TalkTalk
For Everyone

BT Regulatory Financial Reporting

Proposed regulatory reporting directions covering all regulated fixed telecoms markets

TalkTalk submission

February 2019

NON-CONFIDENTIAL VERSION

1 This is TalkTalk's response to Ofcom's consultation regarding BT Regulatory Financial Reporting[1].

2 Our main point is that we strongly disagree with Ofcom's proposal to remove the majority of regulatory financial reporting in the BCMR markets. In particular, Ofcom proposes to remove (except on some inter-exchange dark fibre circuits):

- service level reporting i.e. volumes, prices, revenue and costs for each service in each market; and,
- component level reporting i.e. cost breakdown for each service in each market.

3 This is a significant departure from Ofcom's well-established approach where BT is required to provide service and component level reporting for all services where they have SMP. Despite this major change in regulation Ofcom provides no reasoning for its proposals.

- In respect of the absence of service level reporting Ofcom provides no explanation at all.
- In respect the absence of component level reporting Ofcom provides no reasoning. Instead it merely states: "[we are not requiring this reporting …] *because we are not proposing a FAC-based charge control on BT in the business connectivity markets, and we consider that it would therefore not be appropriate for BT to publish this level of detailed FAC information*" (§5.34). That is simply a statement of Ofcom's approach – Ofcom provides no discernible logical reasoning to rationalise why Ofcom is proposing that approach. It is insufficient simply for Ofcom to opine that it would not be 'appropriate'; it must provide a logical justification for its decisions.

4 Therefore, Ofcom's consultation is procedurally deficient. Ofcom has failed to properly consult which includes requirement that "*sufficient reasons must be put forward for the proposal to allow for intelligent consideration and response*"[2].

5 Ofcom's proposals will be harmful since the lack of this regulatory financial information will be detrimental to consumers:

- Without this information CPs will be unable to monitor for discriminatory behaviour such as increasing margins on services used externally, or squeezing the margin between EAD and EAD-LA services to deter network based operators. To be able to detect discrimination CPs need visibility of margins (as well as prices)
- It will not be possible for CPs to identify the consumer harm from excessive prices and thereby develop and substantiate arguments as to why prices should be regulated at cost.
- It will not be possible to identify when Ofcom is engaging in predatory pricing against competitors in one or more products.

[1] BT Regulatory Financial Reporting - Proposed regulatory reporting directions covering all regulated fixed telecoms markets. December 2018

[2] This is one of the Gunning principles which are used by courts to assess whether public bodies have properly consulted

- In cases where fair and reasonable pricing is assessed by reference to Openreach's cost it will not be possible for CPs to assess whether Openreach is complying with such obligations.
- It will harm stakeholder confidence that costs have been allocated consistently, appropriately and without double recovery.[3]

6 We do not consider that there is any disproportionate cost or harm involved in providing such information (and Ofcom have not explained any such cost).

- First, this information is provided for other services where BT has SMP and prices are regulated. The mere fact that the BCMR charge control is not a cost-based one does not mean that there is more harm from publication of this data than for other services; other services are already regulated above Openreach's cost but have such information published. For example, the price cap for MPF is well in excess of actual costs due to Ofcom's HON adjustment. The same is true of ISDN charge. This is not seen as a reason for failing to publish regulatory financial information for MPF or ISDN products.
- Second, since this data is anyway provided to Ofcom privately (see §5.34) there is no additional cost to BT in providing it publicly.

7 In addition to this key point regarding BCMR reporting we have a number of other comments.

8 Ofcom's general approach is that BT must provide both market level information as well as service level information. However, these two sets of data are not consistent. For instance:

- the market level information provides *inter alia* revenue, depreciation, operating costs and MCE;
- the service level information provides *inter alia* revenue and FAC.

9 Furthermore, these two information sets appear arithmetically inconsistent. In RFS18 for WLA (table 5.1 and 7.1):

- from market level information total FAC is £1.947bn: total FAC = CCA op costs[4] (£1.462bn) + MCE (£5.637bn) x WACC (8.6%);
- from service level information total FAC is £1.983bn.

10 It would be useful if the service level information were to provide a split of costs by depreciation, operating costs and MCE (or RoCE) so that the same data is provided in both market level information and service level information.

11 We note that electricity charges (i.e. the amount paid per kWh of electricity) is not reported as a separate service in the regulatory financial statements – we think[5] that it is included in 'Other WLA' along with GEA. It would add confidence and increase compliance certainty if this service was separately reported since:

[3] Ofcom make this point in respect of market level reporting (§5.27) and these points are equally true of service level reporting and component reporting

[4] CCA op costs includes depreciation

[5] This is the only service category that has a large enough revenue to be able to include electricity

- this charge is controlled in a unique manner[6] (price based on actually incurred costs rather than forecast costs) compared to all other WLA services – charge control based on cost or no charge control. Reporting this service separately would allow CPs to assess compliance and so increase confidence
- it is material service – total Openreach revenue is probably over £30m pa
- there have been significant price increases recently – for instance, the Openreach charge increased by 14% in April 2018 [✂✂✂]

12 We note that at §5.27 Ofcom explains that a benefit of providing cost breakdowns is that it "*mitigates against the risk of double recovery of costs or that costs might be unreasonably loaded onto services or markets*". We agree. However, there could be stronger rules to reduce the risk of double recovery. Double recovery has happened on several occasions before – for example, in the case of ECC costs and certain co-mingling connection costs the cost was recovered up front and then capitalised and recovered again in rental charges. One such approach to mitigate double recovery risk would be to require BT to warrant that, in light of Ofcom's approach to setting charges, that its costs will not be recovered twice (e.g. in connection and rental charges).

13 BT incurs non-domestic rates (NDR) / cumulo costs on Ethernet (or WDM) circuits that use dark fibre services. However, where BT sells dark fibre services it does not incur NDR costs. In the case where BT does incur NDR costs, Ofcom proposes (§3.10, footnote 41) to attribute this NDR costs to dark fibre services. We consider it would be more appropriate for the NDR cost to be attributed to the Ethernet service (not the dark fibre service) since it is the addition of Ethernet equipment (and the associated lighting of the fibre) that results in BT being liable for NDR costs.

14 With regard to DPA network adjustments (§4.8*ff*) Ofcom proposes that where a network adjustment is paid for by a CP (because it is above the limit) then this cost is expensed (whereas if a network adjustment is paid for by BT it is capitalised and recovered in rental charges). The purpose of this approach is to prevent double recovery. An alternative approach to avoid double recovery (in cases where a CP pays for a network adjustment) is that the cost is capitalised but that the asset is excluded from the cost base used to calculate charges. This would have the benefit of the asset reflecting the full extent and value of Openreach's network – Ofcom's approach would essentially under-report the value of Openreach's network asset. The same approach could be considered for ECCs (§5.7) where these costs (which are paid by a CP) are expensed.

15 We note (§3.57) that Ofcom has revised the components for service reporting. We consider that it would be useful to stakeholders for Ofcom to explain its perspective of the particular role of component level reporting and why it has proposed the particular approach outlined.

16 Lastly, we remain a little mystified why it should remain necessary for Ofcom to specify that EE integration costs should not be allocated to SMP services. It is patently obvious that these costs are not relevant to or caused by SMP services. The general rules for preparation of the regulatory financial statements (e.g. regulatory accounting principles) should be sufficient to make plain that these type of costs must not be attributed to SMP services. If

[6] See WLA Statement March 2018 Annex 33 SMP Condition 6.1 (page 33)

Ofcom considers it has to intervene on EE integration costs in this way then it begs two questions:

- are the general cost attribution rules inadequate ?
- are there other inappropriate costs being attributed to SMP services ?