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Dear David,

**BT Regulatory Financial Reporting**

UKCTA is a trade association promoting the interests of fixed-line telecommunications companies competing against BT, as well as each other, in the residential and business markets. We advocate regulatory outcomes designed to service consumer interests particularly through competition to Ofcom and the Government. Details of membership of UKCTA can be found at [www.ukcta.org.uk](http://www.ukcta.org.uk). The views expressed in this submission don't necessary reflect those of Virgin Media.

We welcome the opportunity to comment on Ofcom's proposals on BT Regulatory Financial Reporting. UKCTA members are clear on the benefits that accurate and reliable regulatory accounting output can bring. Regulatory reporting is a key element of the UK Regulatory regime, helping stakeholders and Ofcom to understand what remedies are required, gauge how effective those remedies have proven to be and identifying instances of non-compliance. They help stakeholders engage with regulation and its formulation and are critical to ensuring a degree of transparency and accountability for the wider industry. In order to be effective and meaningful they need to provide consistent, comparable information year after year. UKCTA members are key in helping Ofcom understand markets, assisting it in improving regulation year on year to the benefit of competition and consumers – and without proper detailed regulatory accounting data this becomes increasingly difficult.

In the past regulatory accounts have been a source of significant tension in the industry, undermined through a series of financially motivated re-statements. We consider that previous alterations have been made with the aim of avoiding overcharging claims, or to secure more favourable charge control outcomes. This behaviour compromised their usefulness, rendering them unsuitable as a fair and impartial factual reference point.

In recent years, Ofcom has worked hard to try to rebuild trust in the accounts, first through improvements in the process around their production, with BT having to declare in advance significant changes that affect the numbers, and Ofcom then having the right of veto if concerns are apparent. This ensures BT is now mindful of what changes can be attempted. The work done in the cost attribution review by both Ofcom and Cartesian was also a significant step forward, helping to remove errors, correct inappropriate attribution and bring a level of fairness and rigour to the accounts that was previously lacking.

This process of trust restoration is not yet complete, and there remains much work to be done. As services fall out of price regulation, but continue to be classified as SMP, stakeholders need to be assured that regulatory accounting output will be produced and published, particularly where common costs and assets are shared between regulated and unregulated services. There is a danger that, once accounting obligations fall away, they cannot easily be reinstated and data can be lost or never generated in the first place. It is therefore extremely important that such obligations are maintained until there is absolute certainty that the relevant reporting will never be needed at any time in the future.

### Ofcom's Proposals

Ofcom are proposing to reduce the amount of public and private reporting within the RFS while making it more relevant, however it is not clear to UKCTA members why reduced reporting is required. There appears to be no justification set out in the consultation to explain why this is the interests of consumers where market failure exists. This leads us to fear the consequences of this lack of transparency, which has the potential to allow BT to leverage its market power and distort competition.

Future Ofcom decision making regarding these market will be impaired. This is in terms of the information available to Ofcom to assess the market and the ability of stakeholders to engage in meaningful dialogue to ensure SMP is adequately addressed and consumers are not disadvantaged. In the absence of quality regulatory financial reporting, it is impossible to understand what the counterfactual would be – so where consumers are in fact being overcharged with pricing drifting well above competitive market levels, it would be very difficult to identify.

Ofcom are rightly held to account on just what returns BT are earning in regulated markets. This scrutiny is vital if the consumer interest is to be properly served. By removing a level of detail from the RFS, Ofcom will make it harder for stakeholders to hold the regulator to account. Ofcom has previously failed to identify and act on serious overcharging in business connectivity markets, requiring communication providers to pursue claims with BT independently and then raise disputes with Ofcom (and defend subsequent Ofcom decisions through the courts). Ofcom has also implemented charge controls, which have been ineffective at constraining BT excess returns of successive years. The only means to assess Ofcom's performance in this area is via the published RFS and it would be wrong for Ofcom to pursue a policy to obscure numbers, which are clearly in the consumer interest to be published.

Ofcom has a duty to impose regulatory financial reporting obligations where it finds Significant Market Power. UKCTA members are concerned the proposals set out in this consultation fail to do that. While there may be an opportunity to improve what accounting output is produced, it is vital that transparency and adequate levels of detail are maintained in regulatory reporting wherever SMP is found.

UKCTA members are concerned that Ofcom is proposing to remove service level and cost level reporting in Business Connectivity Market (except Inter-Exchange dark fibre where charges are controlled at cost). UKCTA members believe this would be a mistake. This reporting is required:

- 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 identify the consumer harm from excessive prices and thereby develop and substantiate arguments as to why prices should be regulated at cost;
- To identify when BT is engaging in predatory pricing
- To assess fair and reasonable pricing in the context of Openreach's costs.
- To provide assurance and promote stakeholder confidence that costs have been allocated consistently, appropriately and without double recovery.

At a practical level, it is important that there is consistency in the regulatory accounting approach taken between passive and active services in order to prevent gaming and over-recovery between the products. As Ofcom focuses more on passive regulation, the need for accurate, transparent cost-based passive product reporting is ever more important. Alternative investment and competition will be hampered if BT leverages excessive SMP profits to drive down prices in contestable markets. For example, in the treatment of cumulo rates for active products, the active product cost stack should include the passive infrastructure asset costs. Dark fibre products sold to CPs will include infrastructure costs in their price and thus CPs will pay the cumulo rates or the

equivalent on the passive access products indirectly. This pass through of costs needs to be robust and fair, allowing no opportunity for over-recovery or double counting.

The prospect of this arising is particularly concerning in light of the fact that BT lines of business generally exclusively procure active services from Openreach, with external CPs likely to use both active and passive services. Separately Ofcom have set out proposals, which effectively reduce the active product regulatory reporting that BT is expected to publish and confidentially submit to Ofcom whilst proposing to replace it with enhanced passive product reporting. We believe it is vital that adequate report on both active and passive services is retained to ensure consistency. This is particularly true in the early years of passive services.

Communication Providers using Openreach passive services need long term pricing certainty in order to consume passive products with confidence. In the past, BT has been able to revalue upwards its network assets by a material amount (through commissioning hypothetical re-build studies). If such behaviour were repeated, it could have a serious impact on the price of passive services in the longer term (potentially introducing price shocks), removing certainty and harming their use over the longer term. We would seek assurances from Ofcom that their revised approach to regulatory report would prevent this from occurring and thereby remove a very significant business risk from CPs' investment models.

While PIA products are in their infancy, with very low usage and not likely to take off in any significant volumes for some considerable time, Ofcom appear to be jumping the gun and are proposing to significantly reduce the reporting requirements for active products, especially in business connectivity markets, whilst at the same time accepting that PIA products will have little effective in the market and thus requiring little reporting. We do not consider that this is an appropriate or sustainable position to take and may have longer-term detrimental impact on the market. As stated previously active product, regulation should be relaxed when PIA product use has demonstrated that other operators rolling out network can provide a competitive constraint on BT.

It is impossible for UKCTA members to comment fully on the private information provided to Ofcom by BT because we are unclear over the detail of what is provided and the work undertaken by Ofcom to interrogate that information. Given Ofcom have failed to act on BT overcharging without CP involvement we are clear that Ofcom neither have the incentive nor the resources to do anything meaningful with the data produced. We have a strong preference for this detail to be published and indeed, we consider it is essential. If there are genuine confidentiality concerns then these should be overcome through confidentiality rings to ensure stakeholders have the opportunity, if desired, to view this material in an appropriate context.

We have longstanding concerns about the LRIC model that we have previously shared with Ofcom. The LRIC model has been extensively used to set charge controls and calculate cost floors and ceilings, despite falling out the scope of audit over a decade ago. While we appreciate, the LRIC model is far from ideal and needs to be updated, Ofcom’s proposal to effectively bypass it leads to a different set of concerns and the potential for inappropriate outcomes. Ofcom believe it is too speculative for BT to develop a new LRIC model given how the market might develop and are proposing to kick the issue out until 2020/21, letting BT off the hook until that point. We do not think this is a satisfactory outcome given that the LRIC model was to be replaced in 2007/8. In that time, Ofcom has had plenty of opportunity to come up with alternatives. Forcing us into an information vacuum in the interim is not in the best interest of consumers or competition.

UKCTA are clear that Ofcom should not reduce any of the current regulatory reporting and transparency remedies to address BT’s SMP, which the LRIC model forms part of until competition actually emerges and that competition actually provides a constraint on BT’s ability to distort or restrict competition in the markets where Ofcom has found it to have SMP.

Yours sincerely

UKCTA Secretariat