CWU Response to Ofcom Pensions Review – Second Consultation

The Communication Workers Union (CWU) has nearly 70,000 members working in the UK telecommunications sector. Around three quarters are employed in BT, with the remainder spread over 30 telecommunications companies.

We take a close interest in Ofcom's regulatory treatment of pensions because of the considerable implications it has for our members, particularly with respect to terms and conditions of work. As we argued in our response to Ofcom's first consultation on this issue, we believe it is appropriate to account for pension deficit repair costs when calculating charge controls. Allowing the recovery of costs in this way will encourage BT to commit the level of investment required to build and maintain a world class digital network for the UK which will be an important platform for jobs and growth and upon which so many communications providers will rely to deliver their services.

Key Points

- CWU is greatly disappointed with Ofcom's decision to exclude deficit repair payments in regulated charges.

- We believe that Ofcom's decision to exclude deficit repair costs neglects an opportunity to encourage greater investment from BT at a time when businesses and society are relying to a significant extent on BT for the nationwide roll out of broadband infrastructure.

- We contend that the decision to exclude deficit repair costs is not consistent with Ofcom's duty to encourage investment in infrastructure.

- We believe the huge challenges now facing the ongoing funding of pension schemes and the consequences of this for BT, its employees and its customers, justifies a reversal of approach to one similar to that taken by other regulators in the treatment of deficit repair costs for regulated charges.

Q2.1 Do respondents have any comments about our relevant duties in the context of this review?

The CWU agrees with the duties that Ofcom has highlighted as relevant in the context of this review. We believe that encouraging efficient investment in infrastructure and promoting innovation is of particular relevance.

Q2.2 Do respondents have any comments on how our proposed pension recommendations are likely to have an impact on equality?

In our first response we expressed concerns about the impact of the recommendations on the workforce, and we asked that Ofcom recognise the rights and responsibilities of the UK communications workforce as citizens through their individual contributions towards general and pension cost efficiencies.

We disagree with Ofcom's response that the experience of the workforce is not relevant to the equality impact assessment. Telecommunications workers form a defined group of citizens who will be affected by the outcome of the review, and we believe that consideration should extend to them as a group within the context of the equality impact assessment.

Q3.1 Do respondents agree with our assessment of the importance of regulatory certainty and consistency in relation to deficit repair payments?

We understand the importance of regulatory certainty and consistency but this should not mean the rejection of changes in policy in the light of new developments, particularly when little detailed consideration was given to the issue in the past by any of the parties that are involved. As far as we are aware the current basis for the treatment of surpluses was not decided upon as a matter of principle but was, in effect, something that just happened. Now that circumstances do require more detailed consideration of the issue, what was decided in the past, more or less by default, is of limited relevance.

Therefore, due to the dramatic changes affecting the funding of pension schemes, we believe that an exception to the principle of consistency over time is justified in this instance, and that a shift in approach to the treatment of the deficit repair costs is a necessary response to those changes.

Ofcom asserts that it was BT and its shareholders who took the rewards of the pension surplus in the 1990s, and therefore BT's shareholders should continue to bear the risks of the pension fund. However, as we argue in response to Q3.4, it is not only the shareholders who bare the risks and rewards of the pension scheme but BT's employees and ultimately BT's customers through the quality of service they receive. Also, as regulatory charges have historically understated the costs of providing pensions, BT's customers have benefited from lower charges than would otherwise have been the case.

Given the broad group of individuals who are affected by the risks and rewards of the pension fund, and the significant challenges now facing the funding of pension schemes, we believe a change in approach to the treatment of deficit repair costs is justified.

Q3.2 Do respondents agree with our assessment of deficit repair payments against the six principles of pricing and cost recovery?

Principle 1: Cost Causation

The CWU disagrees with Ofcom's conclusion that the principle of cost causation does not support the recovery of pension deficit payments from regulated charges.

There were some compelling arguments put forward by various respondents to the first consultation supporting the view that deficit repair costs form part of the costs of providing current services to customers, and therefore should be accounted for in regulatory pricing.

Scottish and Southern Energy (SSE) and Orange both point out customers buying Openreach products today are benefiting from work undertaken in the past on the infrastructure base and so have some responsibility for past pension costs.

As the CWU stated in our first response, the ongoing service costs are only a first step to meeting the full cost of providing the relevant pensions, which is ultimately met through the deficit repair payments. The ongoing costs and the deficit costs are therefore linked and should be treated in the same way for the purposes of price regulation.

As mentioned above, Ofcom states that the consequence of excluding deficit payments from regulated charges is that they are most likely to be borne by shareholders. However, it is inevitable that much of the cost will be borne by the workforce, partly through a weakening of their terms and conditions of employment. The overall size and capability of the workforce will also suffer due to restrictions on recruitment, retention and training brought by the need for efficiencies to service the pension deficit repair costs. This will have a detrimental impact on the service that BT provides which will be felt by both BT's customers and the wider industry.

We feel it is also important to note that Ofcom's own financial framework takes into account its pension liabilities inherited from the legacy regulators. This would indicate that the charges levied upon communications providers to fund Ofcom are calculated based on Ofcom's costs, including the cost of servicing its pensions deficit. If this is the case, then by concluding that consistency with the past is important for the approach to BT's pension deficit, Ofcom is perpetuating an inconsistency for the future between itself and the companies it regulates. The CWU believes that, as the regulator for and funded by the telecommunications industry, Ofcom's treatment of it's own pension deficit costs should be aligned with the rules it applies to govern the market for which it is responsible.

Principle 2 – Cost Minimisation

The CWU rejects Ofcom's conclusion that including deficit repair payments in charges would reduce incentives to minimise costs. We remain of the view that BT will seek to minimise its pension costs regardless of whether or not it can pass some of those costs on in regulated charges.

Principle 3 – Distribution of benefits

The CWU disagrees with Ofcom's conclusion that the distribution of benefits principle suggests that deficit repair payments should be excluded from regulated charges.

There is no doubt that any policy should be consistent for both deficits and surpluses. However, it is an oversimplification to state that it is only BT's shareholders who will ultimately be responsible for any pension deficits or claim any surpluses. As mentioned previously, BT's employees (through their terms and conditions) and its customers (through the level and quality of service provided) are all affected by pension deficits and surpluses.

Furthermore, regulatory charges have historically not been sufficient to meet ongoing pension costs, and from that point of view BT's customers have benefited from lower charges than would otherwise have been the case.

Principle 4: Effective Competition

The CWU is inclined to agree with Ofcom's conclusion that the principle of effective competition does not strongly support either inclusion or exclusion of deficit repair payments. However, on the basis that a healthy competitive market rests on a world class national communications infrastructure that can only be built through significant investment, and given that BT's ability to invest will be strengthened by the inclusion of deficit repair payments, it follows that competition is likely to benefit from the inclusion of deficit repair payments in regulatory charges.

Principle 6: Practicability

In our first response we argued that the principle of practicability does not require that the simplest approach must be taken. We welcome Ofcom's acceptance of this point, and the acknowledgement that if there were a strong case for including pension deficit payments then some practical difficult would have to be accepted.

BT's ability to invest

The CWU disagrees with Ofcom's conclusion that any decision on the treatment of deficit repair payments will not adversely influence BT's investment at the present time.

We believe that Ofcom's decision to exclude deficit repair payments is not consistent with Ofcom's duty to encourage investment, which appears both in the Digital Economy Act under section 3(4)(d) and in the recently revised European Framework Directive in Article 8(5).

We note Ofcom's view that 'In certain cases, where the evidence is compelling, we will consider whether it is appropriate to depart from the pension recommendations in order to further our statutory duties, including to encourage investment.' However, we think this approach is not sufficient to adequately meet Ofcom's duty to encourage investment in infrastructure, which we think Ofcom should be treating as a greater priority.

Given the huge potential benefits of a world class digital communications network for the UK economy and society, the CWU strongly believes there is a need to use every possible regulatory means of maximising investment potential. There can be no doubt that allowing deficit repair payments in regulated charges will improve BT's ability to invest and extend the reach of its superfast broadband infrastructure, benefiting other communications providers and the wider economy. Excluding deficit repair costs therefore represents a missed opportunity to encourage a greater level of investment from BT in the roll out of a national high speed digital network.

We note BT's own view quoted in Annex 10 of Ofcom's second consultation document, which makes clear that excluding deficit repair costs will affect their ability to invest, when they state 'To establish regulation which did not provide such an opportunity (for the regulated supplier to recover all their relevant costs…) would clearly undermine BT's ability to provide the regulated services and challenge incentives to invest in improved service quality and new, innovative services moving forward.'.

Q3.4 Do respondents agree with our recommendation for the treatment of pension deficit repair payments?

The CWU disagrees with Ofcom's recommendation. There are a number of factors that have dramatically increased the funding requirements for defined benefit pension schemes in recent years, including increased longevity and declining investment returns. Consequently, the extra funding required to service BT's pension scheme has exceeded the savings BT made from its pension contribution holiday in the 1990s.

We agree that risks and rewards should be treated in the same way, but it is important to recognise that it is not only the shareholders who bare the risks and rewards of the pension scheme. It is also BT's employees through their terms and conditions of employment, and BT's customers through the level and quality of service that BT can offer.

Given the large and diverse group who are affected by the decision, coupled with the dramatic changes that have created significant challenges for the funding of defined benefit pension schemes, we believe that the case for a change of approach to deficit repair payments outweighs the merits of consistency with the past.

BT's pension deficit repair payments have increased significantly since the 2008 triennial valuation, and given the scheme's current deficit there is little prospect of pension holidays being taken by BT for some years to come. Therefore there is little or no prospect, at least for the short to medium term, of any benefit to BT from regulatory charges not being reduced to reflect pension holidays.

Ofcom's decision to maintain consistency with the past does not acknowledge the scale of the challenge now facing defined benefit pension schemes, which we believe warrants a change of approach to the treatment of deficit repair costs.

Furthermore, no other regulator makes no allowance for deficit repair payments in the way that Ofcom does. Ofgem, Ofwat and Postcomm all make at least some allowance for deficit repair payments in regulated charges. In respect of the other regulators listed by Ofcom, CAA and ORR, the relevant pension schemes were either in surplus, in balance or there was no substantial deficit and therefore no specific policy in place. There is therefore a commonality of approach amongst other regulators where there is a significant pension deficit, which makes Ofcom's approach inconsistent with the way other regulators deal with pension costs.

Q4.1 Do respondents agree with our recommendation for the treatment of ongoing service costs?

No, the CWU disagrees that the accounting charge remains the appropriate measure of the ongoing pension cost incurred in the year. As we argued in our first response, it is more logical that allowance should be made for the payments that actually have to be financed by the company, rather than a hypothetical measure. The actual payments have to be specified in a schedule of contributions that is set in advance, whereas the accounting charge is an estimate.

Q5.1 Do respondents agree with our recommendation for the treatment of the cost of capital?

Yes, the CWU agrees with Ofcom's recommendation to maintain the current approach of making no adjustment to the cost of capital to reflect BT's defined benefit pension scheme. As shown by the report sponsored by Ofcom dealing with this issue, it would be very difficult to accurately measure the impact of BT's defined benefit pension scheme on the cost of capital.

Q5.2 Do respondents agree that we should consider the impact of a defined benefit scheme on the cost of capital as and when we next review the cost of capital?

No, we see no benefit in considering the impact of a defined benefit pension scheme on the cost of capital, given that the effect on the equity beta cannot be accurately measured.

Q6.1 Do respondents have any comments on the next steps and proposed implementation of any pension recommendations

As set out above, the CWU disagrees with Ofcom's proposed recommendations 1 and 2.

We do, however, agree that applying any pension recommendations adopted in the final statement on a case-by-case basis is the right approach. We also agree with the intention to explain the reasons for departing from any recommendations.

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CWU 11th October 2010