

Vodafone's response to Ofcom's consultation

**CHANGES TO BT AND KCOM'S REGULATORY AND FINANCIAL
REPORTING 2012/13 UPDATE**

March 2013

INTRODUCTION

Vodafone welcomes the opportunity to respond to Ofcom's consultation into the changes to BT's and Kcom's Regulatory and Financial reporting for 2012/13. Following its recent acquisition of Cable & Wireless Worldwide, Vodafone is the UK's leading integrated communications provider, hence a key stakeholder and users of BT's Regulatory Financial Statements. Vodafone has a track record of investment, innovation and award-winning customer service. For more information on Vodafone please visit: www.vodafone.co.uk/about-us/

Regulatory Accounting and Cost Orientation are cornerstones of the regulatory framework in the United Kingdom and it is very important that Ofcom places a priority on achieving an outcome that delivers robust, reliable, clear & impartial regulatory accounting output. A stronger and more reliable regulatory accounting regime ensures that consumers are protected from the negative impacts of market power, putting the necessary weight behind the SMP remedies that Ofcom sets and enabling competition to flourish in areas of the market that are constrained by access bottlenecks. We therefore look forward to Ofcom publishing the next stage of its fundamental review of the regulatory reporting framework in the UK later in 2013, which we hope will bring about significant improvements in the quality, suitability and robustness of BT's Regulatory Financial Statements.

The remainder of this response focuses on the specific and more immediate issues as set out in Ofcom's consultation into Financial Reporting for 2012/13. We highlight the need for transparency around NGA volumes, the requirement to identify internal & external volumes, the conditions that should be applied to assess if it is appropriate to amalgamate product reporting and concerns around Ofcom's proposals for obtaining and using DSAC and DLRIC information.

Q & A

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?

We recognise that Ofcom has to strike a balance between the desire to impose proportionate regulation and ensuring that sufficient detail is available to stakeholders. Against the backdrop of certain services being substituted in new supply or reductions in demand, we believe Ofcom's proposals to amalgamate some reporting lines within

BT's RFS are sensible. However, while we agree that it might be reasonable in principle to consolidate low revenue items, we don't think the decision to consolidate or report separately should be a binary one based on revenue alone. A more pragmatic approach is required, one that considers not only current revenue, but how that revenue is expected to change over the next 18 or 24 months¹ or indeed the balance in demand between internal and external supply. Where a product is largely consumed by BT and an alternative product is offered to industry then it would seem both sensible and proportionate to continue to provide a level of reporting in order to demonstrate that BT is meeting its no undue discrimination obligations.

In addition, it is important that the process of amalgamation of services cannot be used by BT as an excuse to omit the publication of the relevant unit information. This issue is particularly pertinent here as it is proposed to amalgamate WES and BES connections into 'other Ethernet connections' but in 2011/12 BT did not provide unit information for either 'other Ethernet rentals' or 'other Ethernet connections and instead used its common '(ux)' and '(sx)' excuses². Amalgamation of similar types of service is not a valid reason to omit total volumes and average price / cost information. There may be some instances where providing volume and average unit information is of little value as the output is meaningless but they will be the exception and should be properly justified. Ofcom should clarify the position in its statement and ensure that BT rectifies the situation when it publishes its 2012/13 RFS, not just within the AISBO market but more generally. We can only support the amalgamation of the services proposed by Ofcom on the basis that total volumes and average unit cost/price information is provided.

Reporting for Next Generation Access

We note the absence of any discussion around how BT will report for its NGA products within the regulatory financial statements. We believe that the materiality threshold for NGA products has now been passed, with growing demand for NGA services. Given their strategic importance we would like to see the 2012/13 RFS output cover details of internal and external sales split by FTTP and FTTC product variants. Furthermore, given that BT has been and will continue to be a beneficiary of state aid funding it is necessary to split BT's regulatory statements into 2 separate regions, i.e. areas with and without such funding.

¹ Based on accessible Market information or by Ofcom requesting product forecasts from BT.

² (sx): This service comprises a number of individual prices as indicated by the value of x
(ux): This service comprises a number of individual volumetrics as indicated by the value of x

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

We support any proposals to increase transparency within this growing and important market. With increasing market demand and an on-going charge control remedy it is important to provide stakeholders with more granular AISBO Regulatory Financial Statement (RFS) data. In our response to the February 2012 consultation we argued strongly that EAD Local Access should be reported on separately, as it was subject to far too much service/volume/price aggregation, impairing the ability of stakeholders to understand the statements, preventing them from fully playing their part in helping to monitor BT's compliance with its obligations. We therefore welcome Ofcom's proposal to improve stakeholder transparency on EAD.

In contrast with Ofcom's approach on EAD, we remain uncomfortable with the lack of progress on efforts to improve transparency on the Ethernet Backhaul Direct (EBD) product and would like to see Ofcom take a similar approach to that set out for EAD, by requiring BT to identify both external and internal volumes separately.

This was an issue we raised in 2011 and again 2012³ and Ofcom's April 2012 statement⁴ said the matter had been referred to the Equality of Access Board, however the 2011/12 Regulatory Financial Statements were not amended in this regard and we remain in the dark over the EAB's deliberations on the matter or Ofcom's current thinking, with all discussion on the topic absent from this consultation.

We would reiterate that we don't believe BT has provided any justification for the information to be withheld, nor do we believe it would be onerous to provide. BT's claim that they use EBD solely as an input to Wholesale products and therefore report it indirectly as part of their wholesale cost base isn't a credible reason for not including internal EBD volumes within their RFS output. EBD is an EoI product and if BT makes use of the service it should report on volumes. The fact that some or all of that internal consumption is used to support downstream wholesale products is irrelevant. EBD is a strategic product that is expected to grow strongly in the years ahead, meeting demand for both new supply and also as a direct replacement for legacy services. By BT's own

³ <http://stakeholders.ofcom.org.uk/binaries/consultations/948231/responses/CableWirelessWorldwide.pdf>

⁴ <http://stakeholders.ofcom.org.uk/binaries/consultations/948231/statement/statement.pdf> (see 3.11)

admission EBD is a product developed to meet their obligations in the Undertakings for a WES Backhaul requirement. It is therefore essential that we have this disclosure to ensure compliance. To deny stakeholders this level detail will undermine transparency in the market, making it easier for BT to potentially discriminate against external supply and avoid detection.

A key aspect of the current regime is the ability of stakeholders to raise concerns they may have, based on the information available. Indeed the recent PPC & Ethernet Cost Orientation disputes serve to highlight the important role that stakeholders have in helping to police compliance, helped by access to accurate and sufficiently detailed regulatory accounting information. BT's internal consumption is an important and potentially significant section of the market and we are at loss as to why this information is not being included within the accounts. It is important that Ofcom now address this issue for the 2012/13 accounts and does not preside over another year of inadequate reporting on EBD.

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

We welcome the decision to publish the Regulatory Financial Statements in excel format from 2012/13 onwards. This simple step is long overdue and will make the accounts themselves far more accessible and user friendly.

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?

We have made no secret of our objections to Ofcom's proposals to remove cost orientation in certain markets, believing that it removes the linkage between price and cost and all the information we have today to challenge BT prices. We would highlight the comments we have made previously in relation to the need to maintain cost orientation and provide for appropriate regulatory reporting. These comments formed a significant part of our August 2012 response to Ofcom's Business Connectivity Market review and Charge Control⁵. In our August 2012 response we made it clear that the cost accounting obligation should be retained and that FAC cost information should be provided on an annual basis in support of requirements to set future charge controls and ensure individual prices are reasonably aligned with cost.

⁵ <http://stakeholders.ofcom.org.uk/binaries/consultations/lcc-2012/responses/CWW.pdf>

We have significant concerns over Ofcom's proposals in relation to DLRIC and DSAC information. Ofcom has not provided stakeholders with any guidance around how it will judge prices to be fair in the absence of a cost orientation obligation, either in this consultation or elsewhere, or indeed given guidance over how and when it will use DLRIC and DSAC information available to it. Clearly Ofcom sees merit in preserving the ability to access DLRIC and DSAC information, even if it does not form part of a publication obligation, yet stakeholders have no idea how Ofcom would make use of this information. As it stands these proposals enable Ofcom to access the data if they think there may be a problem, but at the same time prevent stakeholders from getting to see it, thus helping Ofcom avoid external pressure from stakeholders who will be kept in the dark about the criteria that Ofcom will assess the information under and also be prevented from seeing the information itself.

This is not satisfactory outcome for stakeholders and Ofcom must set out clearly how it intends to use the information in the future and at the same time provide adequate disclosure to stakeholders. It is our firm view that there must be a means of judging if charges in regulated markets are appropriate for the circumstances to see how effectively the issue of market failure is being addressed by regulated pricing remedies.

We therefore consider that if it is proportionate for Ofcom to require BT to produce the information then it should also be published. There are many examples of where information ultimately proves to be both poor and unreliable due to poor disclosure⁶. If stakeholders are to have trust in the process then we should have the same level of access to DSAC and DLRIC data for regulated products as Ofcom. Stakeholders themselves remain instrumental in ensuring the appropriate level of scrutiny over regulated charges is maintained. Given the SMP nature of the products concerned there is no valid reason for this detail not to be produced annually and disclosed to stakeholders. Ofcom must do all that it can to remedy market failure and regular stakeholder access to DSAC and DLRIC information is a key part of that.

Vodafone Limited
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⁶ E.g. in the 2009 LLCC the point of handover costs were vastly overstated by BT and Ofcom did not pick that up despite comments from stakeholders and it was only after BT disclosed the basis of its cost information that the errors were picked up by CWW.