7th February 2025

Flint response to OTA-BTS Consultation on Arqiva's Regulatory Accounts (Consultation 2/2024), on behalf of D34

[Note: ✂ denotes redacted information confidential to D34]

FLINT

Executive Summary

As part of its Undertakings to the Competition Commission (CC) in 2008, Arqiva agreed to produce annual regulatory accounts (RA) which are intended to "*fairly represent the state of the businesses' affairs to which they relate*".

The RA should include the relevant figures for Arqiva's regulated Managed Transmission Services (MTS) and Network Access (NA) services.

For NA, reported revenues are the regulated charges that Arqiva charges its NA customers, and therefore in order to fairly represent the state of the business affairs, we would expect the costs and assets for NA services to be the costs and assets that are used to calculate regulated charges. However, this is not the case.

To improve Arqiva's RA we recommend:

- NA fees charged to D34 (and others) are calculated based on a notional regulatory asset base (RAB). We would expect the RAB to be reported in the RA, so that the reported assets match the reported revenues for NA services. This is not currently what is shown in the RA, where the asset base is reported on a historical cost basis. The RAB is used to calculate an allowed return on capital employed (based on an allowed weighted average cost of capital) and allowed depreciation, and this calculation should be clearly shown. We provide an example below of how this might look in Figure 5.

- Operating costs should also be reported at a more granular level, with an emphasis on explaining changes between periods.

- A commentary of the changes in revenues and operating costs, for both NA and MTS, must be included.

- Arqiva should provide a forecast for the next 12 months so that customers can understand how the NA revenues and Opex are forecast to change over the next reporting period.

The table below shows the regulatory accounting principles that Ofcom set out in relation to BT's regulatory financial statements, which provide a useful 'checklist' to help assess the effectiveness of Arqiva's RA. We find that Arqiva's RA, as currently set out, fail to comply with the principles of **Completeness** and **Causality**, while **Objectivity** may be an issue in relation to reported NA assets.

Table 1: Regulatory accounting principles (Ofcom)

Regulatory accounting principles	Assessment of Arqiva's regulatory accounts
Completeness All relevant revenues, costs, assets, and liabilities must be included in the Regulatory Financial Reports.	Not all the relevant costs or assets are fully included in Arqiva's RA currently. More detail is required on costs to understand why costs are moving, and what proportion of Arqiva Group costs are being assigned to regulated markets. The assets currently listed for NA do not reflect the asset base on which regulated fees are calculated.
Accuracy The reported figures must be sufficiently accurate, free from material errors and double counting.	The audit process should be designed to ensure that reported figures are accurate. We are unable to test this.

Objectivity Financial reporting should be impartial and take into account all available data, with any assumptions justified and supported.	Some of the figures in the RA (specifically the capital employed for NA) do not provide an objective justification for the regulated fees paid by D34 and others. We do not suggest they are not impartial, but we believe that not all available data has been taken into account or reflected in the RA.
Consistency with regulatory decisions Regulatory financial reporting must be consistent with Ofcom's regulatory decisions.	Arqiva's RA are in line with the requirements set out by Ofcom and the OTA-BTS. But we believe those requirements need to be revisited and welcome the opportunity to contribute to that process with this consultation response.
Causality Revenues, costs, assets, and liabilities must be attributed to the activities that give rise to them.	This is the key area where Arqiva's RA does not comply with the principles. The NA revenues listed in the RA are not consistent with the capital employed shown in the statement of financial position. Hence it is not possible for a user of the accounts to assess whether the revenues, costs and assets are fairly attributed to the activities that gave rise to them.
Compliance with the statutory accounting standards Reports must follow the same accounting standards as statutory accounts, except where Ofcom directs otherwise.	We have no reason to believe that Arqiva's RA do not comply with statutory accounting standards.
Consistency of the Regulatory Financial Statements as a whole and from one period to another Reporting methods must be applied consistently across all statements and over time, with any changes clearly explained and prior statements restated as necessary.	Arqiva's RA are prepared on a consistent basis over time. This is not the issue – the issue is that the RA are not *internally consistent*, i.e. the revenues don't match the assets/capital employed, for NA.

Source: Ofcom (2014) – Regulatory Financial Reporting, Annex 3
Notes: RED = not consistent with best practice; ORANGE = partly consistent with best practice; GREEN = consistent with best practice.

Response to consultation questions

1. **How often does someone in your business or organisation read and analyse Arqiva's Regulatory Accounts and the supporting information? What purposes are they used for?**

Arqiva's Regulatory Accounts (RA) are reviewed each year by D34 and its shareholders' (Channel 4 and ITV) finance and regulatory teams.

The primary purpose of reviewing the RA is to try and assess the basis for charges related to Network Access (NA), to verify the fairness of charges and understand cost allocations and provide a basis for D34 to engage with Arqiva.

In particular, [✂]

Figure 1: [✂]
[✂]
Source: [✂]

D34 therefore uses the RA to understand the movement in opex each year and to determine any year-on-year trends.

However, the opex presented in the RA only shows costs at a high level. The headline operating costs are not broken down into constituent parts or accompanied by any form of commentary explaining the drivers of costs or reasons for movements (we explain this further in Q2). Furthermore, network assets in the regulatory accounts are reported on a different basis to how charges are calculated, which means D34 is unable to use the RA to verify other non-opex charges included in the NA core charge (which include more than opex charges). Together, these flaws mean the RA are not as useful as they could or should be for D34, and hence are not used as much as they otherwise might be.

2. **How useful are the Regulatory Accounts for your business or organisation?**

The RA are essential for determining the actual opex charges that Arqiva charges D34. As explained in Q1, the regulated NA opex in the RA is the starting point for understanding cost movements each year. D34 therefore tries to use the RA to understand the movement in opex charges each year and to determine any year-on-year trends.

However, the accounts do not provide sufficient transparency to fulfil this function well, as the **total regulated opex for TV** – which is used to calculate D34's NA core charges – **differs from the total NA opex shown in the RA**.

- [✂]

Figure 2: [✂]
[✂]
Source: [✂]

- [✂]

- The lack of reconciliation between the opex reported in the RA and the actual opex charges paid by D34 prevents D34 from appropriately understanding and scrutinising these charges, particularly due to the [✂].
- Furthermore, the regulated NA opex in the RA are presented at a high level – only three line items (Labour Cost of Sales and Maintenance, Operating Expenses and Exceptional Costs) are given, with no accompanying commentary explaining changes from year to year.
- We would therefore expect to see greater detail and commentary on how operating costs are incurred, [✂] and recovered operating costs. We set this out in more detail in Q4 below.

[✂]

Figure 3: [✂]
[✂]
Source: [✂]

[✂]

Beyond serving as a starting point for opex charges, Arqiva's RA are limited in scope and **do not provide a basis on which to understand non-opex regulated charges**, which limits their usefulness to D34 and other customers.

In particular, **network assets in the regulatory accounts are reported on a different basis to how charges are calculated.**

- The assets reported in the regulatory accounts are given on a historic cost accounting (HCA) basis, while charges are based on the depreciated replacement cost (DRC) of the assets. HCA means that assets are reported at the purchase cost less depreciation to date, whereas DRC shows the cost of replacing the assets in their current state. In the case of Arqiva's NA assets, the DRC value has always been above the HCA value, meaning that Arqiva is allowed to recover more than the original cost of providing the assets.
- This mismatch between reported regulatory fixed assets and the regulatory asset base used to determine charges means that users of the accounts cannot easily understand how charges are calculated, or how they change over time. It is surprising that the OTA-BTS has not historically sought to align the reported assets in the regulatory accounts with those used for calculating charges previously.

The Undertakings signed by Arqiva emphasised the need for transparency: users of Arqiva's NA and MTS services (and the OTA-BTS) should be able to understand how their charges were calculated and check that the charges were fair, reasonable and non-discriminatory. Indeed, under Section 11 of the Undertakings, Arqiva must be able to demonstrate that MTS providers have been provided with sufficient transparency and information regarding the basis for the calculation of charges. In theory – and in keeping with the original intentions of the Undertakings – Arqiva's RA *should* play a crucial role in facilitating this transparency.

In practice, however, the RA have failed to fulfil this objective. As the Adjudicator is aware, [✂]. This would not have been possible solely from the RA.

3. **In the current format, how clear and easy to understand is the financial information? How easy is it to track year-on-year changes and identify trends?**

Regulated opex is presented in a high-level way in the RA (see Figure 4), and is not accompanied by any form of commentary explaining the drivers of costs or reasons for cost movements from year to year.

Figure 4: Arqiva FY23 Regulatory Accounts – income statement

	Network Access	Managed Transmission Services	Network Access	Managed Transmission Services
	Year ended 30 June 2023	Year ended 30 June 2023	Year ended 30 June 2022	Year ended 30 June 2022
	£m	£m	£m	£m
TV revenue*	154.8	39.6	149.9	38.6
Radio revenue**	50.5	20.4	49.6	19.9
Total revenue	**205.3**	**60.0**	**199.5**	**58.5**
Rent and rates	(13.9)	-	(14.9)	-
Labour Cost of Sales and Maintenance	(11.3)	(9.3)	(9.2)	(8.0)
Cost of Sales	**(25.2)**	**(9.3)**	**(24.1)**	**(8.0)**
Operating expenses	(22.4)	(1.8)	(23.7)	(1.7)
Depreciation	(10.9)	(18.9)	(42.2)	(19.7)
Total operating expenses	**(33.3)**	**(20.7)**	**(65.9)**	**(21.4)**
Exceptional costs	1.1	(0.2)	(8.8)	(0.5)
Operating profit (after exceptional costs)	**147.9**	**29.8**	**100.7**	**28.6**

Source: Arqiva FY23 Regulatory Accounts

As explained in Q2, regulated TV opex allocated to D34 includes three line items: labour cost of sales and maintenance ((£11.3m) in FY23), operating expenses ((£22.4m) in FY23), and exceptional costs (£1.1m in FY23) in the RA, but these are then subject to further adjustments not stated in the RA (see Q2 for details). The RA therefore do not provide sufficient granularity on opex, or indeed any commentary, for D34 to understand the drivers of costs or reasons for cost movements from year to year. As Figure 4 shows, Arqiva's NA operating profit increased by almost 47% between FY22 and FY23, but there is no clear explanation for this in the RA.

4. **Is there additional information would you like to see and if so, why? Could some information be dropped and, if so, why?**

The updated RA should include the following additional information

1) Information on cost movements

The RA should provide comprehensive explanations of cost movements, especially operating costs. [✂]. The RA should include a reconciliation between the total regulated opex for TV and the total regulated NA opex, and provide commentary which explains the drivers behind the cost movements to a reasonably detailed level, so that all parties can understand why costs are increasing or decreasing compared to prior years/forecasts.

2) Breakdown of NA reported revenue into constituent parts

One of the key drivers of NA fees charged by Arqiva (and shown as NA revenues in the RA) is the deemed asset base for NA. But network assets in the RA are reported on a different basis (HCA basis) to how the NA core charges are calculated (based on depreciated replacement cost).

The updated RA should provide a reconciliation between the RA and customer charges, linking asset values to the charges they underpin. To do this, the updated RA should show the regulatory asset base (RAB) on which regulated charges are based.

The table below gives an example of how this information might be presented in a way that allows Arqiva's customers to see how a notional asset base and notional costs relate to revenues. It would be appropriate to break this analysis down further between TV and radio costs and assets. The total regulatory asset base could be further broken down into assets related to digital switchover, and those pre-digital switchover.

Figure 5: NA Reported revenue breakdown

	2023				2024			
	WACC	*Regulatory asset base*	**Allowed cost**		*WACC*	*Regulatory asset base*	**Allowed cost**	
Estimated asset base/allowed return	*7.7%*	*1,425*			*7.7%*	*1,588*		
Core charges								
Return on capital employed			110				122	
Depreciation			45				50	
				155				172
Operating costs								
Rent and rates (passed through)			14				14	
Labour cost of sales and maintenance			11				13	
Operating expenses			22				27	
				47				54
Other cost adjustments				3				-6
Reported revenue				**205**				**220**

Source: Flint analysis based on D34 invoices and Arqiva regulatory accounts

3) Reconciliation between actual operating costs and recoverable operating costs

As explained in Q2, the lack of information on opex recovered in the RA prevents stakeholders, including D34 and the OTA-BTS, from undertaking an accurate assessment of the returns Arqiva is making, as (in the case of D34) opex benchmarks increasingly diverge from actual operating costs.

To address this, the updated RA should include a reconciliation between actual operating costs and recoverable operating costs. [✂].

A reconciliation between actual operating costs and recoverable operating costs could shed light on any opex over-recovery and whether Arqiva is making higher returns than the regulatory cost of capital. This is important as Ofcom's initial regulatory objectives was for Arqiva to provide services on reasonable terms, so as to protect customers from any exploitation of Arqiva's market power.[1] To achieve this, Ofcom stated that charges for network access should be reasonably derived from the costs of provision.[2] [✂].

4) Forward-looking projections

[1] Ofcom - Broadcasting Transmission Services: a review of the market (2005)
[2] Ofcom - Broadcasting Transmission Services: a review of the market (2005)

Finally, the RA should include forward-looking cost and revenue projections for the next year to increase transparency and assist with stakeholders' financial planning.

In our view, there is no information which can be dropped from the RA

At 14 pages, the RA are about as condensed and limited as it is possible to be. There are just 6 pages of figures, including income statement, statement of financial position (balance sheet), and then reconciliations of both to the statutory Arqiva Group accounts, for the current and prior year. Given the current limited level of disclosure, and no commentary, we do not think there is anything that could be dropped from the RA.

5. **Do you encounter any difficulties in navigating or understanding the documents? Do you have views about whether an alternative format or way to present the information would help enhance their usability?**

The real issue with the RA is not how the documents are presented, but what is and is not included in them, including level of detail. We provide details of additional information we believe should be included in our responses above.

In particular, from a presentation perspective, it would be helpful to show detailed bridges on the various components of operating costs (as set out in Q4) to help illustrate the different cost drivers from year to year. The RA should also include clear presentations of historic changes in each cost category over time to make it easier to follow trends on a like-for-like basis.

6. **If a stakeholder has questions arising from the Regulatory Accounts, is it clear how to get answers? Have you any experience of how well the process for follow-up works?**

[✂]. As part of this process, Arqiva provides some information on the underlying cost drivers and movements, which D34 appreciates.

However, this process is long, involves a significant amount of back-and-forth, and often yields incomplete information. [✂]

[✂]

[✂].

7. **In your opinion, which of the options in Section 2, i.e. a), b), c) or d), most closely reflects your views and why?**

Option C – changes to the RA to be more useful to stakeholders – most closely reflects our views. Without meaningful changes, the RA will continue to fail stakeholders by providing inadequate transparency and utility. Significant updates – as set out in our response to Q4 and Q5 – are needed to align the RA with cost recovery methodologies, enhance transparency, and meet the needs of stakeholders. This should be the first priority when considering any changes to the RA.

Secondary to this is the issue of cost – as set out in Q4, our view is that the RA are already as minimal and condensed as they can be. We therefore oppose any changes to the RA which reduce the usefulness of the RA for stakeholders (limited as this may be given the shortcomings), even if such changes might reduce the cost to Arqiva.

In our view, the other options are unsuitable and risk undermining the effectiveness of the Undertakings:

- Option A (remain unchanged). As set out in our response to Q2 above, the RA in their present form have significant shortcomings which limit their usefulness for stakeholders. Option A – leaving the RA unchanged – would continue to undermine the effectiveness of the Undertakings by denying stakeholders the transparency required by the Undertakings.

- Option B (be left largely unchanged with relatively minor changes). In our view, relatively minor changes are unlikely to be sufficient to provide stakeholders with the required transparency, although this will of course depend on what the "relatively minor changes" are.

- Option D (the requirement to produce the Regulatory Accounts should be lifted). We strongly oppose this option.

    - As Ofcom noted in its 2005 market review, in markets where competition is not effective, dominant providers (such as Arqiva) are likely to maximise their profits by setting excessive prices.[3] Following the 2008 merger, Arqiva is now a monopolist provider.

    - The Undertakings were therefore intended to "*provide adequate protection to customers from the market power that the merger bestowed upon Arqiva*".[4] The RA are intended to serve an important purpose as part of the Undertakings by providing the OTA and Arqiva's customers with transparency into Arqiva's costs and charges.

    - While the RA in their current form have failed to meet this objective, the solution is not to lift the obligation to produce the RA, but to modify it to make it useful, which is what Option C does. In particular, we strongly oppose any suggestion that the obligation should be lifted in order to reduce costs to Arqiva.

8. **Are there new tools or technologies that could be adopted to improve the transparency, usability or usefulness of the Regulatory Accounts?**

N.A.

[3] Ofcom - Broadcasting Transmission Services: a review of the market (2005), page 29.
[4] CC, Macquarie UK Broadcast Ventures Limited/National Grid Wireless Group Final Report (2008), para 10.73

9. **Are there other regulatory accounts which you regard as examples of best practice and what do you regard as their strengths in the context of the Arqiva regulated businesses?**

The purpose of regulatory accounts

The main purpose of regulatory accounts is to provide financial information about regulated businesses for use by the regulator, industry, investors, consumers, and other stakeholders.

Regulatory accounts fulfil various roles across different industries depending on the specific regulatory objectives, the structure of the market, and the needs of stakeholders. For example, some of the key objectives of regulatory accounts include:

- Monitoring compliance with price controls: Regulatory accounts help assess whether a regulated entity's performance aligns with the assumptions underpinning price controls.
- Providing transparency for stakeholders: By disclosing financial data specific to regulated activities, they enable stakeholders – including customers, regulators, and investors – to understand the costs and revenues associated with regulated services.
- Ensuring fair competition: Accounts are used to monitor and prevent anti-competitive behaviour, such as cross-subsidisation and undue discrimination.
- Supporting future price control reviews: The data allows for informed decision-making and setting of fair price controls in subsequent regulatory periods.

Best practices

Table 1 sets out the regulatory accounting principles that Ofcom set out in relation to BT's regulatory financial statements, which provide a useful 'checklist' to help assess the effectiveness of Arqiva's RA. As explained earlier, we believe Arqiva's RA do not meet the criteria of Completeness and Causality.

From a customer perspective, good regulatory accounts should provide **clear cost causality**. They must include detailed information linking costs to the services provided. This means breaking down operating and capital costs in a way that directly relates them to the specific regulated activities. Customers should be able to see how costs incurred by the regulated entity are reflected in the charges they pay, enabling them to assess whether those charges are fair and reasonable. Good RA should also be **usable** – presented in a clear, standardised and user-friendly format – and delivered in a **timely** manner to ensure stakeholders can use the information effectively for decision-making.

Given that regulatory accounts may fulfil different roles depending on the context and industry, our view is that there is no single "best practice" model for regulatory accounts. However, examples from various UK regulated industries highlight elements that could significantly enhance the utility of Arqiva's regulatory accounts.

1) BT

BT's regulatory accounts provide detailed **commentary** on performance and costs in each of the regulated markets, which helps users understand the reason for movements from year to year. For example, on the WLA markets:

> *"Revenue increased by £481m from £2,950m to £3,431m. This is mainly due to the continued volume improvement to higher speed FTTP and SOGEA services as customers switch towards faster speeds and price increases across most services, partially offset by volume decreases in FTTC and MPF services and increased take-up of Equinox discounts.*
>
> *Costs increased by £999m from £2,128m to £3,127m. Nearly 60% of the increase is attributable to the holding gain CCA reduction, both through an increased attribution of cost from the PI market and direct holding gain reduction in the WLA asset base. In addition, net labour costs have increased due to pay rises, increased allocations to this market as the fibre rollout continues, and increased depreciation on fibre assets in line with the build programme."* (Source: BT Regulatory Financial Statements 2024)

Although we do not propose that Arqiva's RA be as detailed and comprehensive as BT's – given the differences in number of markets, market size, and number of users etc, and the need to be proportionate – Arqiva's RA currently lack **any** meaningful commentary on costs, which limits their usefulness for users. There is therefore scope for Arqiva to provide some commentary along the lines of BT's RA, which would not be disproportionate or overly burdensome.

2) Heathrow

Heathrow's RA provide significantly more granular information on operating costs compared to Arqiva's.

Figure 6: Heathrow regulatory accounts (2023) – operating costs

4. Operating Costs

For the year ended 31 December 2023, total operating costs at £1,452 million were 5% higher than the forecast based on the CAA decision.

£million	Actual	CAA Forecast[1]	Variance £m	%
People costs	439	382	57	15
Operational costs (excluding insurance)	371	328	43	13
Insurance costs	19	19	-	-
Facilities and maintenance costs	214	200	14	7
Rates	113	143	(30)	(21)
Utilities (excluding distribution)	134	122	12	10
Distribution contract costs	4	35	(31)	(89)
General expenses	165	139	26	19
Surface access initiative costs	6	6	-	-
Other overlay costs	-	4	(4)	(100)
Operating costs before adjustments	**1465**	1,378	87	6
Add back MTI rebates	(13)	-	(13)	-
Total operating costs	**1,452**	1,378	74	5

Source: Heathrow regulatory accounts 2023

Unlike Arqiva, Heathrow also provides commentary on movements in each of the components of operating costs, particularly where they are more or less than expected.

Figure 7: Heathrow regulatory accounts (2023) – commentary on operating costs

People costs were £57 million higher than forecast based on the CAA decision, driven by ramp up costs across all business areas with increased passenger numbers.

Operational costs (excluding insurance) were £43 million higher than the forecast based on the CAA decision, mainly driven by the reopening of T4 in June 2022, which saw higher levels of 3rd party resourcing and bussing in 2023 to accommodate increased terminal utilisation as well as additional passenger demand.

Insurance costs were in line with the forecast based on the CAA decision.

Facilities and maintenance costs were £14 million higher than the forecast, driven by increase in passenger volumes and price increases.

Rates were £30 million lower than the forecast based on the CAA decision, driven by higher occupation and more refunds received during 2023.

Utilities (excluding distribution) were £12 million higher than the forecast based on the CAA decision, primarily driven by electricity costs due to an increase in price per unit to £0.38 (2022: £0.22).

Distribution contract costs were £31 million lower than the forecast based on the CAA decision, as the forecast does not account for the accounting adjustments for IFRS 16 leases.

General expenses were £26 million higher than the forecast based on the CAA decision, primarily driven by the increase in charges set by the Department for Transport in 2023, and the increase in colleague travel throughout the year.

Surface access initiative costs were in line with the forecast based on the CAA decision.

Source: Heathrow regulatory accounts 2023

Both of these elements – more granular breakdown of operating costs and commentary on movements – are currently lacking in Arqiva's RA and should be included to assist with customers understanding of the regulated fees.

There are many other examples of regulatory accounts that provide cost granularity and a commentary on movements from year to year, including those of IDS (formerly Royal Mail), and all the UK regulated water companies and energy companies. In short, providing such detail is fairly standard in a set of usable regulatory accounts.

10. **Bearing in mind the resources needed to produce Regulatory Accounts, do you think there is still a need for Arqiva to produce them in some form?**

Yes, there remains a critical need for RA – as explained in Q1, the RA are essential for D34 as the starting point from which opex charges are calculated.

Furthermore, the Undertakings were intended to "*provide adequate protection to customers from the market power that the merger bestowed upon Arqiva*" following the 2008 merger, which made Arqiva a monopolist. Given Arqiva's monopolistic position in the market, the RA are intended to play a crucial role in the Undertakings by providing transparency and accountability.

At the same time, we recognise that there is a significant resource requirement for producing the RA. Our view is that the current format requires significant reform to justify the resources expended in preparing the RA. As set out in our response to Q2, the current set of information presented in the RA is the wrong one. We do not wish to increase the resource requirement needlessly, but it is important that the RA are changed to make them useful to stakeholders. We set out these proposed changes in our response to Q4 above.

11. **Are there other views, in areas not covered by the previous ten questions, which you believe are relevant to this consultation?**

We believe one of the most fundamental issues with Arqiva's NA fees is the basis on which they are calculated. Providing more granularity on how this is done is the focus of this response, but addressing the way in which asset costs are allocated to NA core charges, to ensure that cost recovery is fair and proportionate, will be crucial in future.

We set out below the crux of the issue. We believe the way that Ofcom has allowed Arqiva to recover asset costs is flawed, being based on an operating capability maintenance concept that allows over-recovery of costs in order to entice a new entrant into the market. We would welcome the opportunity to discuss this with the OTA-BTS and Ofcom in due course.

Financial Capital Maintenance (FCM) vs Operating Capability (or capital) Maintenance (OCM)

Conceptually, there are two ways to approach depreciation and asset valuation.[5] Either of these approaches could be used to guide the setting of regulated charges, although regulators typically use the financial capital maintenance (FCM) approach. In contrast, Arqiva's RAB is currently calculated on an operating capability maintenance (OCM) basis.

- Under **Operating Capability Maintenance (OCM)**, depreciation is the reduction in the value of assets over the course of the financial year, which is associated with the reduction in the asset's remaining life.[6] OCM seeks to ensure that the depreciation charge to the profit and loss account relates to the current replacement cost of the firm's assets, i.e. taking account of specific and general price inflation.

    - OCM assumes that a regulated entity operates in a contestable market where competitive forces drive efficiency. As the name suggests, it focuses on maintaining the **operational or physical capability** of the assets, ensuring that they are replaced or renewed in line with their depreciated replacement cost.

    - This approach assumes that the market is contestable – i.e. competitors can enter the market and provide services using equivalent assets at replacement cost. In such markets, replacement cost aligns closely with the price a competitor would charge – if the incumbent's prices exceed this level, customers can switch to competitors – ensuring pricing reflects competitive benchmarks.

    - However, without this competitive dynamic, the use of replacement cost in pricing can inflate prices unnecessarily, as there is no external pressure to ensure cost discipline.

    - In the broadcasting transmission market, where is no meaningful threat of market entry (particularly following the merger of NGW and Arqiva), customers have no alternative suppliers to turn to if prices reflect inflated replacement costs, undermining the cost-control discipline that OCM assumes.

[5] Analysys Mason (2010) – [Report for Ofcom - Alternative methodologies for the valuation of BT"s duct assets – Public version]

[6] Ofcom (2017), [Wholesale Local Access Market Review – Further consultation on proposed charge control for wholesale standard and superfast broadband], footnote 67

- **Financial Capital Maintenance (FCM)** is an alternative approach which seeks to maintain the financial capital of the firm, and thus the firm's ability to continue financing its functions.[7] For modelling purposes, this involves including an allowance within the capital costs for the holding gains or losses associated with changes over the year in the value of the assets held by the firm.

  - Because FCM bases depreciation on the historical cost of assets rather than their replacement cost, this ensures that prices reflect the actual investment made by the regulated firm, rather than the hypothetical cost of replacing the assets. In a monopolistic market like Arqiva's, where customers lack alternative suppliers, using historical costs prevents the firm from inflating prices based on rising replacement costs.

  - Ofcom adopts the FCM approach to CCA for establishing the allowed capital costs for BT.[8]

  - Ofwat's approach to remunerating capital investment is also consistent with FCM principles because it sets regulated charges to be sufficient to allow the recovery of all capital invested irrespective of the current value of any assets.[9]

Arqiva's RAB for NA services should be calculated (i.e. revalued) on a financial capital maintenance basis, rather than the current operating capital maintenance basis.

Improved transparency over preparation of regulatory accounts

We propose granting key stakeholders, such as D34 and the BBC, observer status at tripartite review meetings involving Arqiva, its auditors, and the OTA-BTS. This would enhance transparency and foster a better understanding of cost drivers. Allowing stakeholders observer status may help to reduce the costs of preparing the RA as this will improve transparency and reduce the need for (costly) follow-ups.

Of course, relevant safeguards regarding commercially sensitive information would need to be put in place. If these cannot be established, an alternative approach, in addition to providing more transparency and commentary in the RA, would be for Arqiva to offer to present their RA to its customer base (and the OTA-BTS) at a series of meetings (e.g. one for TV customers and another for Radio customers), where Arqiva could provide an explanation of the various cost movements with sufficient transparency to enable customers to better understand what is driving cost increases/decreases and charges.

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[7] Ofcom (2017), Wholesale Local Access Market Review – Further consultation on proposed charge control for wholesale standard and superfast broadband, footnote 69

[8] Ofcom (2016), Business Connectivity Market Review – Annex 26, para A26.28

[9] Ofwat (2015), Financeability and financing the asset base – a discussion paper, para 95