Vodafone response to Ofcom's review of BT's regulatory financial reporting consultation

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Non-confidential

Contents

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1. Executive Summary

- Regulatory accounts are a vital tool in holding a player with Significant Market Power to account.
- They provide the transparency necessary to ensure pricing is being set and services provided at an appropriate level and that customers are getting value for money.
- Ofcom has a legal duty to impose regulatory financial reporting obligations where it finds SMP, with only limited discretion on the standard of reporting it imposes.
- We believe these proposals fall short of this legal duty.
- While there may be scope to improve the accurancy and relevance of the accounts, it is essential that the same level of transparency and detail is maintained while SMP persists.

1. In an industry where there is market failure and a player with Significant Market Power, the regulatory accounts are crucial to creating a regulatory environment that seeks to emulate competitive market outcomes. The accounts provide the transparency necessary for the compliance with EOI and non-discrimination SMP obligations and enable the required and appropriate monitoring of BT's legal separation in a transparent and accountable manner. Regulatory accounting is a key aspect of the regulatory regime, essential to protecting consumers from SMP. Where there is market failure there is an absence of competitive benchmarks to determine if the pricing offered to the market is within an acceptable range. This is true for services subject to charge controls, safeguard caps or indeed obligations around the reasonableness of charges.
2. While Ofcom has a degree of discretion with respect to how it meets some of its obligations under the Communications Act, . Ofcom does not have discretion with respect to carrying out its EU and domestic law duties [1] Specifically:
    - Ofcom is positively required to impose regulatory financial reporting obligations (FRO) on BT where it finds SMP;
    - Ofcom has a narrow discretion in relation to the appropriate standard of FROs it must impose;

However:

- Ofcom's proposals to reduce or remove FROs do not meet the appropriate standard

[1] EE Limited & Ors v Office of Communications [2017] EWCA Civ 1873, paragraph 54.

- Ofcom's proposed financial reporting Directions are deficient in that they do not meet the test for modifying or withdrawing a direction set out in section 49(2).

3. As a consequence of the above, Vodafone considers that Ofcom's proposals currently fail to discharge it's domestic and EU law duties. We are therefore deeply concerned that Ofcom is about to err from its legal duties by proposing to remove and reduce regulatory financial accounting obligations from BT.[2]

4. We cannot overstate the importance to our industry and the wider consumer interest of reliable, unbiased regulatory accounting information. The detail within these accounts is used to set prices within charge controls; resolve disputes before Ofcom; settle subsequent litigation before appeal bodies and the courts; and provide transparency of BT behavior in relation to internal and external supply of services. Customers – business and end consumers - need to have confidence in the regulatory system, and the regulatory accounts are at the heart of that system.

5. In the period between 2008 and 2015 we saw confidence in BT's published regulatory accounting output evaporate. This was as a result of hasty restatements, apparently motivated by BT's desire to reduce overcharging claims before Ofcom, and then through the reallocation of costs in one year to the next, moving costs from regulated markets where charge controls have already been set into other regulated markets. There was also the exposure of a series of material errors and inappropriate allocations by Cartesian on behalf of Ofcom[3].

6. Since then we have seen Ofcom work hard to restore trust in the numbers, undertaking a fundamental review of the regulatory accounting framework to ensure that a level of bias is removed from regulatory reporting. While the accounts remain imperfect, they are in a considerably better state than they were five years ago. It is therefore vital that this hard work to restore trust is not undermined through a lack transparency on what services are actually reported on. It makes no sense to move back from this position.

7. Stakeholders have a vital role to play in holding BT to account, particularly given Ofcom's resource constraints. Stakeholders provide oversight and insight and their review of the published regulatory accounting numbers and associated consultations remain an important tool in helping to protect the consumer interest.

8. BT's RFS is a fundamental part of the remedies Ofcom impose to combat BT's SMP. It is clear that active wholesale remedies will remain a vital part of the market and the efforts to remedy SMP for some considerable period. Ofcom should continue to impose regulatory reporting obligations as a remedy until such time as SMP is no longer found.

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[2] See legal annex

[3] https://www.ofcom.org.uk/__data/assets/pdf_file/0025/83482/ofcom_bt_cost_attribution_review_final_report.pdf

9. Ofcom have not put forward any evidence and/or robust reasoning to justify removal or reduction of regulatory reporting where SMP remains. It is vital that in the physical infrastructure market, business connectivity market and wholesale broadband market reporting remains in place. Vodafone therefore considers that if Ofcom is to proceed with its proposals to remove or reduce the obligations on BT with respect to the RFS, Ofcom is likely to be in breach of a number of legal obligations in relation to how it regulates BT's SMP.

10. We are not opposed to improving the accounts to make them a more relevant set of documents, ensuring that the information presented is both reliable and relevant. However, we are deeply concerned at the removal of transparency on regulatory reporting where SMP has been found.

11. While Openreach is a legally separated company, its ownership resides 100% within the BT Group, with much of the tasks of the business being performed by other BT Group functions or assets. It is vital Ofcom does not overstate any potential benefits of legal separation, and understands that common ownership and reliance on other BT functions and assets represents a continued risk to consumers without adequate remedies in place to counter the impact of SMP.

12. We urge Ofcom to set out principles around how regulatory reporting across multiple markets could be harmonised to improve consistency, however nothing should be done to remove transparency given the importance of the accounts to the entire regulatory process.

2. UK Business Connectivity: Market Background

Business Connectivity; no deregulation without evidence of competition

13. Vodafone is a significant player in the UK business connectivity market, with decades of experience as a major supplier to UK enterprises and the public sector through our substantial fixed line business. We are the second largest provider of business connectivity to the UK enterprise sector. We are also a major purchaser of connectivity in our own right, securing backhaul to our own mobile sites throughout the length and breadth of the United Kingdom. Although we are significant player, with decades of market experience, we are a distant second, with BT's market presence many times larger.

14. In a market where demand is growing rapidly, but barriers to infrastructure competition remain high, it is important for us to understand when existing network assets can be viably used and where the duplication of fibre is uneconomic and we need to rely on BT's wholesale regulated products.

The investment history and climate in UK business connectivity

15. The business connectivity market is responsible for the majority of the UK's existing fibre assets. Although UK fibre penetration is less than 6%, that fibre is largely concentrated in the business

connectivity market, where the 167,000 large enterprises that Ofcom sees as being served by the BCMR market have fibre to their sites where and when they wish.

16. A number of business focused telecommunication companies entered the market in the 1990s and early 2000s. Cable & Wireless, Energis, THUS, Your Communications, Torch, MCI-Worldcom, Global Crossing, COLT and Fibrenet all started to compete against BT for enterprise business, investing in new fibre networks to do so. Their networks were focused on major UK cities, with trunk connections between these locations. With the exception of COLT, all these businesses have been subject to some form of takeover, asset sale or financial restructuring, prompted in most cases by an inability to sustain their original business models, taking account of the very large sunk costs incurred in laying down enterprise fibre networks.

17. While the fibre assets of these businesses remain in situ, they remain under-utilised and struggle to compete against the scale, cost base and ubiquity of Openreach's fibre Ethernet network. ✄

18. The ubiquity of BT's network, its ability to aggregate demand from a range of retail buyers (including all BT lines of business) and its incumbency advantages in connecting buildings, allowing it to connect premises with the least amount of disruption – including greater certainty around excess construction costs – has allowed it to cement its dominance in the business connectivity market. This dominance is also evident in the mobile backhaul market, where BT's market share is in the range 80-90%[4], with BT able to use volume discount schemes and long-term purchasing commitments to secure most industry demand, even in locations where alternative supply options might be present. The acquisition of EE by BT in 2016 has allowed BT to tighten its grip on the mobile backhaul market yet further.

19. The structure of the industry has resulted in other retail providers of business connectivity funding BT's network expansion. By our calculations sourced from RFS data, over £500M[5] has been paid by industry to Openreach in the form of Excess Construction and Connection charges to fund Openreach's business fibre footprint over the past decade. This wealth transfer from other retail providers to BT has left the alternative business connectivity networks established in the 1990s/2000s underutilised, as the cost of connecting new customers to these alternative networks remains prohibitive in comparison. This has left alternative investors ultimately unable to capture the market share necessary to justify their initial investment, even over a prolonged period when active service pricing was high.

20. Today, 20 years after that significant wave of initial investment, Openreach's market position appears as dominant as ever. Even the presence of rival infrastructure has failed to reduce Openreach's

[4] https://assets.publishing.service.gov.uk/media/558a835ded915d1592000001/BT-EE_full_text_decision.pdf [102]
[5] Taken from BT's Current Cost Financial Statements which recorded ECC payments of ~£50M in 2014/15 & 2015/16 and £70M in 2016/17 - £500M is a conservative extrapolation over the past decade.

market share in a material way – Openreach has a very high share of 2017 business connectivity new customer orders in every part of the United Kingdom:

2.18 In the Central London Area, viewed as the most competitive part of the market, BT attracted between **61-70%** of new customer connections, approximately three times as many as their nearest rivals COLT;

2.19 In metro areas and the areas of High Network Reach where there are multiple networks present, BT recorded a service share of **over 50%**[6];

2.20 In locations where BT and one other CP had infrastructure, BT's 2017 service share was between **61%-70%** of new orders;

2.21 In areas where BT is considered the only provider, with limited presence of other CPs, BT's share was recorded at **81% - 90%**[7]**;**

2.22 Alternative providers dug for **just 5%**[8] of all new connections provided in 2017, irrespective of the bandwidth;

2.23 Openreach had existing duct connections to **81-90%** of its 2017 new customer ends

21. A typical retail business connectivity provider's annual order book would have far less than ✂[9] of orders to existing connected buildings/ locations.

22. Market share is not the only determinant of dominance. However, persistently high market shares – at these very elevated levels – are highly instructive. Ofcom should at least assume dominance above 50%[10]. Market shares at the levels indicated above will require some very serious, well-founded explanation if Ofcom is not to find SMP; the BCMR consultation or this RFS consultation does not contain such a level of explanation.

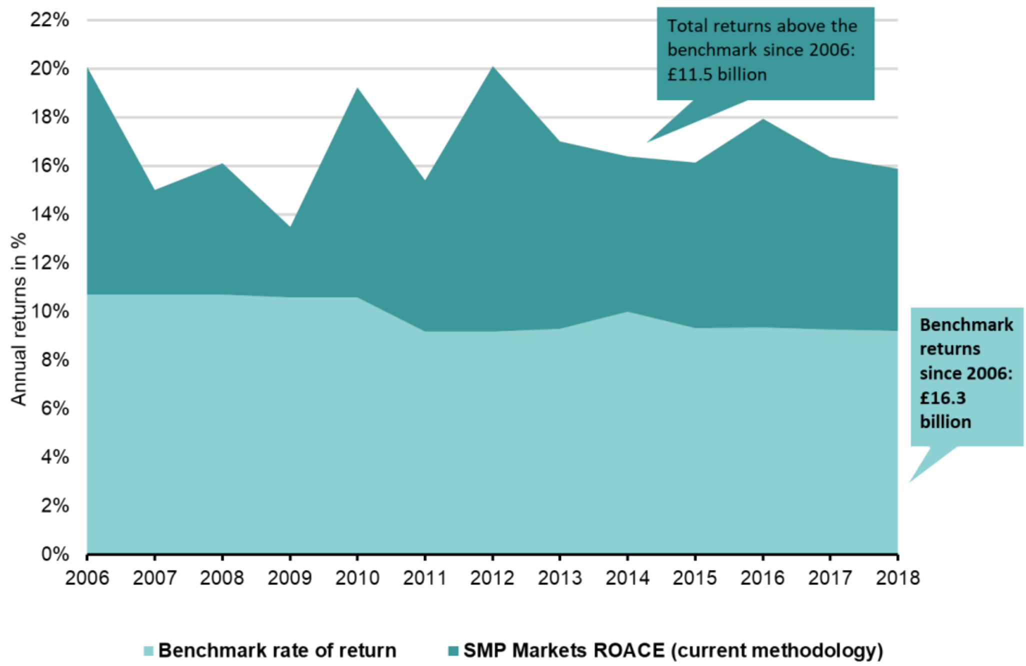
Past excessive profits and the importance of active product regulation

23. One of the fundamental functions of the RFS is to report the overall level of profitability that BT is making in all regulated SMP markets, not simply charge controlled markets. This gives a high level view as to whether BT's market power is being constrained in the market or whether they are able to use it to profit maximise. The RFS has shown that BT's profitability has remained significantly above the determined cost of capital since 2006. In the first part of the period, this was in large part due to charge controls not adequately constraining BT's prices to costs, however in recent years Ofcom's charge controls have more effectively constrained regulated prices to cost. Instead in recent years BT's excess profits are increasingly derived from services where Ofcom choose either not to charge

[6] See BCMR 6.83
[7] See recent BCMR consultation 6.46
[8] Page 69 of Annex to Consultation
[9] ✂
[10] See Case C-62/86 AKZO Chemie v Commission [2003] ECR II-3275 para

control prices ('pricing flexibility') in order to try and stimulate investment or to control prices at a level reflecting the 'hypothetical' cost which were above BT's actually incurred costs.

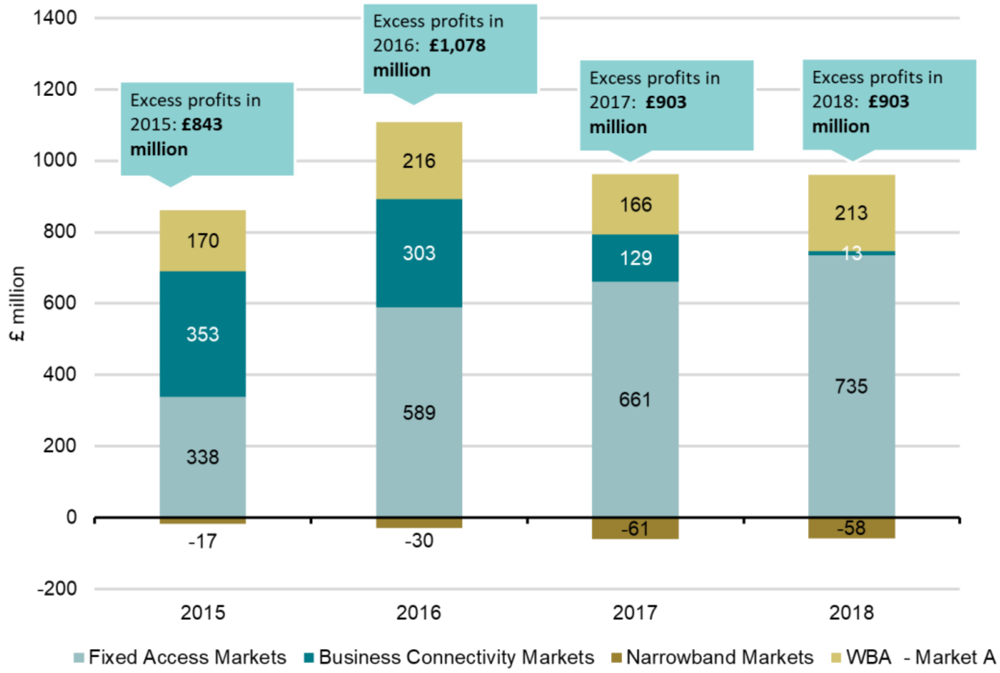
Table to show BT's total regulated Profitability



Source: *Frontier analysis of BT RFS*

24. At a market level, the majority of recent excess profits are generated by the Fixed Access market underlying the provision of mass market broadband and voice services. Excess profits reported in the BCMR market, which underlies services to large corporate customers and provides capacity for other network operators, have dropped considerably since the last charge control was introduced in 2016. Profits in the WBA market A have remained strong despite the market only consisting of those geographies where there is limited competition to BT even at a retail level, i.e. where Openreach is closest to a utility unconstrained by competition. This is fundamentally important information, especially at a time where Ofcom is proposing to transition to a passive access regulatory regime.

Table to show BT's Profitability by regulated market

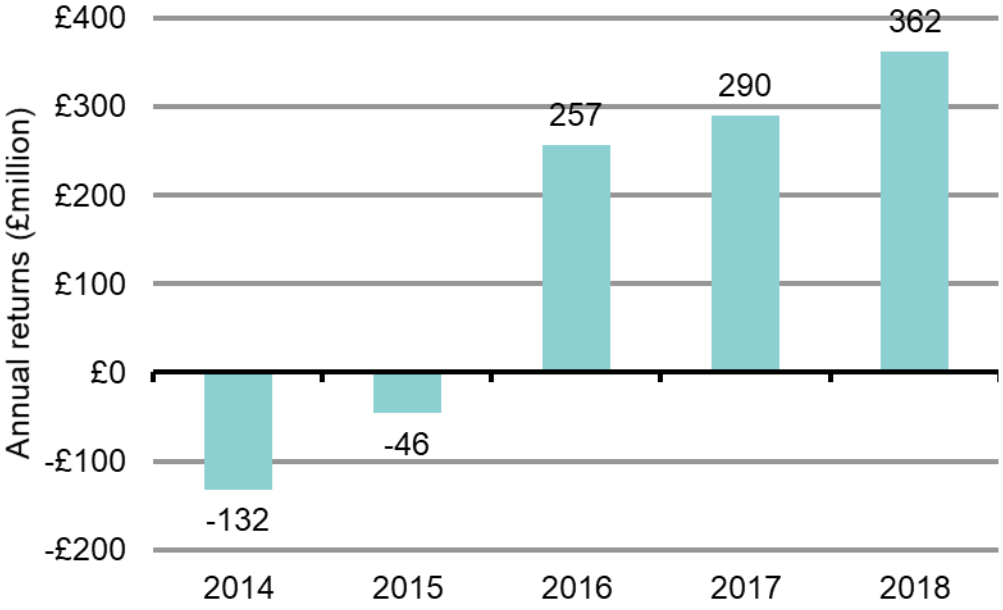


Source:Frontier analysis of BT RFS

25. In the WLA market the growth in excess profits are largely driven by the 'Other WLA' category, which mainly consists of the GEA service revenues used to provide superfast broadband services and the corresponding incremental costs associated with the FTTC overlay network.

26. As shown below, until 2015 this service was reported as loss making, i.e. the revenues from GEA services were less than the cost of rolling out a FTTC overlay network to deliver these services.

Table to show GEA ('Other WLA') excess profits



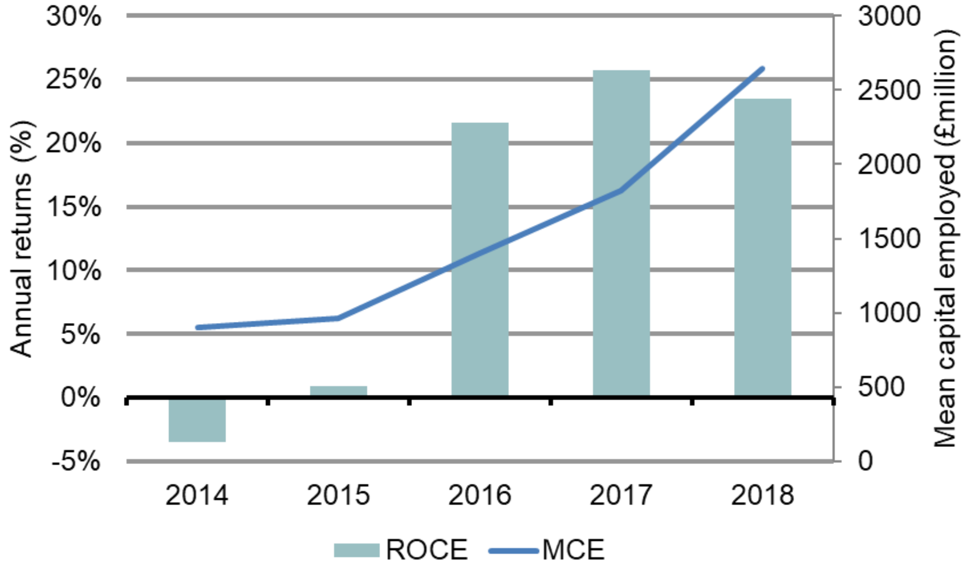
Source: Frontier analysis of BT RFS

27. Despite finding BT to have SMP for these services, during this period there was no charge control, with BT free to set the level of wholesale prices[11]. The justification of this approach was that the potential to make returns above the cost of capital was necessary to offset the potential downside risk if there had not been sufficient demand to make the investments profitable, the so-called 'fair bet'.

28. If we compared returns with the capital employed for these services in the chart below, it appears the majority of the investment to date took place once returns were above the costs of capital, i.e. when there was relatively little downside risk for BT when making these investments. This suggests that the risks, and hence the additional return required, could be (and were) mitigated by BT in terms of the timing of roll out, waiting until the business was profitable before making most investments.

[11] Subject to a margin test to ensures sufficient margin between BT retail prices and the wholesale prices for competing operators to deliver services profitably.

Table to show GEA ('Other WLA') returns and capital employed



Source: *Frontier analysis of BT RFS*

29. The business connectivity markets consist of high quality wholesale services which are used to provide services to corporate customers and which are used by operators, such as mobile operators, to connect equipment in their networks. The RFS has shown with detailed active product costs, volumes, and revenues that the profitability in the Business Connectivity Market has reduced over recent years, and because of the detail produced in the RFS we can determine that this is the result of two factors:

30. A charge control that resulted in significant real terms price reductions following the 2016 BCMR decision; and

31. A change in the services determined definitely to have SMP following BT's successful appeal of parts of the 2016 decision.

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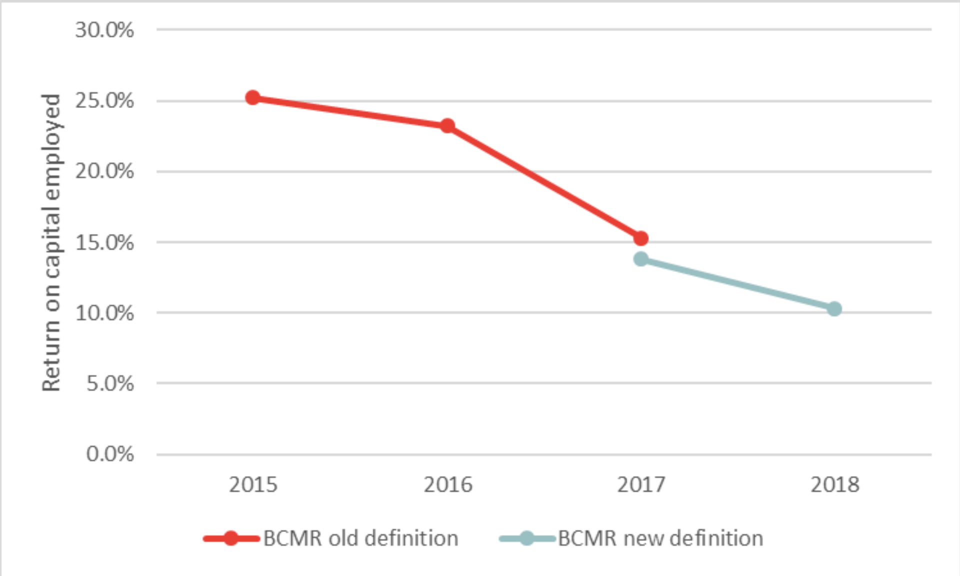
Table to show returns in the Business Connectivity Market



Source: Frontier analysis of BT RFS

32. BT noted in its commentary issues with the accounts that if the price reduction required for 2018/19 were hypothetically applied to costs and volumes for 2017/18, BT's returns would be below their cost of capital. However, because of the detail published in the RFS we can analyse this further and determine that in fact this is unlikely, and BT has not taken into account the product volume growth and expected cost efficiencies. Without the current level of active product volume and cost detail we could not do this analysis and would have remaining questions, Ofcom's current proposals will drastically reduce the level of active product reporting in the business connectivity markets.

3. The importance of the RFS

33. The RFS is *the* critical input for informing Ofcom and industry on the health of competition in the communications sector. This has been previously recognised by Ofcom:

> *"Regulatory financial information is **fundamental** to the economic regulation of the electronic communications sector and in particular to many of the decisions of Ofcom…"*
>
> *"…where…obligations have been imposed it is **essential** that they are monitored and enforced properly. **Therefore, it is necessary to have appropriate regulatory reporting**."*[12]

[12] Ethernet Determinations, paragraph 11.23.1

34. As well as evidencing the compliance of BT with Ofcom charge controls the RFS provides reporting that also evidences compliance with other SMP conditions. Ofcom puts in place the obligations for EOI and non-discrimination. The RFS provides reporting on the all of the products that BT sells and the quantities that are purchased by both itself and external CPs. This level of detail is a first step overview as to whether EOI and non-discrimination are working appropriately. For example, if BT's volumes over time change significantly for a particular product and this is not matched by external changes in demand this provides an initial alarm as to whether there has been a breach of EOI or non-discrimination. As Ofcom has accepted legal separation, it is evident that detailed data on service provision differences and their changes over time are essential to understanding whether legal separation is both working and adequate to address the competition issues that arise from BT's vertical integration.

35. As Ofcom set out in the Digital Communications Review[13] document in July 2016, Accounting Separation is the primary separation building block. As noted by BEREC in the 2017 BEREC Report on Regulatory Accounting:

> *"In general, accounting separation is often imposed together with the cost accounting obligation, and some NRAs consider that it is necessary to impose both of these obligations in order to ensure that robust regulatory accounting information is available for each product. The ratio is related to the fact that Accounting Separation could in this regard still be useful for vertically undertakings even when using cost models for price control, to prevent unfair cross-subsidy (e.g. if the result of the cost model is higher than the cost derived from the accounts of the SMP operator), and when the regulatory framework, in perspective, can become less intrusive (i.e. reducing regulatory burden such as cost orientation)"*

36. Ofcom go on to say that successive models provide tighter constraints on the ability of Openreach to discriminate between competing providers: each step beyond Accounting Separation must offer something more than the last step. In BT's own words[14]

> *"it is clear that the legal separation that BT has offered to put in place offers no further accounting transparency than that currently in place: there is no agreement mechanism on transfer pricing or any level of statutory account publication which could be considered an improvement on the regulatory accounts that are in place today."*

37. As Ofcom shifts its regulatory focus from traditional wholesale active product regulation towards a focus on passive access regulation and driving competition through investment the regulatory accounts become ever more important:

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[13] See table 1 in Ofcom's document "Strengthening Openreach's strategic and operational independence" https://www.ofcom.org.uk/consultations-and-statements/category-1/strengthening-openreachs-independence
[14] Section 7 of the Agency and Services Agreement: https://www.btplc.com/UKDigitalFuture/Agreed/index.htm

a. **Cost based passive regulation**: As Ofcom focuses more on passive regulation the need for accurate, transparent cost based passive product reporting is ever more important.

b. **Investment capital expenditure**: As investment increases and moves towards fibre within the industry and the network is increasingly funded by different sources (BDUK, ESN, B-USO, and ECC's) it is important to gain further insight into how that investment is treated and accounted for.

c. **Assisting Ofcom meet both its statutory duties and organisational priorities:** Transparency allows stakeholders to be better informed and help pinpoint areas of importance early for Ofcom to consider. This means Ofcom can keep pace with the changes in the market and focus on the right areas earlier, securing its objective of furthering the interests of citizen consumers.

d. Crucially, in the absence of transparency on **BT's costs at a product-by-product level**, CPs will rely increasingly on Ofcom to investigate apparent anomalies on BT's pricing.

e. **Monitoring excess profitability**: As Ofcom focuses more on passive regulation rather than active regulation it is of paramount importance that excess returns are more closely monitored. Alternative investment and competition will be hampered if BT leverages excessive SMP profits to drive down prices in contestable markets.

38. Vodafone uses BT's Regulatory Accounting in a variety of ways, from conducting industry level / market level analysis to investigating specific issues with individual products or services. This may extend to identifying errors and inappropriate methodologies in the RFS themselves, or identifying instances of overcharging on specific products. In the absence of comparable peers in the market (unlike other regulated industries), we consider the RFS, even in its imperfect state, as being of great value to both Vodafone as a purchaser of SMP services and the consumers we serve (as well as to all consumers in the wider market). There is no obvious substitute for the information contained within the RFS and we are not alone in recognising its considerable value:

> *EC Recommendation: "It is recommended that NRAs make relevant accounting information from notified operators available on request to interested parties at a sufficient level of detail to ensure that there has been no undue discrimination between the provisions of services internally and those provided externally and allow identification of the average cost of services and the method by which costs have been calculated"* [15]

> *CAT: "We are a little sceptical as to the benefit of the "adjustments" that OFCOM explored between the draft determination and the Determination itself, and in ordinary circumstances (where there is no error in BT's audited regulatory financial statements) we would expect the figures in these statements to stand without great investigation, re-checking or adjustment by OFCOM.*

[15] Commission Recommendation of 19 September 2005 on accounting separation and cost accounting systems under the regulatory framework for electronic communications", OJ L 266, 11.10.2005, p 64, at paragraph 5

That, after all, is one of the purposes of regulatory financial statements: to ensure that the appropriate data is published to enable compliance with SMP obligations to be monitored. In this case, OFCOM's approach may, perhaps, be justified because BT's originally published regulatory financial statements could not be relied upon." [16]

Ofcom: "sufficient information should be published to enable informed stakeholders to contribute to the development of robust regulatory decisions by allowing them to review and potentially challenge the data on which those decisions are made… [17]

39. Two things jump out from this passage relevant to Ofcom's proposals. First the CAT recognises the fundamental role of the RFS in monitoring BT's compliance with its SMP conditions. Secondly, as Ofcom observes in this case (and with other significant instances of overcharging like *Ethernet* and *TRCs*), it was industry doing the monitoring that Ofcom had failed to do. Secondly, in light of the CAT's and Ofcom's observations about the importance of the RFS in monitoring and in light of the fact that BT was found to have falsely reported in the RFS at that time which require Ofcom to make adjustments, it seems paradoxical (and perverse) that Ofcom is seeking to remove or reduce RFS obligations on BT rather than make them more robust.

40. Given the SMP nature of the services documented in the accounts, we have no alternative market frame of reference on which to analyse the costs we face. While competitor products are sometimes available in limited parts of the market or geographies, these tend to be sub-scale with pricing often set with reference to BT's price. In light of BT's dominance in these markets this price following approach by others is entirely understandable.

41. We have set out below some of the key uses of the accounts as an example of their importance to us.

    a. **Compliance with Charge Control / Cost standards:** The RFS are often the only means to properly ascertain compliance with a charge control / fair and reasonable / cost orientation or to calculate the level of return being achieved. Cost orientation (in whatever form) is only useful when stakeholders have access to robust, reliable accounting information.

    b. **BT's regulated business is a small part of BT Group:** Ofcom regulates a small part of the BT Group business and ultimately regulated products should only recover a relatively small percentage of BT's overall Group costs. This means there is massive scope for over recovery of non-regulated costs that are incorrectly allocated and recovered from charge controlled products. The regulatory accounts need to be detailed, in-depth, and comprehensive to ensure BT is held to account and does not recovery non-regulated costs from regulated markets and distort markets where it has SMP. Having transparent regulatory accounts that

[16] BT v Ofcom, Case 1146/3/3/09, Judgement of 22 March 2011, paragraph 161. The judgement of the CAT was upheld by judgement of the Court of Appeal of 27 July 2012, Case C3/2011/1683
[17] 2.29 to 2.30, Regulatory Financial Reporting - Statement, Ofcom, May 2014

both the regulator and other CPs can scrutinise goes some way to limit BT's ability to over-recover non-regulated costs.

c. **Reasons for BT's dominance:** CPs compete with BT in many downstream markets (i.e. enterprise business connectivity) and we invest and try and compete with BT's Wholesale products, however given BT's SMP we typically find this area of the market very challenging. The detail in the regulatory accounts allow us to better understand the full extent of BT's dominance in specific markets. For example, in BCMR markets the product costing and volume data allows us to understand how BT's pricing differs from its cost and why we can't compete with BT on certain products. Therefore, the regulatory accounts aid the promotion of competition and help competing CPs plan investments and wholesale product purchasing plans.

d. **Checking Charge Control Notifications:** We review the change control notifications to see whether BT have actually made methodology changes to ensure more accurate cost recovery, or whether it has "gamed" methodological changes in view of upcoming charge controls or regulation as was the case with the restated accounts back in 2011/12. For example, in 2017 we reviewed change control notice 3.07 relating to time related charges in view of our current claim against BT for repayment of TRC's relating to historic periods. It is important that BT does not overcharge for ancillary type charges as it has serious effects on competition within the market

e. **Volume information**: in relation to the BCMR market we have had lots of decisions to make regarding what BCMR products to procure and have spent time analysing the DPA, dark fibre, and active product choice. The RFS provides further insight into the volumes of regulated products within the market and how BT has manipulated the purchasing behaviour of CP's.

f. **Non-discrimination:** the accounts are useful at demonstrating that BT has not discriminated in favour of BT Group businesses in downstream markets. This is particularly useful where BT lines of business purchase a different mix of services (e.g. BT LoB don't purchase WES in the BCMR).

g. **Responding to Ofcom Consultations:** Publishing Regulatory Financial Statements on a regular basis supports stakeholders' contribution to an informed regulatory framework, as stakeholders (who often have a better understanding of the relevant activities and costs than Ofcom) can review and comment on the data that might otherwise only be viewed by Ofcom and areas of significance might not always be immediately apparent.

h. **Stakeholders assisting with compliance assurance:** The role that Stakeholders play in monitoring compliance has be recognised by Ofcom previously. With Stakeholder action often prompting Ofcom to investigate issues formal or informally, effectively helping Ofcom to intervene in a timely fashion when required.

i. **Investigations into anti-competitive practices**: Although regulatory reporting obligations are *ex ante*, stakeholders are able to take comfort from knowing that Ofcom can move quicker to resolve investigations and disputes more quickly knowing that BT is already required to retain and monitor relevant costs data.

42. This positive scrutiny of BT's activities in markets where is it found to have SMP can only really happen if RFS information is available. Over the past ten years the number of disputes that have arisen or been influenced by the RFS have been very significant and resulted in repayments from BT to industry in the order of £1bn. Had these repayments not been made the cost to consumers from market distortion would have been far higher.

43. It is doubtful whether any of these – for example, PPC, Ethernet, or TRC over-charging – would have been identified or remedied had RFS material not been available to stakeholders who had the financial incentive to ensure prices were set appropriately.[18]

44. BEREC has produced a large volume of data, guidance, and policy documents on regulatory reporting in this sector. BEREC in their annual review of regulatory accounting across Europe always re-enforce the importance of transparency and consistency,[19] these current proposals from Ofcom reduce transparence and make significant changes to the consistency of a regime that has been in place for many years.

45. Given this background and the importance industry place on these important regulatory documents it is not surprising that we are very concerned with the current proposals in this consultation. These proposals effectively reduce the active product reporting that BT's is expected to publish and confidentially submit to Ofcom whilst replacing this with very high level passive product reporting and acknowledging that the uptake of passive products and the competitive constraint they place on BT will be very slight in this market review period.

4. Regulatory financial reporting in all regulated markets

46. Ofcom state they propose to reduce the amount of public and private reporting within the RFS while making it more relevant, however it is not clear to Vodafone why it is necessary to reduce the amount of public and private reporting. We can find no explanation in the consultation document to explain why allowing BT to reduce the information provided in the RFS and to Ofcom will continue to ensure BT cannot leverage its market power in a way which could distort competition.

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[18] https://www.ofcom.org.uk/__data/assets/pdf_file/0027/55539/ethernet_fd.pdf

[19] https://berec.europa.eu/eng/document_register/subject_matter/berec/download/0/7316-berec-report-regulatory-accounting-in-pr_0.pdf

47. Ofcom state in section 7:

> *"Overall, they [The RFS] ensure that stakeholders have sufficient information about the products and services they purchase to provide them with reasonable confidence about BT's compliance with its SMP conditions and that we have sufficient information necessary to carry out our functions. Ultimately, this helps to ensure that BT cannot leverage its market power in a way which could distort or restrict competition."*

48. Ofcom quoted a similar passage in the Ethernet Determinations, from the NCC Guidelines:

> *"BT is required to prepare and publish financial information for interconnection services* ***unless*** *Oftel is satisfied that* ***it is not a proportionate*** *obligation for it to require this level of cost and charge information. BT has to publish financial information to enable: a) the industry to view actual long run incremental, current and stand alone costs and charges for interconnection services and the components making up these services; and b) to provide transparency in the calculation of interconnection charges so that other market players are in a position to ascertain that these charges have been fairly and properly calculated."*[20]

49. This chimes closely with Ofcom's statutory duties. Section 3(3) of the 2003 Act requires that

> *"OFCOM must have regard, in all cases, to… the principles under which regulatory activities should be transparent."*

50. It is not possible for Ofcom's decision making in relation to these markets to be transparent in the absence of detailed regulatory accounting information. Ofcom does not appear to have considered this – a clear reviewable error.

51. Beyond, this the fundamental question that requires answering is; what has changed in the market to reduce the need for the current level of reporting? How has BT's market share or market dominance decreased? Why does Ofcom consider it proportionate to remove the obligation?

52. Vodafone considers that BT's level of market dominance and market power remains unwavering.Whilst we acknowledge Ofcom's aspiration for a competitive infrastructure market, if this does emerge it will take time - many years to actually present a viable competitive constraint on BT. It would be completely premature to diminish reporting at this stage, an action that could not be easily reversed and one with significant implications for consumers.

53. Specifically, in this section we discuss that; while we agree with Ofcom's logical change to the allocation of general overheads, we do not understand Ofcom's approach to Cumulo costs, and we consider that all of the 'simplication' removal of schedules generally reduces the transparency of BT's activities with no justification.

[20] Ethernet Determinations Paragraph 5.3

Cumulo Costs

54. Vodafone understands Cumulo rates are the non-domestic rates that BT pays on its rateable network assets (primarily passive assets such as duct, fibre, copper and exchange buildings) in the UK. Vodafone believes that Cumulo costs should be attributed across all active products in line with the general principle that it is the occupation of those assets that triggers the rating. However, when the cumulo rates are attributed to the active products, the active product cost stack should include the passive infrastructure asset costs. For example Dark fibre products sold to CP's will include infrastructure costs in their price and thus CP's will pay the cumulo rates or the equivalent on the passive access products indirectly.

55. Vodafone would like clarification that what Ofcom is now proposing will mean that in essence, BT pay cumulo rates on the products that it consumes in the same way. BT's lines of business generally procure active services from Openreach, although potentially the new enterprise division (previously BT Wholesale) could procure dark fibre products. We consider it important that when BT allocates its cumulo costs it does so on the active services it procures itself and those prices/costs include the passive cost input elements.

56. Ofcom state:[21]

> *"that Cumulo costs should not be attributed to physical infrastructure markets, and that cumulo costs should not be attributed to dark fibre products sold to other telecom provides (but to dark fibre that is sold to BT)"*

57. Vodafone considers it most appropriate that cumulo costs are attributed only to active services, therefore if BT procures dark fibre from Openreach, cumulo costs should be allocated to the active services which includes the costs of dark fibre. It would be inappropriate for BT to only allocate cumulo costs to the active elements of the services it consumes when those services consume/include a large portion of passive infrastructure costs.

Simplification and clarification of reporting within the RFS

58. It appears that the changes Ofcom is proposing in this area is due to a letter received from BT[22] where they requested two changes to the RFS and Ofcom accept them both. Vodafone would like to remind Ofcom that it is for Ofcom to impose, through SMP conditions suitable regulatory reporting requirements, and it is for BT to comply with those reporting requirements. It is not for BT to suggest or dictate what reporting it believes is simplest or easiest to produce given their financial systems and operational issues. The tail should not be wagging the dog.

59. The first change BT has requested is associated with the materiality threshold, BT would like the threshold increased in the reconciliation report from £1m or 5% to £5m or 5%. Ofcom notes that all

[21] BT Regulatory financial reporting consultation, paragraph 3.10
[22] BT Regulatory financial reporting consultation, footnote 45

changes are noted in the change control notification and uses this as justification for agreeing with BT's proposal. However Vodafone considers that the reconciliation report is a simple report that highlights the impact of methodology changes and errors in the RFS and that having to open yet another report and working through the many pages is not actually simplifying the process but making it more difficult for readers of the RFS.

60. Ofcom notes that changing the materiality threshold will reduce the number of reported errors and material changes by approximately half, [23] for example in 2015/16 errors will reduce from 5 to 3 and material changes will reduce from 22 to 7. This markedly changes the perception of the RFS and covers up a number of important issues that CP's would very much like highlighted. For example, removing this threshold would have excluded the working capital methodology change in 2017/18 that reduced the mean capital employed by a staggering £182million, although Ofcom state this only effected the FAC of regulated markets by £18m it is nevertheless a change that CP's are interested in.

61. Highlighting this change to the working capital employed raises questions as to why regulated services are so affected by working capital, whether BT's financing policies should effect regulated services at all, and whether Ofcom should be more prescriptive as to how BT include working capital in their reported mean capital employed. This is the purpose of the RFS to highlight these issues and bring them into the light There are also a number of other changes and errors which Ofcom include[24] which we consider should be highlighted; i.e. Remote testing platform, a £12m increase in costs, as a percentage of remote testing platform costs this is probably very significant, Group property, CPE switch £31m increase in opex, and so on.

62. BT also asked for the removal of percentage change tables in the reconciliation report. As Ofcom states these add no additional information, however what they do is provide an easy and simple way to scan the reconciliation report and see what the changes with the largest percentage impact are. Without these the users has to perform a number of calculations, which considering the RFS is published in excel is not that unreasonable, however the percentage tables do simplify the RFS and make review easier, thus correspondingly removing them adds complexity for the reader and makes review more time consuming.

The preparation, delivery, publication, form and content of the RFS direction

63. In paragraph's 3.31 to 3.33 Ofcom details BT's suggestions of format changes, Vodafone considers these sensible revisions, and that combining Wholesale and retail residual does not reduce reporting transparency. However, Vodafone would like reassurance that the detail currently published on pages 26 to 28 of the 2017/18 RFS will still be published at the current level of granularity, albeit in a different place. Vodafone considers the breakdown of cost categories to regulated product groups to be very important in providing an overall picture as to the relativity of BT's cost category allocations.

[23] Ofcom's consultation, Table 3.1
[24] Ofcom's consultation, Table 3.2

64. BT then suggest to Ofcom a number of other formatting changes in the following paragraph's which appear not to diminish the content in the RFS but more group similar information together and truly seek simplification which Vodafone fully supports.

Private information provided to Ofcom

65. It is difficult for Vodafone to comment fully on the private information provided to Ofcom by BT because we do not know precisely what Ofcom do with the information and the full extent of the usefulness of the information, this is why it is always our preference that information is made public and CP's can aid the auditing and validation of such information.

66. However, Vodafone does consider in the case of the LRIC model, which has been extensively used to set charge controls and calculate cost floors and ceilings that Ofcom's proposal is inadequate. Whilst we understand and discuss in the prior section Ofcom's aspirations for the future of telecoms markets and infrastructure competition there is no evidence today that the market is actually developing and changing.

67. Ofcom is proposing here that because they foresee the market changing that the requirements of the LRIC model might change, however instead of maintaining the current system until such times that the market does change and develop Ofcom proposes now to reduce the requirements on BT for regulatory reporting. Not only that but Ofcom think it is too speculative for BT to develop a LRIC model on what the market might develop into as they are going to consult on this in 2020/21 and therefore concludes that BT should only provide high level limited data.

68. Vodafone re-states that Ofcom should not reduce any of the current 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.

5. Regulatory financial reporting in the physical infrastructure markets

Network adjustments

69. We understand that Ofcom is proposing specific regulatory financial reporting requirements related to network adjustments carried out by Openreach. The purpose of these requirements is to allow us as stakeholders to monitor BT's compliance with Ofcom's proposals for how network adjustments costs should be recovered, and the proposed requirement for no-undue discrimination, as set out in the 2018 PIMR Consultation.

70. In the 2018 WLA statement Ofcom allowed BT to recover additional costs of between £100m and £150m (precise amounts were not disclosed) from WLA regulated services to cover the cost of

network adjustments required to BT's network to enable operators access to BT's ducts. In this current review period CP's pay more for BT's WLA wholesale products to enable BT to develop its ducts to enable access.

71. In the WLA statement Ofcom forecast the amount of users of PIA services and thus the amount of costs BT is lightly to incur: [25]

> *In terms of the total cost of network adjustments, we estimate that approximately 1.4 million premises will be passed by other telecoms providers using a mixture of PIA-based and end-to-end build. This equates to around 0.6 million premises passed using 100% PIA, by the end of this review period, 0.5 million of these being passed in the final two years. The financial limit therefore implies a maximum cost of network adjustments associated with these network deployments by other telecoms providers of less than 50m over this review period. If as many as 1 million premises were passed using 100% PIA, this would imply a maximum cost of network adjustments of less than £100m over this review period.*

72. And Ofcom go on to say: [26]

> *"To estimate the total network adjustment costs incurred by Openreach over this review period, we multiply the per premises passed figure by an estimate of the number of premises passed by new networks built using Openreach's physical infrastructure (by other telecoms providers or Openreach itself) in 2019/20 and 2020/21. In total, we estimate that between 1.5 to 2 million ([·]) premises will be passed by networks built using Openreach's physical infrastructure in 2019/20 and 2020/21, giving a total cost incurred by Openreach of between £100m to £150m (£[·])."*

73. We consider that it is appropriate for CP's and purchasers of BT's wholesale products that contribute to BT's network adjustment fund to have visibility of the number of households that are actually passed by PIA consumers and the amount of the funding pot (between £100 and £150m) that has been used to improve BT's duct and pole network. For example it is very worrying that Ofcom in this consultation state that: [27]

> *"While we appreciate that network adjustment costs in total are unlikely to be significant in 2019/20……"*

74. It seems that at the time of the WLA statement that PIA use was forecast to be higher than Ofcom are now forecasting in 2019/20, if this is the case then it could be that purchasers of BT's wholesale

[25] Paragraph 4.69, https://www.ofcom.org.uk/__data/assets/pdf_file/0023/112469/wla-statement-vol-3.pdf
[26] Paragraph 5.91b, https://www.ofcom.org.uk/__data/assets/pdf_file/0023/112469/wla-statement-vol-3.pdf
[27] Paragraph 4.15, https://www.ofcom.org.uk/__data/assets/pdf_file/0018/129060/Consultation-BT-regulatory-financial-reporting.pdf

services have overpaid for these services and in effect contributed more to the network adjustment fund than necessary, thus the importance of monitoring and providing transparency of these costs.

75. Ofcom discusses network adjustments which are above the threshold limit, these are cases where the operators seeking access to BT's ducts and poles is required up front to pay the network adjustment costs and the costs are not taken out of the BT general fund derived from CP's overpaying for other WLA products. Ofcom discuss[28] BT's statutory treatment of these costs explaining that they recognise the revenue the access seeker would pay for the network adjustments upfront but then depreciate the costs of the work over the duration of the larger (duct and pole) asset life. Ofcom then on go to say how this causes an inconsistency with regulatory reporting due to the need for the RFS to as a higher priority reflect consistency with regulatory decisions.

76. Vodafone is unclear as to why this discrepancy arises and why in line with IFRS15 BT on a statutory basis does not match revenue and costs. When an access seeker such as Vodafone seeks access to BT's ducts and poles and pays up front for network adjustment activities the associated costs should be recognised when the revenue is, i.e. when they are incurred and not depreciated over time. There have been many papers on this and the principles are now clear.

77. Network adjustments could be viewed as "network operations and maintance" or could be reviewed as a customer connection or acquisition cost and as such cannot be depreciated, for example PWC in a paper on the subject state:[29]

> *"Most costs incurred to fulfil a contract relate to network operations and maintenance and overheads of the business. These are general costs and while they may be allocated internally to perform contracts or customer profitability analysis, these costs do not meet the definition….[of costs that can be capitalised]"*

78. Vodafone requests that Ofcom seek clarity from BT as to why they do not comply with IFRS 15 in respect of network adjustments for payments access seekers make that are above the threshold. In addition, whilst on the subject of IFRS 15 that BT have mentioned in their letter to Ofcom (and used it as a reason to make changes to the regulated accounts) Vodafone would request clarity as to how BT treat excess construction charges since IFRS 15 has been in force. Vodafone and other operators pay additional ECC's when they require network extension work in the business connectivity markets that incurred BT costs of over £2,800. Vodafone pays up front for these actives and believes BT capitalises these costs and depreciates them over the contract period or potentially over the life of the network asset. Presumably under IFRS 15 all these associated additional costs for which the revenue has already been recognised when us and other operators paid require to be expensed.

The preparation, Delivery, Publication, form and content of Physical infrastructure reporting

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[28] Paragraph 4.11, https://www.ofcom.org.uk/__data/assets/pdf_file/0018/129060/Consultation-BT-regulatory-financial-reporting.pdf

[29] https://www.pwc.lu/en/ifrs/docs/pwc-tiag-perspectives-on-ifrs-15-capitalizing.pdf

79. Vodafone understands that Ofcom is proposing that BT only provide minimal physical infrastructure reporting to Ofcom, both in the public (RFS) reporting and in the private (AFI) reporting. Ofcom is proposing that BT only need produce; minimal summary market level information, service level information that is aggregated, no cost information until 2020/21, no breakdown of any network components (when previously Ofcom had suggested ten new network components relating to PIA products), and very limited private information directly to Ofcom.

80. We believe that Ofcom's proposal's if considered in isolation seems reasonable, PIA products are in their very early stages, current use is extremely low, operators have stated that on-boarding the product and setting up systems and processes will take some time, and long term use and adoption is unknown. However when Ofcom's proposals on PIA reporting are considered alongside all their other proposals they seems entirely inappropriate. Ofcom is significantly reducing 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. At 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. Ofcom is giving up its day job before its singing career has proven to pay to bills and this is a very risky strategy.

6. Regulatory financial reporting in the business connectivity markets

81. We have explained in our BCMR response that BT is clearly shown by Ofcom to have SMP in business connectivity markets in most of the UK landmass for business connectivity products. This has been the case since this market was first reviewed by Ofcom and remedies imposed back in 2004. In fact over that period and during the transition from PPC products to Ethernet product, BT's market share and dominance has remained firm. There are a range of reasons why BT's market power has endured, however difficulties around customer switching, the limited reach of rival networks and the cost burden of extending those networks has had a significant bearing, as has the difficulty that system integrators have experienced in piecing together different wholesale networks to address retail demand. In addition, consumption by BT's own lines of business (BT Global Services, BT Enterprise and now EE) represents a significant portion of the retail market that is uncontestable by rival networks. This aids BT's scale and aggregation efficiencies, making the economics of infrastructure competition challenging.

82. There is no evidence that BT's dominance in this market will change in any way over the next review period, and there is no evidence that FTTH investment will provide any meaningful constraint on BT's behaviour or pricing. To safeguard the interest of Business Connectivity customers, it is necessary for

Ofcom to establish strong and meaningful remedies that constrain BT's conduct in the market, preventing it from exploiting its SMP. This is particularly true where bandwidth demand is growing and business consumers need to consume more Business Connectivity bandwidth to keep pace with demand. Businesses have enjoyed the positive aspects of regulation over the past 5 to 10 years where prices have reduced in line with the costs incurred by BT. This has led to annual price reductions of over 10% each year, which has in part offset their costs as their volume demand increases.

83. Ofcom have as a fundamental part of this process relied on regulatory reporting to monitor and constrain BT's behavior and ensure its does not exploit its SMP. If Ofcom is now relaxing the regulatory reporting on BT in regard to its active products then Ofcom need to prove that the market has changed, that BT's SMP has diminished, or that BT's SMP is effectively being controlled by another product or competitive constraint. Ofcom have not provided any evidence or information in this regard and therefore we consider the suggested relaxing of active product service level reporting, cost component reporting, and additional AFI reporting to be wholly inappropriate in this market.

84. Ofcom explain that the reason for the relaxing of active product reporting in this market is because Ofcom have not set an active product cost based charge control, we explain below why we consider this to be inappropriate.

The role of active product charge controls in this market

85. Ofcom's overall objective when setting charge controls is to address an SMP finding, as prescribed by the Act. It is required to set such conditions as appear appropriate for the purposes of promoting efficiency, promoting sustainable competition, and conferring the greatest possible benefit on the end-users of public electronic communication services.[30]

86. Although this description of Ofcom objectives is not specific or overly prescriptive it is very clear that in markets where one operator has SMP, Ofcom has a duty to ensure goods and services provided by the SMP operator are provided in a way that is 'efficient' and 'confers the greatest possible benefit for consumers'.

87. Ofcom have clearly identified that BT has significant market power for the majority of business connectivity services in the majority of geographies in this market, and as a result has both the incentive and ability to distort competition, make excessive profits, and act in a way that is damaging to the market, consumers, and other operators.

88. Clearly in deciding what regulatory tools to use to address dominance in this market there are a range of regulatory options, and in selecting the individual or suite of remedies Ofcom must strike a balance, and in doing so they must carry out an impact/cost benefit analysis to explain and justify their selected approach.

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[30] Para. 2.3, the BCMR consultation https://www.ofcom.org.uk/__data/assets/pdf_file/0022/124726/llcc-bcmr-2018-volume-2.pdf

89. Ofcom explain that[31]

> *"In our Strategic Policy Position, we set out how we plan to reform the way in which we carry out competition assessments in telecoms markets to further support network investment in the long term. In 2021 we will, for the first time, align our reviews of business and residential markets. We also said we would look to vary our regulation by geography depending on the level of competitive intensity.*
>
> *At this stage, the path that future prices might take under our revised approach is not clear. With greater geographic differentiation in our regulation, and given the short timescale of this review, we are placing the greatest weight on price stability and regulatory certainty over other factors we take into account when setting charge controls. In this period of transition to a new regulatory regime, a key objective is to promote certainty for investors in full-fibre networks and the benefits that full-fibre investment brings through competition at more levels of the value chain. While our focus is on maintaining price stability, we also have regard to balancing the potential benefits to customers from having prices more tightly aligned to costs, with ensuring BT has a fair opportunity to recover efficiently incurred costs "*

90. It is not clear at all to Vodafone what this means and how this justifies Ofcom's proposed suite of SMP remedies. What Ofcom is doing after 2021 is interesting, however it is not directly relevant to the regulatory remedies Ofcom select to solve the SMP it has identified in this market for the period 2019-2021. Ofcom go on to state that they are uncertain of how this market and prices will develop in this review period, and therefore state:

> *"we are placing the greatest weight on price stability and regulatory certainty" and develop this further to explain "we also have regard to balancing the potential benefits to customers from having prices more tightly aligned to costs, with ensuring BT has a fair opportunity to recover efficiently incurred costs "*

91. In summary Ofcom place the most weight on "price stability" and regulatory certainty. Other factors are downgraded to become a standalone balancing act between the interests of consumers and the opportunity for BT to recover its costs. In fact, those latter considerations are not materially in tension here – it is established Ofcom practice to set a price control which achieves both objectives. But in any event they seem to be largely discounted here. There appears to be no serious attempt to set a price control which even acknowledges the benefits to end users in lower prices.

92. Rather, what Ofcom have proposed is caps and safeguard caps with wide ranging baskets that both allow BT to increase all product prices by at least 7%-CPI, and make additional excessive returns well above their WACC. This is why detailed regulatory reporting at an Ethernet product level (bandwidth speed) is so important, it provides the insight to be able to understand how BT is using its market power and artificial bandwidth price gradient to manipulate the market.

[31] Para 2.7, the BCMR consultation

93. In summary we consider that the proposed form of charge controls on active products in this market do not address the SMP Ofcom have found and we further consider that relaxing the regulatory reporting around these controls would be a further dereliction of duties from Ofcom. It is common practice for Ofcom, even in markets where charge controls have been removed to continue regulatory reporting to ensure the other market constraints are effectively working. We have used the detailed reporting Ofcom is suggesting to now remove a number of times in this market, we have used it comprehensively to respond to Ofcom's business connectivity market review and if these proposals are introduced we believe our ability to engage with Ofcom's consultations and respond in an enlightened way will be drastically reduced.

The current level of adjustments and corrections within the RFS

94. Ofcom propose a number of changes and adjustments to BT's RFS data before they consider it fit to be used to accurately reflect BT's costs in the business connectivity charge control cost model. In fact Ofcom propose nine significant adjustments to BT's cost base before they consider them suitable for use in the cost model, and for over half of these Ofcom consider that BT should correct their RFS and permanently implement the changes in the financial statements.

95. Vodafone do consider that these adjustments are necessary and that Ofcom's work in analysising them at a low level of detail and requesting that BT make these adjustments does ensure that BT's RFS better reflects the regulated costs of them providing these regulated services. However we also consider that the large number of adjustments and significance of them does show that the regulated accounts still require a high level of scrutiny and focus and external (to BT) intervention. Detailed reporting and transparency will only aid and help this process, Ofcom should not be expected to be the sole reviewer of detailed RFS information, publication does aid the accuracy and improvements within the RFS.

96. We consider that it is imperative that Ofcom provide the evidence that these proposals will address the SMP identified and ensure that the remedies confer the greatest possible benefit on the end-users in this market.

7. Regulatory financial reporting in the wholesale broadband access markets

97. Vodafone understands that similar to the other markets Ofcom is proposing that BT only provide minimal physical infrastructure reporting to Ofcom in this market, both in the public (RFS) reporting and in the private (AFI) reporting. Ofcom is proposing that BT only need produce; minimal summary market level information, service level information that is aggregated, no cost information until 2020/21, no breakdown of any network components (when previously Ofcom had suggested ten new network components relating to PIA products), and very limited private information directly to Ofcom.

98. As discussed previously we believe that Ofcom's proposal's if considered in isolation seems reasonable, PIA products are in their very early stages, current use is extremely low, operators have stated that on-boarding the product and setting up systems and processes will take some time, and long term use and adoption is unknown. However when Ofcom's proposals on PIA reporting are considered alongside all their other proposals they seems entirely inappropriate. Ofcom is moving away from cost based regulation of active products in this market, only lower speed 40/10 GEA products are regulated, whilst at the same time accepting that PIA products will have little effective in the market and thus requiring little reporting. At 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 to BT.

8. Legal Annex

Summary

99. Vodafone appreciates Ofcom has a degree of discretion with respect to how it meets some of its functions and obligations under the Communications Act. However, Ofcom does not have discretion with respect to carrying out its EU and domestic law duties or meeting the obligations contained within them.[32] By reference to its domestic and EU duties, Vodafone considers that:

    a. Ofcom is positively required to impose regulatory financial reporting obligations (FRO) on BT where it finds SMP;

    b. Ofcom has a narrow discretion in relation to the appropriate standard of FRO's it must impose;

    c. Ofcom's proposals to reduce or remove FROs do not meet the appropriate standard; and

    d. Ofcom's proposed financial reporting Directions are deficient in that they do not meet the test for modifying or withdrawing a direction set out in section 49(2).

100. As a consequence of the above, Vodafone considers that Ofcom's proposals currently fail to discharge it's domestic and EU law duties.

Analysis

101. Ofcom's domestic duties, found in section 3 of the CA3 and EU law duties, found in the CRF, are binding on Ofcom when carrying out its functions.

102. Article 9 and 11 of the Access Directive states that Ofcom <u>may</u> impose obligations including requirements to publish accounting information for transparency and to ensure compliance with, *inter alia*, non-discrimination obligations, <u>subject to Article 8</u>. Similarly, Article 13 specifies that in accordance with Article 8, Ofcom <u>may</u>:

> *"impose obligations relating to cost recovery and price controls, including obligations for cost orientation of prices* ***<u>and obligations concerning cost accounting systems</u>****, for the provision of specific types of interconnection and/or access, in situations where a market analysis indicates that a lack of effective competition means that the operator concerned may sustain prices at an excessively high level, or may apply a price squeeze, to the detriment of end-users."*

[32] EE Limited & Ors v Office of Communications [2017] EWCA Civ 1873, paragraph 54.

103. This *appears* to afford Ofcom some discretion as to whether to impose FROs under Articles 9, 11 and 13, however this discretion is severely constrained by Article 8:

> *"Where an operator is designated as having significant market power on a specific market as a result of a market analysis carried out in accordance with **Article 16** of Directive 2002/21/EC (Framework Directive), national regulatory authorities **shall impose the obligations set out in Articles 9 to 13 of this Directive** as appropriate."*

104. It follows that where Ofcom has determined that BT has SMP, per Article 16 FD, it must impose regulatory FROs set out in Articles 9, 11 and 13 on BT. With regards to what 'as appropriate' FRO's look like i.e. what the standard is, Article 8(4) AD specifically sets out that any such (FROs) must be:

a. based on the nature of the problem;

b. proportionate and justified; and

c. in the light of the objectives of Article 8 FD.

105. Article 8(1) and (2) specify the 'problem' that FRO's must address are the objectives of:

> *"promot[ing] competition in the provision of electronic communications networks, electronic communications services and associated facilities and services by…ensuring that there is no distortion or restriction of competition."*

106. Article 8(5) sets out that these objectives should be achieved by the NRA/Ofcom by:

> *"applying objective, transparent, non-discriminatory and proportionate regulatory principles by, inter alia:*
>
> *(a) promoting regulatory predictability by ensuring a consistent regulatory approach over appropriate review periods;*
> *(b) ensuring that, in similar circumstances, there is no discrimination in the treatment of undertakings providing electronic communications networks and services;*
> *(c) safeguarding competition to the benefit of consumers…;*
> *(d) promoting efficient investment and innovation in new and enhanced infrastructures, including by ensuring that any access obligation takes appropriate account of the risk incurred by the investing undertakings and by permitting various cooperative arrangements between investors and parties seeking access to diversify the risk of investment, whilst ensuring that competition in the market and the principle of non-discrimination are preserved;*
> *(e) taking due account of the variety of conditions relating to competition and consumers that exist in the various geographic areas within a Member State;*

(f) *Imposing ex-ante regulatory obligations only where there is no effective and sustainable competition and relaxing or lifting such obligations as soon as that condition is fulfilled.*

107. As set out in the main body of this response, Ofcom itself considers robust financial reporting critical to monitoring BT's compliance with SMP conditions and to ensure they are proportionate and justified…thereby promoting and ensuring there is no restriction on competition, for the benefit of consumers etc. What's more, we expect BT would not quibble with the statement that robust FROs are necessary for Ofcom to ensure that BT's investments in its network are protected and to ensure that ex-ante regulatory obligations are lifted where competition becomes effective.

108. For the reasons discussed above, it is impossible to therefore reconcile Ofcom's proposal to relax public or private reporting in the RFS with its duties in the CRF Directives or Communications Act. Ofcom cannot escape the fact that 'appropriate' regulatory accounting obligations are required by the regulatory framework where Ofcom determines BT has SMP. At its highest level of principle, SMP regulation is necessary to address the incentive and ability of an SMP holder to distort competition and, in practice, BT has time and time again demonstrated that it will exercise that ability where constraints are relaxed. That alone is sufficient to ensure robust FRO's are in place. Putting this aside, Ofcom has provided no evidence of a material change in BT's position in the market or its behavior to justify relaxing or reducing the FRO's. On the contrary, Ofcom finds it appropriate to designate BT with SMP and impose remedies to address this, triggering the requirement for FROs' that are appropriate. The main reasons given for Ofcom's proposals therefore appear to amount to administrative convenience.

109. In view of the above, reducing FRO's cannot be proportionate or justified in this case. As a consequence, Vodafone considers that Ofcom's proposed FRO's are likely to be in breach of its domestic and EU law duties if it removes or reduces the FRO's it currently imposes on BT.

110. In addition, the reasons given for the proposed FRO Directions by Ofcom to satisfy the test, set out in section 49(2), appear to be entirely misdirected to high level reasons for *giving* a FRO Direction in the first place, not at providing proper justification for withdrawing or modifying the existing Directions. Ofcom therefore appears to have erred in its approach to meeting the test required by section 49(2).

111. We reserve all rights to add to this legal analysis in due course, should it become necessary.