

Non-Confidential Response to OFCOM Call for Inputs

Review of cost orientation and regulatory financial reporting in telecoms

Introduction

Level 3 owns and operates a national network in the UK where we supply a wide range of advanced and traditional services to business users in the private and public sectors and to other Communications Providers. In order to extend our network to customer premises, we rely extensively on regulated access products supplied by BT. Following findings of BT's continuing Significant Market Power ('SMP'), these access services are generally subject to ex ante cost orientation regulation and the Regulatory Financial Statement ('RFS') is an essential tool in demonstrating that BT continues to meet the first order tests of its compliance obligations.

As a member of UKCTA, we have contributed to and support their submission on this subject. Cost orientation will continue to remain an essential regulatory remedy until such time as adequate market competition develops in the local access market.

Our confidence in the current RFS process has been damaged recently, particularly since BT signaled the first of its restatements in 2008, and the identification of a serious cost allocation error in the context of the current LLU/WLR consultation exercise. In view of BT's enduring control over the local access infrastructure bottleneck, we cannot overstate the importance that we place on this Ofcom project which we sincerely hope will strengthen Industry's confidence in the accuracy and clarity of the RFS.

The Basis of Charging together with the SMP obligation on the dominant supplier to demonstrate the cost orientation of each and every regulated service are essential requirements, the absence of which would undermine Ofcom's ability to ensure the future competitiveness of the access market. We believe that regulatory certainty for new entrants can be significantly improved if Ofcom takes this opportunity to selectively strengthen the controls applied through the RFS process.

We acknowledge that the UK regime is more developed than is the case in other EU Member States in which we operate and believe that this has played a role historically in ensuring that the level of sustainable competition in the UK market has grown more quickly than elsewhere. This lead has arguably been eroded somewhat in recent years and we believe that this is in part due to a loss of market confidence. In order to maintain the UK's international lead, we urge Ofcom to take a robust line in exposing the weaknesses that are inherent in the present RFS regime and talking these in such a way as to lay strong foundations for competitive investment in the future.

Cost Orientation

Cost orientation remains essential as one of the most useful regulatory remedy. Provided compliance can be assured, C/O goes further towards establishing a level playing field than many other remedies such as

charge controls and mandated services. We find this to be particularly so in relation to infrastructure-based product markets such as Business Connectivity.

Furthermore, as one of the remedies put forward within the EU Regulatory Framework, we would welcome its support by Ofcom within BEREC as one of the tools that can deliver the greatest benefits to the level of competitiveness within the sector.

In our view, the primary purpose of the RFS is to identify the compliance of the SMP operator with relevant regulatory conditions. We acknowledge that there is something of a trade-off between alignment of the RFS with statutory and product/ management accounts however, the strengthening of the alignment between RFS and statutory accounts would ultimately deliver the maximum consumer benefit and we believe this can be achieved without compromising the existing linkage with the product

We would propose that the SMP obligation to ensure that each and every service is Cost Oriented should continue and that this should be subject to a rigorous level of scrutiny so as to greatly reduce the chance of a recurrence of errors.

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Regulatory Reporting

We are content that the level of obligation currently applied to Kcom is sufficient and proportionate. However, it is in relation to BT that we believe there is both a need and an opportunity to strengthen the existing regime.

The cost to Level 3 of procuring access services primarily from BT ✂

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We make use of BT's RFS in a number of ways, but primarily to assess whether BT's cost recovery is within the bounds that are deemed acceptable, ie between the relevant floors and ceilings. The RFS also provides information as to ✂

As stated above, our level of confidence in the accuracy of BT's RFS, despite Ofcom's overview, has been seriously damaged in recent years. In our view, one of the most effective ways in which demonstrable and systemic improvements can be made would be to address the level of audit opinion by moving to a 'Properly Prepared' regime. Any third party costs associated with such a change would, in our view, not be excessive and would more than repay themselves within a short period of time.

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