

The omission of any mention of the ISDN30 markets in this review, contrary to the explicit statements in the ISDN30 statements themselves, prompted Virgin Media to contact Ofcom to see if there had been an inadvertent omission to this consultation, or whether there was some other proposal to deal with ISDN30. Ofcom responded to confirm that "*The current proposals reflect a view that the current reporting requirements for ISDN30 are sufficient for monitoring charge control compliance and, subject to responses to the consultation, we do not propose to make any changes to the RFS at this stage ahead of the outcome of our more fundamental review of BT's regulatory reporting requirements.*"[6]

We have two comments in relation to the response. Firstly, if Ofcom have decided that, following a review the levels of reporting currently in place in the ISDN30 market, that no changes are required, then this is a change of position from the published position set out in both of the ISDN30 statements. Such a

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[4] Paragraph 6.11 ISDN30 Price Control Statement (draft version dated 12 March 2012)
[5] Paragraph 4.10 Consultation
[6] Email Ofcom to Virgin Media dated 31 Jan 13

change of view (which was consulted upon at the time) would require a consultation given that stakeholders who responded at the time to Ofcom's proposals in the ISDN30 market were given a legitimate expectation that the issue of ISDN30 financial reporting would be separately addressed within this review. Secondly, we consider that in the event that a full review of the appropriateness of the ISDN30 reporting requirements has been undertaken, the conclusion that no changes to the reporting direction are required is wrong, as there are compelling reasons as to why the introduction of a charge control should be supported by an increased transparency requirement to ensure that industry can have sight of BTs regulatory compliance. It is of particular note that the pricing of ISDN30 services were required to reduce significantly under the control, and those pricing levels have a significant effect on investment incentives within the market and within associated markets for IP based alternative solutions.

Virgin Media would submit that Ofcom needs to follow through on its commitment to review the ISDN30 reporting positions and fully consult with industry as to any proposal it may have, even if the proposals (following an evidenced based review) provisionally conclude that no change is required.

Specific Proposals for LLU/WLR services

When Ofcom concluded its reviews of the WFAEL and WLA markets and its review of the LLU/WLR Charge Controls it made no policy statement as to whether the decision to remove cost orientation in respect of certain services would have a definitive impact on financial reporting obligations.

The reporting direction was certainly not consulted upon in any of the reviews, and our understanding was that any impact on financial reporting obligations would be consulted upon separately. As discussed above, we consider Ofcom's analysis of the interrelationship between market reviews and the review of financial reporting obligations is accurately set out in the ISDN30 reviews.

Ofcom have suggested that the decision to review the financial reporting obligations derives solely from the LLU/WLR Charge Control Statement. In fact, several of the decisions to disapply cost-orientation are substantially less recent, with decisions in relation to MPF/WLR rental services deriving from 2005.

The clear inference in this consultation is that the justification for the proposed changes is that this is the most recent opportunity to review and revise the reporting direction (since the relevant decision in relation to market obligations). This is not the case, and as such, the basis for making the changes is not as stated. Virgin Media does not suggest that there is necessarily no case for justifying a change, and rather than taking a technical point we set out our views on each of the affected services individually below. However, we do seek clarification from Ofcom as to the basis as to why the changes are sought to be made now, in order that any decisions taken in the course of this review can be properly justified.

Ofcom propose to remove LRIC reporting for the following services

- MPF rental
- MPF cease
- SMPF cease
- Analogue core WLR rental
- WLR transfer
- Enhanced service level care services.

Our understanding as to when a decision was taken in relation to cost orientation on each of the services is as follows:

Service	**Statement**	**Date**
MPF Cease	LLU/WLR CC	Mar 2012
MPF Rental	Review of the wholesale local access market	Oct 2010
SMPF Cease	LLU/WLR CC	Mar 2012
Analogue WLR Rental	Review of wholesale fixed analogue exchange lines markets	Dec 2010
WLR Transfer	LLU/WLR CC	Mar 2012
ECS (WLR)	Charge controls for WLR: implementation and cost orientation	Feb 2010
ECS (LLU)	LLU/WLR CC	Mar 2012

Our views on each of the services are as follows:

MPF / WLR Rental

The direction made under the LLU/WLR Charge Control Statement[7], as set out at Annex 12, confirms the existing position in relation to MPF Rental and WLR Rental, but as discussed at paragraphs 8.67 (LLU) and 8.120 (WLR) of that statement, the non-application of cost orientation for these products was already confirmed by the SMP conditions set under the market review (FAA4(A).2 and AAAA3.2 respectively). Additionally, these SMP conditions simply reflected previous regulation deriving, initially, from the 2005 reviews.

[7] Charge Control Review for LLU and WLR services : Draft Statement dated 3 February 2012

It does not, therefore, appear to be appropriate to rely on the LLU/WLR Charge Control Statement to justify an amendment to the RFS requirements in relation to these services. BT's RFS have provided DLRIC and DSAC values for LLU and WLR rental services during this time, and LRIC information has proved valuable in that, although there has been no cost orientation obligation on these services, the relative difference between WLR, SMPF and MPF pricing is important to ensure competitive incentives to purchase products remain true and are not distorted by making one method of supply (WLR+SMPF or MPF) artificially more attractive than the other. Given that the obligation to ensure that charges for both services remain "fair and reasonable" in accordance with the obligations to provide network access, the ability to monitor this issue remains important for stakeholders who purchase such wholesale inputs.

It is also highly relevant that Ofcom consider that LRIC data remains important for the setting of charge controls. A particular concern for Ofcom in setting charge controls is whether a one off adjustment to starting charges should be made, and LRIC floors and ceilings have typically been used to assess this. Given that controls, if they are to be aligned with market reviews, will be set on a three year basis, the process for consulting on the control (Ofcom's current practice of consulting on a call for inputs, consultation and publishing the EC consultation document), means that the relevance of LRIC figures in charge controlled markets, especially where the levels of the controls are of particular significance to industry, is heightened, with the market review process for the next control taking up approximately two of the three years of the current control.

In light of this importance Ofcom are proposing to continue require BT to maintain these figures and therefore there would be minimal additional effort required on BT's part to publish them as they have already been doing for many years. Therefore, Virgin Media would suggest that the small incremental effort required on BT's part, when balanced against the legitimate reasons for this information to remain transparent to stakeholders should mean that publication is an entirely appropriate and proportionate obligation to place upon BT.

MPF / SMPF Cease

These charges have been set, by virtue of the decision in the LLU/WLR Charge Control Statement at zero. The service costs of these charges are now recovered in equal proportions from their respective line rental charges.

Therefore, provided the costs of provision of the relevant rental service includes these costs and continue to be published in their current format, we would agree that it would be inappropriate to continue to publish separate cost information in relation to these charges.

ECS

Enhanced Care Services are available on both WLR and MPF services. However, they are not currently subject to separate reporting in the RFS, in that no entry was made in the 11/12 RFS.

The removal of the cost orientation obligation for WLR ECS services was made in the market review in 2010. Therefore, there is no reason why a change to the RFS could not have been made earlier. However, given the apparent uncertainty over whether this information should be published, this may be academic.

If data on these services should be published, as this consultation suggests (in that it is implied that on the basis of the proposals taking effect FAC data should be published), then Ofcom needs to clarify why this information is not currently available.

If BT is not required to report on these services, then this consultation appears superfluous as the proposed position reflects current practise.

One of the reasons given by Ofcom for the removal of cost orientation from WLR ECS in 2010, was the uncertainty over the level of costs of providing an enhanced service. To the extent that this would mean that any LRIC data would not provide any meaningful information to stakeholders, then this could be argued to support the removal of a publication obligation. However, Ofcom do not seek to argue that this is the case, and indeed, the requirement that BT continues to provide this data to Ofcom suggests that it retains regulatory value. There is no definitive argument as to why these services should be removed from the obligation to publish, other than the removal of cost orientation. Virgin Media considers that the reasoning contained in the consultation is not sufficient to allow for informed comment, and would seek advance clarification of Ofcom's proposals before any statement is published.

WLR Transfer

WLR transfer was set by the LLU/WLR Charge Control Statement at below the level of the cost of provision. It was therefore necessary to ensure that BT did not apply the basis of charges obligation (requiring the charge to be based upon the cost of provision) to this service, otherwise BT would face two incompatible SMP conditions.

That said, this should not necessarily alter the level of cost information provided about the service, as this remains important for industry to see how costs are reflected in the overall charges for services within the market as a whole. Although transfers are required to be charged at an artificially low level to encourage switching, their costs are effectively covered by other charges in the product set.

BT's pricing of WLR transfer charges has traditionally been low[8], although in 2012 specific cost levels were not reported due to the service comprising of "a number of individual volumetrics".

If it is correct that where BT is not able or obliged to provide the LRIC data for this service due to the number of "individual volumetrics" involved, then there is presumably no need to change the position from 11/12, although it does raise the question as to why BT were previously able to provide this data in 10/11. Again, similar to the position for ECS, there is no explanation of why reporting of a service has ceased between 10/11 and 11/12, and there is a need for Ofcom to explain the current regulatory position, and explain how is seeks to effect and justify any change to it.

Overall comments on LLU/WLR services

Our observations on Ofcom's consultation are also relevant to the parallel review of Regulatory Financial Reporting obligations currently being undertaken by Ofcom. Whilst this substantive review will not affect regulatory data requirements in the short term, it will be incumbent upon Ofcom to ensure that any revision of the regulatory financial reporting framework proposed ensures that the quality of data published is high to ensure confidence in BT's RFS going forward. Therefore, Virgin Media considers that where our comments in response to this consultation suggest that there is a lack of clarity regarding whether a service should or should not be reported, this is a matter that can be usefully addressed in the substantive review to ensure that any revised regime provides an appropriate level of transparency to industry.

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?

Virgin Media agrees with the proposed amalgamation of the specified low revenue services as set out in the consultation.

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

Virgin Media agrees with the proposal to require separate disclosure of EADLA and WBC services. We specifically agree with the rationale that these services have been the subject of significant growth, and it is entirely appropriate that

[8] 2012 RFS 2011 Av Price £3.09; DLRIC £8.40/£8.71 (ext/int)

these services are brought in line, in terms of financial reporting, with other significant Ethernet services.

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

Virgin Media agrees with the proposals to change the presentation of the RFS, as described.

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?

Virgin Media does not agree that Ofcom has fairly reflected decision of the relevant market review in these proposals. We would refer to our concerns set out at the start of this response, as we do not consider that the cited review (LLU/WLR Charge Control Statement) is the review in which all the relevant decisions as to cost orientation occurred, and furthermore the underlying market reviews did not foreshadow any particular approach towards financial reporting information, they simply decided that cost orientation was no longer an appropriate remedy. We also consider that Ofcom has failed to recognise the relevant decisions in the ISDN30 reviews in the scope of this consultation.

Virgin Media
6 March 2013