CHANGES TO BT & KCOM'S REGULATORY FINANCIAL REPORTING - 09/10 UPDATE

26 MARCH 2010

Cable&Wireless Worldwide

1. Introduction

Cable&Wireless Worldwide is one of the world's leading international communications companies. On the 26th of March 2010 C&W Worldwide demerged from C&W plc, beginning an exciting new chapter in the company's history. Cable&Wireless Worldwide is a major provider of communication solutions to enterprises in the United Kingdom. We aim to provide great value and great service to all our customers; however we remain reliant on products from BT to give our customers the end to end experience they demand.

Regulatory Accounting is one of the vital building blocks of the regulatory regime. Without it we'd have no way to judge if BT had met its regulatory obligations in relation to cost orientation or charge control compliance. We always welcome any initiatives that improve the usefulness of the accounts themselves so we broadly welcome the proposals put forward by Ofcom in this consultation.

The requirement for robust regulatory accounting information has never been greater, with BT's regulatory accounting output coming under far greater scrutiny than ever before. The ramifications from the 2008 restatement have still to be fully worked through and we are looking forward to working with Ofcom in the forthcoming review of Regulatory Accounting to help restore confidence in the UK's regulatory accounting regime.

We believe a fundamental review of the regime is now overdue and a strategic review is required to drive improvements in the quality of the regulatory accounting output produced, bringing about changes to create the right kind of culture around the preparation of the accounts. It is crucial that cost allocations are made using objective and transparent criteria that are designed to align with Ofcom's regulatory objectives and aren't influenced by the needs of BT's businesses or the objectives of its shareholders. The creation of this culture alongside a more robust assurance approach will help to deliver more transparent and useable output that will make a real difference, bringing benefits to the entire industry and ultimately end users and consumers.

The remainder of this response will focus upon those issues specifically raised by Ofcom in the current consultation.

2. Disclosure of AISBO Services

We agree with Ofcom's proposals to increase transparency within this growing and important market. With increasing market demand and the imposition of a new charge control remedy it is important to provide stakeholders with more granular AISBO RFS data. The current level of disclosure is not adequate and it leads to service/volume/price aggregation that impairs the ability of stakeholders to understand the statements, preventing them from fully playing their part in helping to monitor BT's compliance with its cost orientation, no undue discrimination obligations and most recently its charge control obligation.

We recognise that Ofcom has tried to strike a balance between the desire to impose proportionate regulation, by taking into consideration the £10M materiality revenue threshold for reporting services on an individual basis in conjunction with the need to separate out new and growing services by conducting a review of the 2008/09 AISBO revenues by individual service, taking out any instances where the price / volume mix could result in a misleading outcome if services with revenues of less than £10M were reported in aggregate.

BT's cost orientation obligations are on each and every service and it is important that stakeholders get the necessary information to judge cost orientation on each and every service. As the AISBO market matures we are seeing BT launch a range of new or updated/rebadged products. It is important that BT is not able to circumvent its regulatory reporting obligations by simply changing product names or dissecting existing products to fall below the materiality threshold.

While we might be satisfied with the list of products proposed in the current consultation, it is important that this list is kept up to date. We would also expect BT to be prevented from mixing sub-£10M revenue products in order to suppress the published aggregate level of return, for example by choosing to report a higher margin product with a lower margin product. Such an outcome would be inconsistent with the objectives of the cost orientation obligation and BT's regulatory accounting duties. We believe Ofcom should either lower the materiality reporting threshold to £5M or be prepared to undertake an annual review of the mix of any aggregated reporting lines. We would also like a greater understanding of the audit assurance in this area, will the external auditor be alert to this issue, ensuring any aggregate reporting decision are true and fair?

3. Removal of PSTN Outpayment to other CP reporting requirements

As this information was never divulged to stakeholders it is difficult for us to gauge the importance of it. Ofcom believe the deregulation of retail markets means the supply of this information is no longer required. Clearly the lack of any SMP finding does not mean there will no longer be competition issues in this market where BT retains a very high market share. We would therefore urge Ofcom to impress upon BT the need to retain a robust data preparation capability. Any ex-post Competition Act investigations are expensive to resource (for all parties concerned) and it is important that any information that might be relevant to an investigation is forthcoming within an acceptable timescale.

4. Presentational Changes

We welcome any move to improve the format of the accounts that makes them more straightforward, thereby improving usability. Improving usability should not be achieved at the expense of removing useful and relevant information. Ofcom's proposal to delete the return on turnover information, citing its lack of reporting relevance in the remaining wholesale markets (where ROMCE is they key measure) is not something that we would object to as we are still able to manually calculate this percentage from the other information presented.

Likewise the amalgamation of the two categories of depreciation are unlikely to detract from the usefulness of the accounts, but we would urge Ofcom to be able require BT to produce disaggregated depreciation information upon request (should it ever become relevant).

We are however not comfortable with the final proposal to combine 'internal sales services only provided externally' with internal sale services also provided externally' into one category. Although there is often little difference between the two, it is important to preserve the distinction between these two categories as it allows stakeholders to compare and contrast what BT is selling exclusively to itself and what it is selling to external customer and also buying itself.

We do not believe that preserving this distinction would be particularly onerous and as there is frequent tension and consistent scrutiny over the difference between the products purchased exclusively by BT and those supplied to CPs, it would be wrong to take this transparency away as it would reduce the usefulness of the accounts and make it harder to detect any anti-competitive practices or undue discrimination. We note that area where this distinction is most important is in the Openreach P&L statement where these services are broken down in greater detail.

We would therefore urge Ofcom to preserve this level of detail within the accounts, particularly in the Openreach P&L statement.

5. Outcome of the 2009 Market Reviews

We made our views on the deregulation of the retail narrowband market clear in our response last year so we will not repeat those views in this response. We acknowledge the consequences of deregulation and the resulting removal of BT's accounting separation obligations.

In connection with the regulatory reporting obligations relating to BT's single transit product, we would like Ofcom to clarify in the final statement the distinction between the two sequential markets covering transit, namely: Local-tandem conveyance and transit on fixed public telephone networks, where the SMP conditions are to be revoked from 31 July 2010 and the market for Single transit on fixed public narrowband networks, where no changes to this market are proposed in this consultation document and the remedies of Accounting Separation and no undue descrimination remain in force.

6. Improvements in Leased Line Reporting

We welcome Ofcom's proposals to improve the level of reporting within the leased lines market, believing such improvements are long overdue. We would stress that while such moves are of course welcome, many issues remain.

The correction to remove the costs of other single payments, resilience and third party equipment and infrastructure charges from the cost of unrelated services is vital. The misallocation of these costs is misleading and steps should be taken to correctly categorise these costs so as not to impair the readers ability to judge cost orientation compliance. BT should be required to invest in the necessary systems and processes to enable this information to be provided within the RFS with limited fuss. We would urge Ofcom to force BT to make this change for the 09/10 RFS.

We also support Ofcom's efforts to improve the reporting for sub-2Mbit trunk. This has been a long running concern for CP who purchase these services and reporting improvements are required. The reporting of sub-2Mbit trunk and distribution in aggregate hampers usability, preventing a proper assessment of cost orientation and undue discrimination requirements. Even with this change a number of inadequacies remain within trunk reporting, not least the reporting of costs for trunk and distribution in aggregate. We believe that this change should occur for cost and revenue at the same time and we would urge Ofcom to make the necessary arrangement for this to happen.

We also welcome the proposal to report enhanced maintenance revenues and costs separately within the trunk market. This level of detail is already provided within the TISBO market and we do not believe it to be unduly onerous. It is also necessary to provide this level of detail to judge cost orientation compliance.

We welcome Ofcom's proposals to create five new point of handover categories within the technical areas section of the regulatory financial statements although we do not understand why it is necessary to include separate categories for 2M and 2M CLZ. Point of hand over costs are material to our business as they are only levied on interconnected operators and we need a far greater understanding of those costs. While we welcome this additional level of detail we don't believe it goes far enough. It is vital that there is greater scrutiny of BT's PoH costs, specifically a more detailed breakdown on of how the costs are derived and the attribution decision used. We believe BT has far too much discretion over the composition of PoH costs and we would welcome a detailed review of the cost inputs to prevent competitive distortion and over recovery.

In addition, will Ofcom be requiring changes as a result of the other issues that have come to light during the Leased Line Charge Control project? Some of the key issues are:

- Some 64Kbit/s local end rental services are incorrectly reported under 2MBit/s local ends at present;
- The revenue from DPCN Bearers purchased by CPs to enable them to pick up 64Kbit/s PPCs is reported under Technical Areas whereas the cost appears to be reported in the low speed TISBO market, at the very least the revenue and cost should be reported in the same place;

- The revenues and costs associated with Site Connect should be clearly included as they are wholesale services sold in the TI market;
- The usage factors associated with RBS Backhaul should be amended to properly reflect average usage otherwise it is not possible to consider cost orientation or compliance with no undue discrimination with respect to this product;

We hope these will be the first in a series of eventual improvements to BT's leased line regulatory reporting.

7. Implementation of the BCMR

We believe the approach to accommodate the CELA market requires more work and that the approach requires some important decisions associated with regulatory reporting and therefore it should be the subject of public consultation by Ofcom.

Firstly, it is impossible to accurately draw a boundary between the CELA zone and the SMP zone as in fact the same equipment and assets are used within both. Therefore while it is possible to define which revenue falls within CELA and outside it, the allocation of cost will be much much harder. We believe that the only way that stakeholders can have confidence in that cost allocation is to provide clear details of the amount of cost apportioned to the CELA zone compared that in the SMP zone, both in relation to the volume of services provided. This will require some regulatory reporting from a non SMP market but we believe Ofcom does have the power to require this and that it is proportionate to do that in this case.

Specifically on the proposals set out in the Ofcom consultation we believe that the only aspects circuits that should be considered within the CELA zone are the local ends and the terminating segment associated with those local ends. Points of Handover are a technical capability required by the regulation in order to provide PPCs more generally and whether or not they are located within the CELA zone should make no difference to the reporting for circuits where the local end is outside of that zone. The most crucial issue for Ofcom to address with regards the CELA zone is in fact the way internally supplied circuits, which have one end within the zone and one outside it, are reported.

We also welcome the proposal for BT to start reporting separately for the seven netstream markets.

8. Cost Attribution methodology and the treatment of LUS costs

It is clear to us that BT retains far too much discretion when it comes to allocating costs. The scope for cost allocation that favours BT is only going to widen as services are deregulated. We would look to the fundamental review to change the incentives around allocation methodologies and the preparation of the accounts to prevent BT favouring its own business. While we cautiously welcome BT's review of the cost attribution methodology between Openreach's regulated and unregulated offerings, we would also ask Ofcom to review the chosen methodology and request an audit opinion on the attribution to confirm that it represents a true and fair approach.

On the question of LUS costs, we remain of the view that the current attribution of these costs is wholly inappropriate and we would ask Ofcom to intervene to ensure a fair methodology is adopted.

Q & A

In the remainder of this response we respond to the specific questions posed in the consultation document.

Question 1: *Do you agree with Ofcom's proposed list of disclosed services in the AISBO market?.*

Yes, although effort must be put into keeping the list up to date. Please see section 2 for a more comprehensive response on this issue.

Question 2: *Do you agree with the proposal to remove BT's requirement to prepare AI8?*

Yes. Although BT should be required to re-provide this information should the need ever arise. Please see section 3 of this response for further details.

Question 3: *Do you agree with the proposed changes to the presentation of the RFS?*

In part. While we can see justification to remove details of the return of turnover information and the aggregation of depreciation costs, we can see no justification to remove the breakdown of internal sales between services exclusively purchased and those bought alongside other CP. Such a move hampers transparency and is unwelcome. Please see section 4 for further details.

Question 4: *Do you think we have fairly reflected the decisions of the relevant market reviews in the form and content of the RFS?*

Please see section 5 for more detailed commentary on this issue.

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