

Everything Everywhere response to Review of cost orientation & regulatory financial reporting in telecoms: Call for Inputs

Introduction

Everything Everywhere Limited (EE) welcomes Ofcom's review of its approach to cost orientation Significant Market Power (SMP) remedies and regulatory reporting requirements. The approach taken to these types of remedies has evolved over a number of years and through a number of dispute resolution processes, as outlined in Ofcom's "Review of cost orientation and regulatory financial reporting in telecoms: call for inputs"¹ (the Call for Inputs). Reviewing the existing guidance, which has now been in force for some time, is therefore welcome and timely.

The Call for Inputs raises a range of important issues and this response focuses on those questions which raise key points for EE. As such, we have provided a combined response to a number of the detailed consultation questions. We have identified the areas on which EE currently considers this review could usefully and beneficially focus, as well as our views on the general scope of this review. EE will be happy to provide more detailed views to Ofcom, in particular on the "right" approach to be taken with respect to such remedies, during the process of this review - both through on-going discussions and responding to the full consultation expected next year.

EE is a joint venture which runs the Orange and T-Mobile brands in the UK, providing both mobile services and, through its Home business unit, also provides fixed calls and broadband. EE is also a shareholder in Mobile Broadband Networks Limited (MBNL) which is a joint venture with Hutchison 3G UK Limited and operates a shared Radio Access Network. EE therefore purchases price regulated products from BT and Kcom both in its own right and through MBNL. Cost orientation and regulatory financial reporting remedies are therefore important to EE as a purchaser of such products from both BT Wholesale and BT Openreach, as well as from Kcom. EE supports the separate response which MBNL has made to the Call for Inputs and this response concerns EE's views on the issues raised more generally as they apply to EE's wider business.

The parts of this response marked with [X] are confidential to EE and should not be disclosed by Ofcom without EE's prior consent.

Overview

EE considers that cost orientation is a potentially important remedy, especially in contexts where it is applied in conjunction with a charge control to control individual prices. Cost orientation needs to be effectively implemented to act as a constraint on excessive or anti-competitive prices. The current approach of floors and ceilings could usefully be developed to make cost orientation remedies more effective. In many cases the difference gap between these bounds is in practice overly permissive, providing little practical constraint. Greater clarity and guidance on what "appropriate" allocations of common costs could be would therefore be an improvement to the regime. EE's view is that the best approach is likely to depend on the nature of the market power issue being addressed and believes this review is an opportunity to develop such a pragmatic approach (rather than developing into a theoretical debate over the "right" cost standard to use in

¹ Published 8 November 2011

all circumstances). Whatever approach is used, monitoring and enforcement also needs to be effective and more proactive.

Regulatory financial reporting requirements are also an important remedy to enable competing and purchasing Communications Providers (CPs) to assess whether charges are appropriate and understand how they comply with other regulatory requirements. This type of information also provides stakeholders with the ability to comment on and engage with charge control processes. Such requirements therefore need to align with other SMP remedies imposed and the information provided needs to have sufficient accuracy and detail to allow stakeholders to understand whether, for example, charges are cost orientated and non-discriminatory.

Answers to specific Questions

Cost Orientation

Objectives of cost orientation

Q1. How important is cost orientation as a regulatory remedy in telecoms? Why is it important to you in particular?

Requiring certain charges to be cost orientated is an important remedy for ensuring, in appropriate circumstances, that a dominant operator's charges are appropriately regulated where SMP is found to exist. Setting individual charge controls for all products in a market supplied by operators with SMP may not always be feasible or appropriate. In these circumstances a more general cost orientation obligation can be, if designed and enforced effectively, a more appropriate and proportionate remedy which still prevents the risk of competitive harm through excessive charging. Further, a cost orientation remedy can also provide some *ex ante* protection from charges being anti-competitively low or creating a margin squeeze situation. While competition law will also provide some protection in the latter situations, an Ofcom monitored cost orientation remedy can provide a more effective and timely way to ensure that prices are not set in a way which harms competition in markets where SMP has already been established, given the fast moving pace of innovation and growth in telecoms markets.

These are broadly the reasons given for having cost orientation as a potential remedy as set out in the Access Directive (under Article 13 of that directive).

Cost orientation is therefore important to EE as a remedy which, when implemented effectively, ensures that BT and Kcom are not able to "sustain prices at an excessively high level"² where there is a lack of effective competition in relation to specific products which EE purchases and which are not individually charge controlled for whatever reason. We note that such individual products can be important competitively even where they are not sold in high volumes relative to BT or Kcom's overall wholesale sales.

Q2. What should we seek to achieve with cost orientation, and in what circumstances?

Cost orientation is one of the regulatory tools for controlling prices at Ofcom's disposal. The circumstances in which it is best applied are either as a complement to other controls on prices

² As set out in article 13(1) of the Access Directive.

(such as a charge control, especially a “basket” charge control) or as the primary constraint on the prices an operator with SMP can charge, where more a more specific charge control is either not feasible or not considered appropriate. The circumstances in which Ofcom should apply such a remedy are therefore where neither competition nor other SMP remedies applied are sufficient to ensure that prices are neither too high nor too low.

Whether a cost orientation remedy is applied as a complement to charge controls (to ensure that individual charges in a controlled basket are not allowed to be too high) or as the main control on individual charges in itself, what Ofcom should be seeking to achieve is therefore that charges are not excessive. Any individual charge should bear a reasonable relationship to the costs of providing the associated service, and recover a reasonable contribution to any common costs. Ultimately, the aim is to promote economic efficiency and protect competition, which will further the interests of consumers. Part of this will be ensuring that the relevant operator found to have SMP is not able to earn an excessive return.

Q3. How should cost orientation interact with other remedies, such as charge controls or non-discrimination?

It seems logical that cost orientation remedies will frequently be part of a package of remedies. Such remedies will likely need to be imposed alongside regulatory financial reporting remedies at the very least to make them effective (see below). Where the market power concern which leads to the remedy is one to do with potential competition distortions then cost orientation may need to be supplemented by non-discrimination requirements as well (to ensure that appropriate common costs are recovered across all purchasers in a way which does not distort competition). It is worth noting that the reverse is not necessarily true (i.e. in other circumstances, a non discrimination remedy may be appropriate which would not require a cost orientation remedy to be effective): the wider context and nature of the market power issue identified will always be relevant.

Finally, as discussed above, cost orientation can be a very important complement to price control remedies which limit average prices across a basket of products rather than individual prices. In these circumstances, cost orientation remedies are an important supplementary control to ensure that individual prices are not set at an excessive level, where, as input costs, they could have a significant detrimental effect on downstream competition even while complying with a price control. Cost orientation as a remedy therefore needs to be applied in a specific context with a clear view of the regulatory objectives which it aims to achieve.

Q4. Are there other remedies that could potentially avoid the need for a cost orientation obligation, and if so what would you propose? (E.g. safeguard price caps).

In considering this question it is worth distinguishing between circumstances where a cost orientation remedy is imposed as the primary constraint on prices and where it is a complement to a charge control.

In the former situation, a safeguard price cap would only be an inferior substitute for a cost orientation remedy. A safeguard cap has less flexibility and would, by definition, not take account of technological and efficiency advances over the period for which it was set. It would therefore need to be assessed on a more regular basis and, EE suspects, would end up being far more intrusive and

require more intervention and regulatory resource than a properly functioning cost orientation remedy.

In the latter situation, a safeguard cap (e.g. on particular competitively sensitive services within a basket) can be a more effective regulatory control than a simple general cost orientation obligation. Accordingly, EE would not rule out different designs of charge control conditions or supplementary sub-caps in appropriate circumstances, where Ofcom can ensure that initial prices are at a suitable level and any efficiency gains can equitably shared between seller and purchaser.

Properly established, a cost orientation remedy can be effective and less intrusive than many of the possible alternatives: EE therefore does not see the need to “avoid” using such remedies where appropriate.

Current use of cost orientation

Q5. How well defined is our implementation of the basis of charges obligation? How useful are the current guidelines, and why? Q6. Which elements of our implementation of cost orientation are least clear / clearest?

EE considers that the broad approach to the basis of charges obligation is relatively clear and well understood in the industry: using DLRIC floors and DSAC ceilings as a first order test, compliance with which needs to be demonstrated by the relevant operator with SMP. Notwithstanding this, given the age of Ofcom’s existing guidance in this area (and the fact since the guidelines were produced there have been a number of cases and changes in the market, especially the PPC dispute and subsequent appeal) conducting a review is appropriate. Areas where Ofcom could consider refining the guidance are with respect to what is an “appropriate” allocation of common costs to an individual price, what additional tests could be applied to charges beyond a first order test and how to ensure that charges in aggregate do not over recover common costs. EE considers that in certain circumstances, a DSAC ceiling has proved too permissive and not an effective constraint. These are therefore all areas where this review could provide greater clarity and improve on the current approach (essentially providing greater guidance on these issues in light of the CAT’s PPC Judgement and Ofcom’s interpretation of the conditions in light of experience and lessons learnt).

Q7. How well do you understand how BT / Kcom demonstrate compliance with the basis of charges condition? Why is that?

Our understanding is that compliance with the basis of charges obligation is meant to be established through the regulatory reporting requirements on BT and Kcom. In particular, BT’s Regulatory Financial Statements contain DLRIC and DSAC cost benchmarks for certain products which can be compared to its prices. However, there are a number of aspects of this approach where it is not clear how compliance with the basis of charges condition is established. First, to the extent that the floor and ceiling approach (and the DLRIC and DSAC benchmarks) is a first order test, it is not clear how charges which are within these bounds are further assessed or charges outside these bounds can be demonstrated to be cost orientated. Second, DLRIC and DSAC benchmarks are not established for “each and every charge offered” (which is to what the basis of charges condition applies). Where there are no such benchmarks it is therefore unclear how compliance is established

for such other charges. Finally, the way in which cost allocation methodologies are set, changed and considered to be appropriate is not clear.

The cumulative effect of these uncertainties makes it unclear to what extent compliance with cost orientation remedies is actually monitored and enforced by Ofcom. In particular, we are concerned that Ofcom's approach to monitoring compliance with the cost orientation remedy relies too heavily on disputes being raised. EE would support a more pro-active approach from Ofcom to ensuring compliance with these obligations.

Examples of where these type of issues have led to BT charging a price which has a negative impact on competition and consumers, which EE has raised with Ofcom in other contexts, concerns the charges which BT Wholesale levies for the provision of voicemail services and Caller ID. We strongly believe that both of these products should be subject to charge control remedies, as the current cost orientation obligations imposed upon BT appear to have had absolutely no effect. EE's fixed business effectively has no choice but to purchase voicemail services from BT Wholesale, which charges [redacted] per customer per month for the provisions of this product. EE is able to self provide this product to its own mobile customers for a cost of around [redacted] per customer per month. EE therefore does not understand how BT Wholesale's charge can be cost orientated. Similarly, in relation to caller ID, this is a functionality inherent within BT's digital local exchanges and involves no incremental cost to BT to provide. Again this is a product which EE's fixed line business has to purchase from BT at a cost of £6 per annum per customer and which does not seem to be cost orientated.

Q8. How do the cost orientation obligations in place on BT and Kcom, and our interpretation of them, compare with your understanding of cost orientation obligations on telecoms operators in other countries, particularly elsewhere in Europe?

EE has no particular comments on this question.

Options for cost orientation implementation

Q9. What are the credible alternative cost standards that could be applied in interpreting the basis of charges condition? (E.g. LRIC+, DSAC / DLRIC, FAC, etc.) Q10. What do you see as the advantages and disadvantages of the different approaches, both theoretical and practical?

A requirement for charges to bear a reasonable relationship to cost could use a range of different cost standards, which all ultimately relate to how an "appropriate" allocation of common cost is made to different individual products. In purist economic terms, no particular approach to allocating common costs is strictly to be preferred. In applied economic terms, choosing between different approaches will depend on a balance of competitive and efficiency effects (for example, impacts on allocative efficiency). The objective of setting a cost orientation remedy in the first place also needs to be taken into account. For example, if the aim is to constrain potentially excessive prices a cost ceiling standard which is above the monopoly price level will not be particularly effective at achieving that objective.

The concern with the current DLRIC/DSAC floors and ceilings is that they create extremely wide potential ranges for charges, which means that the cost orientation remedy becomes an extremely weak requirement – particularly when a cost difference of just a pound or two per customer per

year can in fact make a significant competitive difference. The range between the floor and ceiling in the current MPF rental dispute³ was between £60.40 and £162.01, which is an extremely wide range and effectively means the ceiling creates no meaningful constraint.

As part of this review, EE would therefore urge Ofcom to concentrate on feasible and appropriate methods of allocating common costs, rather than having a complex debate about the theoretical merits of different cost standards. In principle, having a “floors and ceilings” approach makes sense: the cost orientation remedy is there to provide greater flexibility than individual charge controls on each relevant product. These floors and ceilings need to be ones which are meaningful, however, which is a function of how an appropriate allocation of common costs is allowed to be assessed in practice. In this context, EE notes that it appears to be the case that the approach to cost allocation for FAC seems less open to interpretation than the DSAC standard. In some circumstances (see answer to next question below in this context), a ceiling which is at least derived from the FAC standard may therefore be more appropriate. FAC is a standard which includes a fair and reasonable contribution to common costs, assessed on a relatively objective accounting basis, and as such potentially represents a reasonable base for an alternative standard.

Whichever standard is used, it needs therefore to be appropriate to the market power issues which lead to the imposition of the remedy in the first place, and the standard must be based on a robust methodology which is fully tested, such that purchasing CPs can be confident in the figures that methodology produces.

Q11. Which approach do you believe we should take, and in what circumstances? How does this depend, for example, on the state of competition and any other regulatory remedies imposed alongside cost orientation?

While believing that an effective cost orientation remedy is very important, EE does not at this stage have strong views on the right cost standard to apply to achieve an appropriate allocation of common costs. It seems likely that this optimal approach will depend on the circumstances. Important considerations here will include:

- the objective of setting the cost orientation remedy in the first place (for example, whether it is simply as an additional safeguard where there is “weak” SMP, or as a substitute for a charge control where a charge control is not possible, or as a complement to a charge control based on a tariff basket);
- the degree of competition and potential competition in the relevant market; and
- the extent to which the pricing of the product or products in question will have an impact on competition in downstream markets or otherwise impact on incentives in related markets.

For example, where there is entrenched and enduring SMP in the provision of a stable mature product, which has an important impact on downstream competition and where this product is subject to a basket charge control, then EE would consider it is important that the cost orientation remedy would have a relatively “lower” ceiling. Where there are at least some alternatives for purchasing CPs and where greater flexibility is considered appropriate then using an approach with a

³ Dispute between TalkTalk Group and Openreach relating to MPF rental charge. EE is an interested party to this dispute.

wider range may be more appropriate. However, under either approach there needs to be some complementary check such that there is not over recovery of common costs in aggregate.

Whichever approach is used, cost orientation is an important remedy and must be effective. Therefore it cannot simply be left to the SMP operator and operators raising disputes to ensure compliance with this remedy. In this respect, EE urges Ofcom to take a more pro-active and transparent monitoring stance to such remedies. There exist charges subject to cost orientation requirements which appear *a priori* very high and potentially non compliant, which suggests that the remedy is not currently effective.

Q12. What tests should we apply in assessing compliance with the basis of charges condition, for instance in disputes? How should this vary depending on circumstances, for instance different levels of complexity?

In general, we would expect that the approach to testing compliance will be dependent on how cost orientation is interpreted more broadly. EE considers that it is important that compliance is monitored and assessed in appropriate ways. At this stage in this review, however, EE does not have firm views but would expect to comment in more detail at a later point in this process.

Q13. At what level of aggregation (e.g. product level, market level, price list level) should cost orientation apply, and why?

The application of cost orientation remedies needs to reflect the underlying market power issue which they are designed to address. If compliance with such remedies is only assessed at too aggregated a level this will reduce its effectiveness, allowing individual excessive charges which it is meant to avoid. Such aggregation would also create more room for interpretation and uncertainty as a result of different cost allocation methodologies within aggregated groups of products. The condition requires “each and every” charge to be reasonably derived from the costs of provision and some approach is needed to show how compliance with this requirement is demonstrated. Individual charges can have an impact on competition, where they are associated with key inputs required to compete downstream.

There would seem to be no *a priori* reason why cost orientation should not be applied at more than one level e.g. the relevant market in which SMP is found (to ensure that excessive returns are not being made where there is market power) and to a range of individual products (as this is the way in which market power could be exercised in a way which would impact on purchasing CPs ability to compete). The question of the level at which cost orientation should apply is therefore not an “either/or” one.

Any aggregation or focus on particular charges is therefore a practical matter rather than one of principle and should be treated as such. For example, while a cost orientation remedy should apply in principle to individual charges, testing compliance with this requirement could be focused on those charges deemed most material. Such a materiality test needs to take account of the importance of a particular product as an input (and the consequent impact on competition in downstream markets from its being supplied at a particular price) as well as any test based on the level of revenue which BT receives from that product.

Overarching questions on cost orientation

Q14. What impact, if any, should changes in technology have on our use and interpretation of cost orientation? E.g. the transition from copper to fibre in the access network, or the replacement of traditional telecoms network switching equipment with more modern equivalents? Q15. Are there any other factors or considerations we should take into account in our review of our guidance on cost orientation? E.g. demand patterns over time, or efficiency considerations.

Operators with SMP need to be able to recover their efficiently incurred costs over time. In assessing compliance with any cost orientation remedy, Ofcom also needs to have regard to all of its statutory duties, including the impacts on competition. As such, the introduction of new technologies needs to be taken into account but this should ensure that migration is undertaken in an efficient way and the impact on purchasing providers with older technologies is not such as to harm competition. As a general proposition, the introduction of newer technologies should not lead to increasing prices. The application of cost orientation remedies in this context needs to be considered very carefully. The cost bases on which cost orientation is assessed should also take into account the scope for efficiency gains and should not be a way of shielding an SMP operator from reducing prices in line with increasing efficiencies. However, these types of issues are also likely to be very context specific.

Regulatory reporting

Objectives of regulatory financial reporting

Q16. Should we require telecoms operators with SMP to report financial information, and if so why?

Financial reporting SMP remedies are, by their nature, supplementary remedies. The principal benefit of the greater transparency provided by regulatory requirements to report certain financial information is in allowing other remedies to be enforced. Whether such conditions are required therefore depends on the extent and breadth of the SMP found, as well as what other remedies have been imposed (or the likelihood of requiring *ex post* intervention). A mere finding of SMP in and of itself should not lead to the imposition of financial reporting requirements – e.g. where the remedies imposed to deal with that SMP do not require such requirements in order for Ofcom and other CPs to understand whether compliance is being achieved with those conditions. By way of a more specific example, where a price control is set on a discrete set of products, which is based on the objective costs of a hypothetical efficient operator, then regulatory financial reporting of the SMP operator's costs is not required in order to assess compliance with that price control.

However, where an operator is found to have SMP in a range of related telecoms markets and is subject to a range of remedies (including cost orientation and non-discrimination) then the requirement to publish regulatory financial information is part of making those other remedies effective. In short, EE expects that requirements to report financial information are appropriate where they allow competing and purchasing providers to monitor and understand other SMP remedies on an ongoing basis. Such information (including that which is provided on a confidential basis to Ofcom) will also be important in relation to setting charge controls where these are based on the regulated entities own accounting information and/or is subject to a range of charge controls on related products.

Q17. What do you see as the respective purposes of: • The Published RFS. • Broader regulatory financial reporting? Q18. To what extent do you consider that the information currently published achieves the purposes you set out in response to the question above? Where do the current published RFS meet, fall short of, or go beyond, these purposes? Please be as specific as possible, in terms of content, format, structure, or any other parameter.

The current regulatory reporting requirements provide a set of documents which should allow purchasing CPs to assess whether charges they are paying are, in their view, appropriate given other regulatory requirements. This means that the regulatory reporting documents are a first order test of compliance with, for example, cost orientation and non-discrimination obligations. Given the wider importance of costing information to BT and Kcom's charging and regulation of those charges, this information should also provide stakeholders with an understanding of how costs are allocated between products/groups of products. The RFS (and the confidential associated information provided to Ofcom) are also the basis on which Ofcom is able to conduct many of its other regulatory functions such as setting charge controls and dealing with disputes and complaints in a timely manner.

As will be clear from the comments above in relation to cost orientation, EE has some concerns about the effectiveness of the current regime in achieving these aims in all cases. The overall approach and key assumptions made in allocating costs (for example in relation to volume forecasting) are not always clear. This has been highlighted in the recent consultations in relation to the WLR and LLU charge controls for example. Again in the context of WLR and LLU, we note that it is also difficult for us as competitors to track compliance with BT's non-discrimination obligations through the RFS when BT does not appear to report in a manner which enables easy comparison on its internal consumption of equivalents to key competitor input products, such as SMPF.

At this stage in the review, EE does not have detailed comments to make on the current use of regulatory financial reporting outputs, but is constraining its comments to these high level points. The published RFS documents are used to provide inputs to analysis of individual charges and the cost information is also relevant to considerations of charge controls and any potential disputes. As such, this cost information is used in the context of specific individual prices where there is a potential issue. Detail is therefore required in terms of the outputs, which is required to assess whether charges are appropriate and non-discriminatory. Descriptions of the inputs required for each charge (to enable costs of different charges using overlapping elements to be assessed) would make the cost estimates more useful. EE understands the need for great detail in the cost allocation methodology (and individual allocation methodologies for each individual product for which cost benchmarks are reported). However, the detail can make the overall picture hard to discern here. EE would support more high level descriptions of this to complement the very detailed descriptions currently produced. Such a description would then also lead to a requirement to explain and, crucially, justify changes year on year to such methodologies and assumptions. EE would also refer Ofcom to the response made by MBNL in this respect concerning specific issues with the current regulatory reporting requirements.

Options for regulatory financial reporting

Q23. What high-level principles should regulatory financial reporting follow? Or, put another way, how would you describe good regulatory financial reporting? (E.g. “the Published RFS should link closely to the statutory accounts or management accounts”).

There are clear benefits to be able to reconcile regulatory financial reporting outputs to statutory accounting information (and ultimately the management accounts). However, this should not be an over arching requirement and it needs to be recognised that the context and underlying reasons for producing regulatory accounting information are different to those for statutory accounts. EE would therefore consider that, to the extent that there is a conflict, it is more important to ensure that regulatory financial reporting links back to the market assessments and reasons for applying SMP remedies. These reporting requirements should make it easier to make assessments of whether prices are cost orientated, non-discriminatory and provide useful information which can be compared across years for the purposes of setting charge controls. “Good” regulatory financial reporting makes other regulation more effective and transparent.

Q24. What credible options could we take for our approach to the Published RFS and wider Regulatory Financial Reporting Framework? The options could vary on a number of dimensions, for example:

- *The level of detail provided.*
- *The cost standard(s) used.*
- *The estimation of asset values, and the treatment and presentation of holding gains and losses when using current cost accounting (CCA).*
- *Publication vs. private provision of information to Ofcom.*

EE’s views on the issues raised by this question fall directly out of the comments made in answers to previous questions. At this stage in the review, EE does not have anything further to add, expect that it recognises that there is likely to be more confidential information which is only providing to Ofcom. The needs to commercial confidentiality and the requirements for information for effective regulation make this inevitable. The extent to which information should be published should be determined by true needs to commercial confidentiality, which may lead to different information being published where the degree of competition is different (e.g. as between BT Wholesale and BT Openreach).

Q25. What factors should we take into account when weighing up the different options, and why? Which factors do you see as most important? Examples might include timeliness, accuracy, ease of use, transparency.

Financial regulatory information needs to be produced in ways which make it an effective tool for understanding the extent to which charges are appropriate in line with other SMP remedies. Such information therefore needs to be published within timescales which make them effective (within time such that competitive impacts are not suffered irreparably before charges can be properly assessed). In ensuring that this information is useful for assessing other SMP remedies, the most

important factor is likely to be accuracy based on a clear allocation methodology, which, for example, is not subject to arbitrary change between years.

Q26. How would you rate each option against these factors? Bear in mind the trade-offs between different possible factors; for example, increased amounts of detail might very well increase the length of time that the Published RFS take to produce each year. Or decreased detail might increase ease of use but might also reduce overall transparency.

At this stage in the review, the available options seem very wide and therefore EE expects it will be able to provide more detailed views on this at later stages in this process, once more specific options have been identified.

Q27. How should regulatory financial information relate to statutory financial information, if at all?

See answer to Question 23 above.

Q28. Who should control the detailed “rules” by which regulatory financial reports are prepared? What do you consider to be the advantages and disadvantages of responsibility for the decisions on the appropriate allocation methodologies resting with BT, with Ofcom or with a third (independent) party?

The relevant accounting information and expertise clearly resides within BT. There are therefore significant benefits from continuing to have BT undertaking the detailed work to produce this information. However, this does not mean that BT necessarily should be in control of the methodology by which regulatory financial information is compiled and be able to make its own judgments about how to allocate costs. As this information ultimately demonstrates whether charges are compliant with SMP conditions, some independence is required in determining the method by which this compliance is demonstrated. High level assumptions and the approach taken to detailed cost allocation therefore need to be set in a way which BT cannot influence and change between years. One possible option here would be for Ofcom to produce more detailed regulatory reporting guidelines (as is done by other regulators in other sectors, for example the detailed guidelines produced by Ofwat⁴ and the ORR⁵, as well as in the telecoms sphere in many international jurisdictions).

Q29. What would you consider to be the advantages and disadvantages of requiring some of BT’s regulatory financial reporting information – for example the DSAC / DLRIC estimates – to be prepared by a third party other than BT? Q30. How can we best ensure timely and accurate delivery of regulatory financial information?

Subject to the comments above, EE has no further detailed views at this point on this issue but would expect to comment on any more detailed options proposed later in this review. Some independent third party involvement would have the benefit of providing greater confidence in accuracy, consistency and the appropriateness of judgments made in compiling the relevant information. Given the complexity and inherently detailed nature of BT’s data there are also benefits from having BT involved in the production. EE would expect that there is an appropriate

⁴ See <http://www.ofwat.gov.uk/publications/rags>

⁵ See <http://www.rail-reg.gov.uk/server/show/nav.149>

“middle way” to this issue, as has been found in other sectors. This may involve more detailed guidelines being issued by Ofcom and maybe some third party oversight of how data is produced (similar to the “reporters” regime used in other sectors for example). At the very least, Ofcom should have a very good understanding of how and why BT has allocated all major items. It should not, as has recently occurred in the re-consultation on the WLR and LLU charge control, take until the third iteration of Ofcom’s consultation document for Ofcom to realise that £100 million of IT costs have been entirely inappropriately allocated to regulated products by BT.

Audit of Published RFS

Q31. How much assurance do you take from the audit opinions currently provided on the Published RFS? Do you take a different level of assurance from a ‘Fairly Presents’ opinion compared to a ‘Properly Prepared’ opinion?

Q32. How should the audit framework function for the Published RFS?

- *Which parts of the Published RFS should be audited, and to what level of detail?*
- *Should there be rules around the appointment of auditors of the Published RFS, and if so what should these be?*
- *To what audit standard should any audit of the regulatory financial statements be carried out (I.e. Fairly Presents / Properly Prepared)?*

Ensuring confidence in the outputs of regulatory financial reporting information is vitally important. It is therefore very important that the regulatory information published continues to be subject to some external verification / audit requirements. CPs spend considerable amounts of money on the products involved here. Moving to a more stringent audit standard and widening the extent to which this information is audited could well be justified. However, the extent to which it is so justified will depend to a certain extent on what other changes to the regime Ofcom proposes to make. The relevant audit requirements are therefore part of the overall package and EE would expect to comment in more detail on specific options at a later stage in this review.

Overarching questions on regulatory financial reporting

Q33. What other issues should we consider in relation to regulatory financial reporting? Q34. In summary what major changes, if any, do you consider need to be made to the regulatory financial reporting currently imposed on BT (and Kcom) and what do you consider should be Ofcom’s top three priorities for its review of the regulatory financial reporting framework?

EE does not have any further comments to add to those raised above at this stage in the review.