

ERG Secretariat
Avenue de Beaulieu 24
B-1160 Brussels
Belgium

This letter also has been sent to your e-mail address : erg-secretariat@cec.eu.int

Date: 14 June 2004

Re: **Public consultation on a draft ERG Opinion on proposed changes to the Commission Recommendation on Accounting Separation and Cost Accounting.**

Dear Sirs,

On behalf of ACT I refer to your consultation on Accounting Separation. ACT believes that transparency, non-discrimination and cost-orientated charges for SMP wholesale services should be principle objectives of any pro-competitive regulatory regime. These objectives are best achieved through the implementation of Accounting Separation and Cost Accounting measures which ensure that that the regulatory regime is fair and reasonable, but can be seen to fair and reasonable by all participants. Accordingly, ACT welcomes the ERG's initiative in undertaking a revision of the Commission's recommendation on Accounting Separation and Cost Accounting (April 1998) released for consultation on 26th April 2004.

Also welcome is the recognition that a consistent approach to these matters is desirable. At present there is a "two-track" approach in Europe with NRAs such as Ofcom (UK) and ComReg (Republic of Ireland) regarding publication of Accounting Separation information (both statements and, crucially, methodologies) as a natural and necessary measure wherever SMP is found, while other NRAs take a markedly more relaxed approach. In The Netherlands OPTA has taken a more relaxed approach. Strong leadership from the ERG will be an important element in ensuring that an increasingly consistent approach is adopted as markets develop.

Although, ACT does not propose to offer detailed responses to each of the questions in the ERG consultation document, it does support the underlying premises of the consultation. It is entirely appropriate to place obligations of this type on operators who have been found to enjoy significant market power, indeed ACT believes that there should be a general presumption to the effect that Accounting Separation and Cost Accounting measures constitute a necessary remedy in such cases, unless truly exceptional circumstances support the imposition of some alternative remedy.

1 Accounting Separation and Cost Accounting

In ACT's opinion, the ERG should strongly recommend publication and consultation on financial results and methodologies as essential ingredients of the framework. Publication should include publication of a statement reconciling the Accounting Separation results to the statutory accounts for the legal entity.

If the Accounting Separation and Cost Accounting measures are to be seen to be transparent and fair to all it is of the utmost importance that the publication obligation should cover both the financial results and the methodologies involved in their preparation, and that there should be periodic public consultation on the methodologies. Such consultation should encompass international benchmarking and assessment of the effectiveness of any measures already taken permitting comparisons over time and internationally and the scrutiny of the outcomes of the process by all interested parties. Wide consultation allows the NRA to benefit from a diversity of opinions and experience offered from a variety of perspectives – those of operators, academics, consultants and government agencies, for example. Wide consultation should therefore allow impracticalities or anomalies to be identified relatively early, together with competition, regulatory or commercial issues.

One commercial issue which might arise in the course of consultation is the extent to which the information comprising the Accounting Separation system can be considered confidential. In ACT's opinion, very little information comes into this category. All operators buy more-or-less the same equipment from more-or-less the same group of suppliers, and labour rates are not difficult to find. Even if a case could be made keeping cost details confidential, there can be no case for not publishing the methodologies. Accounting Separation information offers the SMP operator the first line of defence against accusations of abusive pricing: thus the time and expense of defending against competition complaints can be minimised if the approach taken to costing different services can be demonstrated to be fair and consistent, and the methodologies by which these costs are allocated to services can be shown to be fair and reasonable. By contrast, methodologies devised between closed doors and not published create suspicions, and incentivise non-SMP operators to complain about pricing abuses when good quality AS information could have shown such a complaint to be groundless. Thus it is in the interest of both the NRA and SMP operator to restrict the treatment of information as commercially sensitive to an absolute minimum.

ACT would also recommend that the final version of the guidance make greater use of illustrative examples, and that illustrations be drawn from both fixed and mobile networks. These examples should cover the entire from the cost build for the network components, the combination of these costs to form services, and the construction of transfer charges. In this way practical guidance would be given on all the key elements of the eventual AS statements.

Finally, priority should be given the publication of recent years, rather than earlier years.

2 Principles for cost causality, driver definition and attribution methodologies

ACT feels that more detail is needed here, and that the guidance given has the potential for differences in interpretation, and therefore inconsistency in application. As noted above, greater use of illustrative examples will go some way towards clarifying any ambiguities. A possible approach would be to establish a set of principles, in collaboration with NRAs and other interested parties, which could then be used as the basis for more detailed specific recommendations.

ACT would also like to see the ERG issue guidance on the scope and application of bottom-up LRIC models. These have their place, can be useful as an interim measure providing information on specific services while a top-down LRIC model is under development. They are also very useful in helping to identify cost inefficiencies and cost misallocations. However, they should be treated as complements rather than substitutes for top-down LRIC models which cover all of the company's activities and which are integrated with the rest of the company's financial reporting system. Only a top-down LRIC model is capable of capturing all relevant costs and revenues, preserving an audit trail to the company's accounts, and therefore giving comfort that that transfer prices have been correctly calculated and that arms-length trading relationships in vertically integrated operators are operating as they should. The ERG should nonetheless encourage NRAs to develop bottom-up cost models for the reasons given above.

3 Guidelines for CCA implementation

The ERG's guidance on CCA implementation is very thorough and very useful piece of work, all of which ACT supports, with the possible exception of the ERG's suggestion that assets could be revalued at an aggregated level, rather than at a detailed level. ACT believes that the revaluation should be conducted at an appropriate level of detail, agreed through industry consultation in a manner comparable to that advocated for cost attributions, and that the criteria applied in setting the level of detail should be published, especially if the values themselves are deemed a business secret. These are valid points but the fundamentals need to be addressed first.

Another consideration is that the guidelines for CCA implementation, while sound and sensible, might represent a significant burden for certain companies if it were insisted that the full CCA system be implemented at the same time. Accordingly ACT suggests that the ERG provide some guidance as to how the transition for the current situation for such companies to the eventual full implementation of CCA be handled. Such guidance will necessarily involve decisions about which parts of the CCA system should be given priority for implementation. The principle that should be applied here is: priority should be given to those parts of the CCA system which deliver the greatest pro-competitive benefits, or which deliver them earliest.

In this connection ACT recommends that

Public consultation on methodologies for (and followed by)
Publication of fully-allocated historic cost audited published accounts, including
The derivation of the transfer changes between SMP upstream and downstream activities;

would constitute a good set of initial priorities for transition. These priorities should not prove unduly onerous as they make use of information the operator already has, and so it should be possible to put them into effect relatively quickly. LRIC modelling and Current cost accounting could then follow according to a implementation plan agreed with the NRA.

4 Cost of capital

The CAPM model for calculating the WACC is such a well-established part of the regulatory environment in most countries, and the benefits of using alternative models is uncertain, that ACT does not consider consultation on alternative models productive. ACT considers it likely that any benefits from the adoption of an alternative model could be outweighed by the disruptive effect of its introduction, and we therefore agree with the CAPM and WACC proposals in the guidance.

Yours sincerely,

F.P. Sickinghe.

Cc: OPTA, The Hague, The Netherlands