



# Directions for Regulatory Financial Reporting

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Consultation

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## About this document

This consultation document sets out how we propose to update BT's Regulatory Financial Reporting requirements following the decisions set out in our statements on BT's Regulatory Financial Reporting (published on 20 May 2014) and the Fixed Access and Wholesale Broadband market reviews (both published on 26 June 2014).

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## Section 1

# Summary

- 1.1 On 20 May 2014, we published a statement setting out our policy conclusions in relation to changes to BT's Regulatory Financial Reporting (the "2014 Statement").<sup>1</sup> These decisions were implemented in the Fixed Access market review,<sup>2</sup> (the "Fixed Access Statement") published on 26 June 2014 and the Wholesale Broadband Access ("WBA") market review,<sup>3</sup> (the "WBA Statement") published on 26 June 2014.
- 1.2 In the 2014 Statement, we set out how BT's Regulatory Financial Reporting framework needs to change. One of the changes was to seek to achieve greater consistency between BT's Regulatory Financial Statements and our regulatory decisions. We also said that we would direct BT as to the specific adjustments to be made to achieve that. This document sets out proposals in relation to such adjustments to reflect our regulatory decisions in the Fixed Access and WBA market reviews in BT's Regulatory Financial Statements.
- 1.3 We also explained that we would require some additional disclosure regarding BT's financial performance from a regulatory perspective. This document sets out proposals for such additional disclosure, both in relation to the form of such reports, as the specific adjustments to be made to BT's financial data to inform the report.
- 1.4 Further, in the Fixed Access Statement, we imposed cost accounting and accounting separation obligations in the Wholesale Local Access ("WLA") market which apply to virtual unbundled local access ("VULA") and the charge on a usage per kWh basis for electricity which BT charges CPs for providing power for equipment used in connection with Local Loop Unbundling Services ("the electricity charge"). This document sets out the information that we propose BT should provide in relation to these costs.

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<sup>1</sup> Regulatory Financial Reporting: Final Statement. 20 May 2014.

[http://stakeholders.ofcom.org.uk/consultations/bt-transparency/statement?utm\\_source=updates&utm\\_medium=email&utm\\_campaign=famr-draft-statement-and-related](http://stakeholders.ofcom.org.uk/consultations/bt-transparency/statement?utm_source=updates&utm_medium=email&utm_campaign=famr-draft-statement-and-related)

<sup>2</sup> Fixed access market reviews: wholesale local access, wholesale fixed analogue exchange lines, ISDN2 and ISDN30. Statement on market definition, market power determinations and remedies. 26 June 2014. <http://stakeholders.ofcom.org.uk/telecoms/ga-scheme/specific-conditions-entitlement/market-power/fixed-access-market-reviews-2014/statement/summary/>

<sup>3</sup> Review of the wholesale broadband access markets. Statement on market definition, market power determinations and remedies. 26 June 2014 <http://stakeholders.ofcom.org.uk/consultations/review-wba-markets/statement/>

## Section 2

# Introduction

## Background

- 2.1 The 2014 Statement followed a call for inputs of November 2011, a consultation in September 2012 and a further consultation in December 2013 (the “2013 Consultation”).<sup>4</sup>
- 2.2 Our policy decisions set out in the 2014 Statement were implemented in the Fixed Access Statement and the WBA Statement.

## Proposals considered in this document

### Proposals to give effect to the 2014 Statement

- 2.3 The 2014 Statement sets out the changes we decided to make to BT’s Regulatory Financial Reporting requirements. We explained that these changes will give Ofcom a greater role in the way that BT prepares its Regulatory Financial Statements, improve the presentation of the Regulatory Financial Statements and supporting documentation and ensure that Ofcom and other stakeholders have the information that they need.
- 2.4 An important aspect of the changes that we made was to introduce a requirement to comply with new Regulatory Accounting Principles. We consulted on a draft direction setting out these Regulatory Accounting Principles in the 2013 Consultation and we will issue such direction in early 2015 alongside the directions on which we are consulting in this document. These new principles include a requirement for consistency with regulatory decisions.
- 2.5 We considered that this meant that information should be, as far as possible, consistent with the basis of our regulatory decisions. However, we explained that we did not consider it appropriate to require BT to model the impact of all recent price adjustments.
- 2.6 We explained that we would also establish Regulatory Accounting Guidelines to provide high level guidelines and accounting rules together with the detail necessary to enable BT to comply with the consistency with regulatory decisions principle. We also explained that the Regulatory Accounting Guidelines will not be in place until we have concluded a review of BT’s cost allocation bases. As BT will be required from 2015 onwards to ensure that its Regulatory Financial Statements comply with the Regulatory Accounting Principles, we acknowledged that, until the Regulatory Accounting Guidelines are in place, BT would require further guidance on a number of points which will ultimately be included in the Regulatory Accounting Guidelines. This included, in particular, reporting requirements arising from regulatory decisions, specifically in relation to consistency with our decisions in the Fixed Access and the WBA market reviews and guidance around the preparation of the Regulatory Financial Statements on a Regulatory Asset Value (“RAV”) basis.

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<sup>4</sup> Regulatory Financial Reporting: A review. 20 December 2013.  
<http://stakeholders.ofcom.org.uk/consultations/bt-transparency/>

- 2.7 In Section 4 of this document we set out for consultation the proposed guidance on the reporting requirements necessary to comply with the consistency with regulatory decisions principle.
- 2.8 We also explained that we considered that users of the Published Regulatory Financial Statements should be able to gain a reasonable understanding of the impact of regulation on BT and its ability to recover costs. We noted that we do not regulate the returns that BT can make but explained that stakeholders should be able to interpret the returns that BT does make, in part to inform their view on what this might mean if and when we need to make further regulatory decisions. We explained that more consultation was required before determining the appropriate form and content of the additional disclosure and therefore explained that we would put forward proposals about the information that we consider the Regulatory Financial Statements should provide and how it will be implemented later in the year.
- 2.9 Sections 3 and 4 of this document set out our proposals for this additional reporting.

### **Proposals to give effect to the Fixed Access Statement**

- 2.10 In the Fixed Access Statement, we imposed cost accounting obligations on BT in the WLA market, which cover, amongst others:
- VULA; and
  - the electricity charge.
- 2.11 We set out in Sections 5 and 6 of this document our proposals concerning additional reporting requirements in relation to both information to be included in the Published Regulatory Financial Statements and information to be provided to us in private as an AFI.
- 2.12 We imposed cost accounting obligations on BT in the WBA market review but no additional reporting (over and above that which is in place already) is required.

### **Proposals and decisions set out in other documents related to regulatory financial reporting but not further considered here**

- 2.13 We published the 2014 Statement alongside the Fixed Access and WBA market review draft decisions. Final decisions in those market reviews were adopted and published later in the summer of 2014.
- 2.14 We explained in the 2014 Statement that with two exceptions, our decisions implemented in the SMP conditions would take effect from 1 August 2014, for the financial year 2014/15 to be reported in July 2015.<sup>5</sup>
- 2.15 We also explained in the 2014 Statement that some of our decisions would be implemented by way of directions which would come into effect for the financial year 2014/15. We said that we may also consult on certain required directions where we have not already done so.

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<sup>5</sup> The first exception concerned the requirement for the Regulatory Financial Statements to be signed by a Director for and on behalf of BT's Board of Directors. The second exception concerned the requirement for BT to publish a reconciliation report. Those requirements have taken effect on 1 July 2014.

- 2.16 As already noted, we considered that further consultation was required to determine the adjustments required to BT's Regulatory Financial Statements to ensure that they are consistent with our regulatory decisions in the Fixed Access and WBA market reviews, and to determine the appropriate form and content of the additional disclosure of information on BT's financial performance.
- 2.17 Further, in the 2013 Consultation we consulted on directions to implement proposals relating to:
- the Regulatory Accounting Principles;<sup>6</sup>
  - transparency requirements;<sup>7</sup>
  - the form of the FPIA opinion;<sup>8</sup> and
  - the form of the PPIA opinion.<sup>9</sup>
- 2.18 In addition, we consulted in the 2013 Consultation on the proposals, which we proposed to implement by amending existing directions:
- reporting of Equivalence of Input ("EOI") costs;<sup>10</sup>
  - non-confidential compliance reports for Fixed Access, ISDN and WBA markets from 2014/15;<sup>11</sup> and
  - the form of basket reporting for Fixed Access, ISDN and WBA markets from 2014/15.<sup>12</sup>
- 2.19 We also made proposals concerning the following:
- the preparation of the Regulatory Financial Statements on a RAV basis;<sup>13</sup>
  - the requirement to publish a reconciliation report with an accompanying audit opinion;<sup>14</sup> and
  - the appropriate materiality thresholds for change control and errors.<sup>15</sup>

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<sup>6</sup> 2013 Consultation, paragraphs 5.6 – 5.19 and Proposal for direction – Regulatory Accounting Principles (Annex 7).

<sup>7</sup> 2013 Consultation, paragraphs 6.28 – 6.41 and Proposal for direction – Transparency (Annex 8).

<sup>8</sup> 2013 Consultation, paragraphs 6.28 – 6.41 and Proposal for direction – Form of the FPIA opinion for Regulatory Financial Statements (Annex 11).

<sup>9</sup> 2013 Consultation, paragraphs 6.28 – 6.41 and Proposal for direction – Form of the PPIA opinion for Regulatory Financial Statements (Annex 12).

<sup>10</sup> 2013 Consultation, paragraphs 6.12 – 6.15, 6.25 – 6.27 and Proposal for modification to Direction 4 and the FA10 Form and content Direction (BT) (Annex 10).

<sup>11</sup> 2013 Consultation, paragraphs 6.20 – 6.23, 6.25 – 6.27.

Proposal for modification to Direction 3 and the FA10 Preparation, audit and delivery Direction (BT) (Annex 9).

<sup>12</sup> 2013 Consultation, paragraphs 6.42 – 6.54.

Proposal for modification to Direction 4 and the FA10 Form and content Direction (BT) (Annex 10)

<sup>13</sup> 2013 Consultation, paragraphs 5.33 – 5.41.

<sup>14</sup> 2013 Consultation, paragraphs 6.16 – 6.19.

- 2.20 We decided in the 2014 Statement to adopt the proposals described above but said that relevant directions would be published at a later date. With regard to the proposals referred to above we decided that for reasons of clarity these directions (with the modifications proposed in the 2013 Consultation) would be issued afresh under the new SMP conditions.<sup>16</sup> In relation to the proposals referred to above, we said that the detailed requirements concerning these decisions will be specified in a direction.
- 2.21 The requirement to produce the Regulatory Financial Statements on a RAV basis was implemented in the SMP Conditions. The methodology to determine the RAV adjustment has been consistently applied since our statement “The Valuing copper access final statement”<sup>17</sup> across markets, and hence we do not consider it necessary to consult on such methodology.
- 2.22 We will issue the necessary directions giving effect to our policy decisions in early 2015 alongside our decisions on the matters on which we are consulting in this document.

## Implementation of our decisions

- 2.23 We explained in the 2014 Statement that the new regulatory reporting SMP conditions would formally apply only to the Fixed Access and WBA markets, but that to preserve the integrity and consistency of BT’s Regulatory Financial Reporting, the changes should be implemented across all regulated markets (including markets considered as part of the Business Connectivity and Narrowband market reviews). We said that there are significant advantages to BT and other stakeholders of BT applying one set of accounting rules across all markets.
- 2.24 We also said that we would work with BT to ensure that, as far as possible, our decisions could be applied on a consistent basis to all markets.

## Legal Tests

### Sections 3, 4, 4A and 49(2)

- 2.25 The proposals we are making in this document either give effect to the SMP conditions which were imposed in the Fixed Access and WBA market reviews or implement the outcomes of these market reviews. We summarise below our duties under sections 3, 4 and 4A and the tests set out in section 49(2) of the Act. We discuss how our proposals meet these duties and tests where we discuss our proposals in detail.
- 2.26 Section 3 of the Act sets out Ofcom’s duties in carrying out its functions, in particular that it furthers the interests of citizens in relation to communications matters and furthers the interests of consumers in relevant markets, where appropriate by promoting competition.
- 2.27 Section 4 of the Act requires that Ofcom acts in accordance with the six Community requirements concerning: the promotion of competition; the development of the

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<sup>15</sup> 2013 Consultation, paragraphs 5.71 – 5.89.

<sup>16</sup> 2014 Statement, paragraph 7.14.

<sup>17</sup> Valuing copper access: Final Statement. 18 August 2005.

<http://stakeholders.ofcom.org.uk/binaries/consultations/copper/statement/statement.pdf>



European internal market; the promotion of the interests of all EU citizens; non-discrimination; encouraging the provision of network access and service interoperability for the purpose of securing efficiency and sustainable competition, efficient investment and innovation and the maximum benefit for consumers; and facilitating service interoperability and securing freedom of choice for consumers.

- 2.28 Section 4A of the Act requires Ofcom to take into account all applicable recommendations issued by the European Commission under Article 19(1) of the Framework Directive.<sup>18</sup> In proposing the changes described in the sections below, we have taken into account all applicable recommendations issued by the European Commission under Article 19(1) of the Framework Directive, in particular Commission Recommendation of 19 September 2005 on accounting separation and cost accounting systems under the regulatory framework for electronic communications.<sup>19</sup>
- 2.29 Ofcom can give a direction that gives effect to an SMP obligation under section 49 of the Act but only where it is satisfied that the tests under section 49(2) have been met. The tests are that the modification of the direction is:
- objectively justifiable in relation to the networks, services, facilities, apparatus or directories to which it relates;
  - not unduly discriminatory against particular persons or against a particular description of persons;
  - proportionate to what it is intended to achieve; and
  - transparent in relation to what it is intended to achieve.

## **Sections 49A and 49B**

- 2.30 Sections 49A and 49B set out the relevant procedures that must be followed for domestic and EU consultations respectively on proposals to give directions. Section 49A applies where the proposals are for the purposes of:
- an SMP apparatus condition; or
  - any other condition set under section 45 where what is proposed would, in Ofcom's opinion, have a significant impact on a market for any of the services, facilities, apparatus or directories in relation to which Ofcom has functions under Chapter 1 of Part 2 of the Act.
- 2.31 Section 49B applies where the proposals are of EU significance. Section 150A(2) sets out the cumulative criteria that must be satisfied in order for a proposal to be of EU significance.

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<sup>18</sup> Directive 2002/21/EC of the European Parliament and of the Council of 7 March 2002 on a common framework for electronic communications and services (OJ L 108 24.04.2002, p33), as amended.

<sup>19</sup> OJ L 266 11.10.2005, p64. This recommends, amongst other things, that "a national regulatory authority, when assessing the features and specifications of the cost accounting system, reviews the capability of the notified operator's cost accounting system to analyse and present cost data in a way that supports regulatory objectives", and that "national regulatory authorities make relevant accounting information from notified operators available to interested parties at a sufficient level of detail" (see paragraphs 3 and 5 respectively).

- 2.32 Section 49A(1)(a) does not apply because Ofcom is not proposing to give directions for the purposes of an SMP apparatus condition. With regard to section 49A(1)(b), we do not consider it is necessary to decide whether this is applicable. This is because in any case we think that it is important to give stakeholders an opportunity to consider and comment on our proposals. Therefore, in line with our approach to giving proposed directions in the 2013 Consultation, we are formally consulting on our proposals and have sent a copy of this consultation and accompanying proposed directions to the Secretary of State in accordance with section 49(C)(1)(a).
- 2.33 We consider that section 49B does not apply because our consultation proposals are not of EU significance, as defined under section 150A(2), in particular because in our opinion, given the nature and limited extent of the proposals on which we are consulting and on the basis of the analysis and impact assessment set out in this consultation, these proposals would not affect trade between Member States.<sup>20</sup>

## Our proposals do not affect KCOM

- 2.34 We explained in the 2014 Statement that the policy decisions which we made in that statement related to the Regulatory Financial Reporting arrangements for BT. We said that in due course we would consider whether any of the changes might be appropriate to apply to KCOM.
- 2.35 As our proposals concern the implementation of the decisions in the 2014 Statement and are proposed under the new SMP conditions which have been imposed on BT in the Fixed Access Statement and the WBA Statement, our proposals will not affect KCOM.
- 2.36 In relation to our proposals about reporting of the VULA services and the electricity charge, they will also not affect KCOM.

## Terminology

- 2.37 In this document, we use the same terminology used in the 2014 Statement, as follows:
- **Regulatory Financial Statements** describes the annual regulatory financial statements, prepared according to a defined framework and methodology. We use the term in this document to refer to both the published and unpublished statements. The unpublished financial statements are submitted to us confidentially.
  - **Regulatory Financial Reporting** refers to the whole of the regulatory reporting methodology, systems and legal framework, as well as the Regulatory Financial Statements.
  - **Published Regulatory Financial Statements** refers only to the subset of the Regulatory Financial Statements that is published by BT

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<sup>20</sup> The cumulative criteria that must be satisfied in order for a proposal to be of EU significance include the criterion that the proposal would, in Ofcom's opinion, affect trade between Member States(see section 150A(2)(d)).

## Impact assessment and EIA framework

### Impact assessment

- 2.38 The analysis presented in this document constitutes an impact assessment as defined in Section 7 of the Communications Act 2003 (“the Act”).
- 2.39 Impact assessments provide a valuable way of assessing different options for regulation and showing why the preferred option was chosen. They form part of best practice policy-making. This is reflected in Section 7 of the Act, which means that generally we have to carry out impact assessments where our proposals would be likely to have a significant effect on businesses or the general public, or when there is a major change in our activities. However, as a matter of policy we are committed to carrying out impact assessments in relation to the great majority of our policy decisions. For further information about our approach to impact assessments, see the guidelines, “Better policy-making: Ofcom's approach to impact assessment”, which are on our website.

### Equality Impact Assessment

- 2.40 We are separately required by statute to assess the potential impact of all our functions, policies, projects and practices on race, disability and gender equality. EIAs also assist us in making sure that we are meeting our principal duty of furthering the interests of citizens and consumers regardless of their background or identity.
- 2.41 It is not apparent to us that the proposals that we set out in this document are likely to have any particular impact on race, disability and gender equality. Specifically, we do not envisage the impact of any outcome to be to the detriment of any group of society. Nor are we envisaging any need to carry out separate EIAs in relation to race or gender equality or equality schemes under the Northern Ireland and Disability Equality Schemes. This is because we anticipate that our regulatory intervention will not have a differential impact in relation to people of different gender or ethnicity, on consumers in Northern Ireland or on disabled consumers compared to consumers in general. Similarly, we do not consider that our proposals will have a particular impact on consumers in different parts of the United Kingdom or on consumers with low incomes.

## Structure of this document

- 2.42 In **Section 3**, we
- explain why some adjustments required in regulatory decisions should not be included in the Regulatory Financial Statements despite the principle of consistency with regulatory decisions. We explain why some adjustments should instead be included in new schedules that will give stakeholders a better understanding of BT's financial performance from a regulatory perspective; and
  - set out our proposals for the format of the additional reporting intended to give stakeholders a better understanding of BT's financial performance from a regulatory perspective.
- 2.43 In **Section 4**, we identify the adjustments that result from regulatory decisions in the Fixed Access and WBA market reviews, and consider if and how they should be reflected in BT's Regulatory Financial Reporting. Specifically, we:

- identify the decisions that we propose should be reflected in BT's Regulatory Financial Statements so they comply with the requirement for consistency with regulatory decisions;
  - where we propose that decisions should be reflected in BT's Regulatory Financial Statements, explain how we propose that should be done; and
  - where we propose that decisions should not be reflected in BT's Regulatory Financial Statements, consider whether the potential impact of those decisions on BT's reported costs should be included in the additional reporting on BT's financial performance from a regulatory perspective, and how we propose that should be done.
- 2.44 In **Section 5**, we set out our proposals about the further reporting that we required in the Fixed Access Statement for VULA.
- 2.45 In **Section 6**, we set out our proposals about the further reporting that we required in the Fixed Access Statement for BT's charging for electricity.

## What happens next?

- 2.46 Responses to this consultation are due by 26 January 2015.
- 2.47 We expect to publish a statement in early 2015 in which we will consider and respond to stakeholders' views on our proposals set out in this consultation. We will also issue in that statement directions setting out those requirements either which have already been subject to consultation or which do not require consultation. In addition, we will issue afresh in this statement directions setting out requirements which are currently included in Directions 1, 3 and 4.<sup>21</sup>
- 2.48 We note that, since 2004, we have each year published a consultation and statement setting out changes to enhance the presentation and improve the quality of BT's Regulatory Financial Statements reflecting developments over the previous 12 months. Following the 2014 Statement and this consultation, we will not publish a separate update this year.

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<sup>21</sup> Directions 1, 3 and 4 set out a list of network components; requirements for the preparation, audit and delivery of the Regulatory Financial Statements; and the form and content of the Regulatory Financial Statements and give effect to the SMP conditions set out in the Statement of 22 July 2004 "The regulatory financial reporting obligations on BT and Kingston Communications, final statement and notification"

## Section 3

# The need for consistency and additional reporting

## Introduction

- 3.1 In the 2014 Statement we introduced a new requirement for BT to comply with Regulatory Reporting Principles, which would include a requirement that BT's Regulatory Financial Reporting should be consistent with the regulatory decisions as defined in the Regulatory Accounting Guidelines.<sup>22</sup>
- 3.2 In this section we explain why some adjustments required in regulatory decisions should not be included in the Regulatory Financial Statements despite the principle of consistency with regulatory decisions. We explain why some adjustments should instead be included in new schedules that will give stakeholders a better understanding of BT's financial performance from a regulatory perspective.
- 3.3 We also set out our proposals on the format of the new schedule about BT's financial performance to be published as part of BT's Regulatory Financial Statements and for a more detailed schedule to be provided to us in private.
- 3.4 Our proposals about the adjustments that should be included in these new schedules are set out in Section 4.

## Background

- 3.5 As set out in Section 2, we consider that BT's Regulatory Financial Reporting should, as far as possible be consistent with our regulatory decisions and we are consulting in this document on the specific reporting requirements arising from regulatory decisions, specifically in relation to consistency with our decisions in the Fixed Access and WBA market reviews.<sup>23</sup> We consider that such consistency will, amongst others, help improve stakeholders' understanding of the impact of regulation on BT and the returns BT makes.

## Defining the requirement for consistency

- 3.6 As previously explained we do not consider that the requirement for consistency means that all regulatory decisions should be reflected in the Regulatory Financial Statements. For example, we explained in the 2012 Consultation that,

“It will not be appropriate to require consistency in all circumstances. For example, some charge controls have been set to reflect the costs of a “hypothetical ongoing network” rather than the costs of the network BT actually operates.”<sup>24</sup>

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<sup>22</sup> 2014 Statement, annex 3.

<sup>23</sup> 2014 Statement, paragraph 3.37.

<sup>24</sup> 2012 Consultation, paragraph 5.59. <http://stakeholders.ofcom.org.uk/consultations/regulatory-financial-reporting/summary>

3.7 We subsequently explained in the 2013 Consultation that,

“When we set prices, we may include adjustments to cost calculations that do not strictly reflect BT’s costs (for reasons that we disclose and consult upon). For example, we have in the past:

- Restated asset values to bring them into line with our view of a “steady state” valuation (for example, in setting prices for ISDN30);
- Calculated prices using a bottom up cost model (for example, in setting prices for Narrowband);
- Set prices that recover costs from one service through the price of another (for example, costs relating to some transfers have been recovered through rental charges); and
- Excluded some costs from the costs to be recovered through regulated prices (for example in setting the prices for LLU rentals).

We have considered if and how it may be appropriate for BT to reflect these adjustments in its Regulatory Financial Statements.

We consider that attempting to model the impact of recent price adjustments such as steady state valuation adjustments and how they might uplift costs in later years, would require BT to make difficult judgements about how it thinks we deal with these costs on an ongoing basis.

Therefore with the exception of items that should be explicitly excluded from the costs used by us to inform prices and which we consider should instead be allocated to residual activities, we do not propose to require BT to attempt to reflect the effect of price adjustments in the Regulatory Financial Statements.<sup>25</sup>

3.8 The identification of regulatory decisions that should or should not be reflected within Regulatory Financial Reporting to achieve consistency is a matter for our judgement and will be considered on a case by case basis. It is for this reason that Regulatory Accounting Principle 4 - Consistency with regulatory decisions is defined by reference to decisions as set out in the Regulatory Accounting Guidelines rather than a more general requirement for consistency.<sup>26</sup> We will make clear in the Regulatory Accounting Guidelines those adjustments which BT must make to ensure consistency.

3.9 In general terms, we would expect regulatory decisions to be reflected in the Regulatory Financial Statements unless we consider that there were good reasons not to.

<sup>25</sup> 2013 Consultation, paragraphs 5.44-5.48.

<sup>26</sup> 2014 Statement, Annex 3. Regulatory Accounting Principles.

- 3.10 In Section 4, we summarise the key regulatory decisions that we made in the Fixed Access and WBA market reviews and consider whether and how they should be reflected in the Regulatory Financial Statements.

## The need for additional reporting

- 3.11 In the 2013 Consultation, we noted that not reflecting all decisions in the Regulatory Financial Statements could mean that

“...differences may remain between the reported view of BT’s financial performance and the way we might interpret the data in the context of regulatory decisions. We have explained [in Section 3] that we do not regulate the returns that BT can make but we consider that stakeholders should be able to interpret the returns that BT does make, in part to inform their view on what this might mean if and when we need to make further regulatory decisions. As explained [in Section 4], there remains a risk that stakeholders may still not understand or potentially misinterpret the reported returns.”<sup>27</sup>

- 3.12 We therefore invited views from stakeholders on if and how stakeholders can be given a better understanding of BT’s financial performance from a regulatory perspective. As we explained in the 2014 Statement, stakeholders other than BT broadly agreed with our proposal for this additional reporting. Hence the need to provide stakeholders with additional information about the impact of regulatory decisions that we have made but which are not reflected in the Regulatory Financial Statements remains.
- 3.13 To this end, we propose that BT must produce and publish a new schedule and provide additional information to us in private. (“the Adjusted Financial Performance Schedules”) as part of its Regulatory Financial Reporting. Those schedules will take the reported financial performance (specifically, Returns, MCE and ROCE) as set out in the Regulatory Financial Statements and show the impact on the reported results of making further regulatory adjustments.
- 3.14 In Section 4, we set out the proposed requirements which will allow BT to calculate the impact of adjustments in order to prepare the two schedules. Going forward, the guidance that BT will need in order to prepare the schedules will be set out as part of the relevant decision document (such as a market review) and in the Regulatory Accounting Guidelines once in place.
- 3.15 We propose to require BT to produce the two schedules from 2014/15 onwards. BT will be required to prepare such schedules for all markets which are subject to Regulatory Financial Reporting requirements. However, we expect that, until the conclusion of the Business Connectivity and Narrowband market reviews and charge controls in 2016/17, the adjustments will primarily be shown in markets considered as part of the Fixed Access and WBA market reviews. This is because we have at present only considered adjustments which flow from those market reviews.
- 3.16 We propose that one of the schedules must be published as part of the Regulatory Financial Statements. The other schedule will be confidential and provided to us in private. The schedules to be produced are as follows:

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<sup>27</sup> 2013 Consultation, paragraph 6.10.

- Schedule 1. “Adjusted Financial Performance at a market review level” will be published as part of the Regulatory Financial Statements. A proposed proforma is set out in Annex 6.
- Schedule 2. “Adjusted Financial Performance at a market level” will be provided to Ofcom on a confidential basis. In simple terms this is a more detailed version of Schedule 1.

### **Schedule 1. Adjusted Financial Performance at a market review level.**

3.17 We propose that Schedule 1 will set out BT’s estimate of the impact of some adjustments we do not think should be reflected in its Regulatory Financial Statements if they would impact on returns at a market review level. Under the European common regulatory framework for electronic communications, Ofcom is required to carry out periodic reviews of electronic communications markets in the United Kingdom. In carrying out these reviews Ofcom considers the level of competition and, consequently, the regulation that should apply. In order to carry out these reviews we group together communications markets in a set of market reviews. This schedule will be required from 2014/15 onwards.

3.18 Our proposal for the form of Schedule 1 is set out in Annex 6.

### **Schedule 2. Adjusted Financial Performance at a market level**

3.19 We proposed that Schedule 2 is provided to us as a confidential report. Its purpose is to provide the information we need in order to understand the way in which BT has prepared Schedule 1.

3.20 Schedule 2 will set out the impacts at market level of those adjustments arising from regulatory decisions that should not be reflected in BT’s Regulatory Financial Statements.<sup>28</sup>

3.21 This more detailed information will allow us to understand BT’s view of the individual impacts of market level adjustments which we made during market reviews and setting of charge controls. This schedule will also help us understand BT’s view of the aggregate impact of all of the adjustments on returns at a market review level.

## **Summary of proposals and legal tests**

3.22 In summary we propose to make a direction that requires BT to produce two Adjusted Financial Performance Schedules:

- Schedule 1, must be produced by BT and published annually by 31 July as part of the Regulatory Financial Statements.
- Schedule 2, must be provided to us annually as a confidential report.

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<sup>28</sup> Each market review level is composed of individual SMP markets. The market review levels and the component SMP markets for which BT has Regulatory Financial Reporting requirements are set out in Section 1 of BT’s Regulatory Financial Statements.

<http://www.btplc.com/Thegroup/RegulatoryandPublicaffairs/Financialstatements/index.htm>



- 3.23 We have considered our proposals to require that BT produces two new Adjusted Financial Performance Schedules against the tests set out in section 49(2) of the Act and have concluded that they are:
- Objectively justifiable because it provides stakeholders with a better understanding of BT's financial performance from a regulatory perspective.
  - Not unduly discriminatory because KCOM is the only other SMP provider which has regulatory accounting obligations, but we have not at present established the need for KCOM to provide such additional financial reporting.
  - Proportionate because our proposals are no more than is required to ensure that stakeholders are able to gain a better understanding of BT's financial performance from a regulatory perspective.
  - Transparent because it is clear that the intention of our changes is to ensure that stakeholders are able to gain a better understanding of BT's financial performance from a regulatory perspective.
- 3.24 We have also considered our proposals concerning BT's additional reporting against the tests set out in sections 3, 4 and 4A of the Act. Our proposals are designed to give stakeholders a better understanding of BT's financial performance from a regulatory perspective. The proposals thereby seek to ensure that the Regulatory Financial Statements remain relevant, thereby increasing transparency. Ultimately, this promotes competition. As noted above, in proposing these changes we have taken into account all applicable recommendations issued by the European Commission under Article 19(1) of the Framework Directive, in particular Commission Recommendation of 19 September 2005 on accounting separation and cost accounting systems under the regulatory framework for electronic communications.
- 3.25 In consequence Ofcom believes the proposed directions meet the tests in Sections 3, 4 and 4A.

## Consultation Question

*3.1 Do you agree with our proposals to give stakeholders a better understanding of BT's financial performance?*

## Section 4

# Consistency with regulatory decisions

## Introduction

- 4.1 In this section we summarise the main adjustments we have made to BT's reported financial data in the Fixed Access and WBA market reviews and consider if and how they should be reflected in BT's Regulatory Financial Reporting. Specifically, we:
- identify the decisions that we propose should be reflected in BT's Regulatory Financial Statements;
  - for those adjustments that should be included in BT's Regulatory Financial Statements, we propose how this should be done; and
  - for those adjustments that we propose should not be reflected in BT's Regulatory Financial Statements, we explain if and how we propose they should be reflected in the Adjusted Financial Performance Schedules.
- 4.2 BT will be required to prepare its 2014/15 Regulatory Financial Statements in line with the requirements that we will direct having considered responses to this consultation.

## Change in terminology

- 4.3 In the 2013 Consultation and 2014 Statement we used the terms "cost adjustments" and "pricing adjustments" when considering which adjustments should and which should not be reflected in the Regulatory Financial Statements.
- 4.4 We explained that there were the following three broad areas where the need for consistency might apply:
- the reporting convention, for example whether the Regulatory Financial Statements should adopt the Regulatory Asset Value ("RAV");
  - the basis of calculation, for example, whether the Regulatory Financial Statements should follow the same allocation rules as those reflected in our recent decisions; and/or
  - pricing adjustments relating to the way we consider costs should be recovered (or not recovered) for policy reasons, rather than preferred basis for calculating or allocating those costs.
- 4.5 We explained that the requirement for consistency should relate only to the first two of the three categories. We explained that the Regulatory Financial Statements should not reflect the third category, the so-called pricing adjustments.
- 4.6 Since publication of the 2014 Statement, BT has suggested that the terms "cost adjustments" and "pricing adjustments" may be unhelpful and the distinction between cost and pricing adjustments was not always clear. We have therefore decided not to use these terms in this consultation. Instead, we will refer to the adjustments that are to be reflected in the Regulatory Financial Statements and those that are not.

## Background

- 4.7 To inform our decisions on charge controls in the Fixed Access and WBA market reviews, we made various adjustments to the cost information reported in BT's most recent Regulatory Financial Statements.

### Decisions in the Fixed Access market review

- 4.8 The basis of preparation of the cost information we used to inform our price controls in the Fixed Access markets, differed from the basis of preparation of the 2012/13 Regulatory Financial Statements in the following key respects:

4.8.1 Asset values were calculated on the RAV basis, rather than the CCA basis used in the 2012/13 Regulatory Financial Statements. We have already explained that we decided in the 2014 Statement that Regulatory Financial Reporting should be on a RAV basis and do not, therefore, discuss the requirement for this adjustment further;

4.8.2 Costs were based on 2011/12 data, including 2011/12 allocation rules and asset valuation methodologies, rather than 2012/13 data, rules and methodologies; and

4.8.3 Specific adjustments were considered in respect of:

- a) Internal SMPF volumes;
- b) Telephone Directories;
- c) DSLAM capital /maintenance;
- d) Group overheads;
- e) Deafness provision;
- f) Cumulo rates;
- g) Test Access Matrix Costs;
- h) Evolutionary Test Access Matrix Costs;
- i) Simultaneously provided services;
- j) Combined fault and service level allocations;
- k) Test Access Matrix Mark Up;
- l) Line cards;
- m) LRIC differential;
- n) Caller Display;
- o) Migrations and WLR Transfers;
- p) LRIC adjustments and recovery of common cost;

- q) SMPF;
- r) Absolute valuation of Copper;
- s) ISDN30 pricing; and
- t) ISDN2 pricing.

- 4.9 We propose that BT should apply the adjustments set out in paragraphs 4.8.3(a) – 4.8.3(q) in the order presented above because some of the adjustments, as we explain below, logically must follow others, whilst others have a cumulative effect on either the Regulatory Financial Statements or the Adjusted Financial Performance Schedules. To be consistent with our regulatory decisions, we therefore propose that BT must be required to apply the adjustments in the order in which they are set out in paragraph 4.8.3 above.
- 4.10 For the reasons set out below, we do not propose that the adjustments set out in paragraphs 4.8.2 and 4.8.3(r) – 4.8.3(t) should be reflected in either the Regulatory Financial Statements or the Adjusted Financial Performance Schedules.

### **Decisions in the WBA market review**

- 4.11 The basis of preparation of the cost information we used to inform our price controls in the WBA markets, differed from the basis of preparation of the 2012/13 Regulatory Financial Statements in the following key respects:
- 4.11.1 Costs were based on 2012/13 cost data, restated using the 2011/12 allocations. In line with our proposals in relation to the adjustments made in the Fixed Access market review, we do not propose that this adjustment should be reflected in either the Regulatory Financial Statements or the Adjusted Financial Performance Schedules.
- 4.11.2 Specific adjustments were made to BT's costs in respect of:
- a) SG&A Broadband, ATM customer interface 2Mbit/s, ATM customer interface 34Mbit/s, ATM customer interface >155Mbit/s, ATM network interface, ATM network switching and Inter ATM transmissions;
  - b) Allocation of IPStream costs between Market A and Market B;
  - c) Market A market size adjustment;
  - d) 21 CN costs and the future benefits principle;
  - e) Some asset values were based on an estimate of the hypothetical ongoing network, which differed from the CCA value in the Regulatory Financial Statements; and
  - f) a one off, non-recurring other CCA adjustment.
- 4.12 We propose that BT should apply the adjustments set out in paragraphs 4.11.2(a) – 4.11.2(f) in the order presented above because some of the adjustments, as we

explain below, logically must follow others, whilst others have a cumulative effect on either the Regulatory Financial Statements or the Adjusted Financial Performance Schedules. To be consistent with our regulatory decisions, we therefore propose that BT must be required to apply the adjustments in the order in which they are set out in paragraph 4.11.2 above.

## Proposals for adjustments

- 4.13 We explain these adjustments in more detail below and consider whether there are any reasons why they should not be reflected in BT's Regulatory Financial Statements. Where our proposal is that an adjustment should not be reflected in BT's Regulatory Financial Statements, we then consider if and how they should be reflected in the Adjusted Financial Performance Schedules.
- 4.14 Some of the adjustments we consider would, in the past, have been considered as changes to the presentation of the Regulatory Financial Statements, and looked at as part of the annual update setting out changes to enhance the presentation and quality of BT's Regulatory Financial Statements. As noted in Section 2, following our 2014 Statement we do not expect to publish separate annual updates each year. Instead, we expect to capture such adjustments in the course of making regulatory decisions as part of our market reviews.

## Adjustments made in the Fixed Access market review

### Consistency with the 2011/12 cost allocation bases

- 4.15 BT's most recent Regulatory Financial Statements are the starting point for the financial models that we use to forecast costs and prices in some of our market reviews. At the time of the Fixed Access and WBA market reviews this would have been the 2012/13 Regulatory Financial Statements. However, during 2012/13 BT made a series of changes to the allocation rules it used in the preparation of its Regulatory Financial Statements, as reflected in BT's "Report requested by Ofcom describing certain changes to the Accounting Documents for the year ended 31 March 2013 and illustrating the resulting differences to the Current Cost Financial Statements had those changes not applied" ("the 2013 Reconciliation Report"),<sup>29</sup> published in October 2013.
- 4.16 We explained in the Fixed Access Statement "that the suite of methodological changes made by BT in its 2012/13 RFS (and their effects) are potentially interdependent; and that the changes do not represent a balanced approach to the review of allocations."<sup>30</sup>
- 4.17 Our view was that "we would not be confident that applying and dis-applying methodological changes on an item-by-item basis would produce a sufficiently accurate or suitable assessment of BT's relevant costs that could properly be used as the basis for the charge controls. Such an analysis would create the possibility of material delays in the setting of the new charge controls."<sup>31</sup> We concluded that it

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<sup>29</sup> <https://www.btplc.com/Thegroup/RegulatoryandPublicaffairs/Financialstatements/2013/ReportrequestedbyOfcomfortheyearended31March2013.pdf>.

<sup>30</sup> Fixed Access Statement, Annexes, paragraphs A22.35.  
<http://stakeholders.ofcom.org.uk/binaries/telecoms/ga/fixed-access-market-reviews-2014/statement-june-2014/annexes.pdf>.

<sup>31</sup> Fixed Access Statement, Annexes, paragraph A22.37.

would not be appropriate to use the new cost allocations used by BT in its 2012/13 Regulatory Financial Statements for the purpose of the charge controls.<sup>32</sup>

- 4.18 For the Fixed Access market review we used the 2011/12 Regulatory Financial Statements as the base year for our cost modelling. For the WBA market review we used 2012/13 data restated using the 2011/12 allocations set out in the 2013 Reconciliation Report.

#### Should this be reflected in the Regulatory Financial Statements?

- 4.19 We consider that a requirement to prepare its 2014/15 Regulatory Financial Statements using the 2011/12 allocations bases would be unhelpful for Ofcom and for stakeholders.
- 4.20 We have already started our work on the Business Connectivity market review (BCMR) and our review of BT's cost allocation bases. The starting point for our review of cost allocation bases and for the BCMR is the cost allocations bases, as reflected in its 2013/14 Regulatory Financial Statements. The review of cost allocation bases will ultimately lead to us setting out requirements for BT's key cost allocation bases.
- 4.21 We consider that requiring BT to revert (from the current allocation bases) to the 2011/12 allocation bases for the 2014/15 and 2015/16 Regulatory Financial Statements before a possible switch to a new basis following the outcomes of our review of BT's cost allocation bases in 2016 would not be appropriate. It could lead to stakeholder confusion in general and during the ongoing BCMR and our next round of charge control decisions in particular. We understand that such a requirement would also present significant practical difficulties for BT.
- 4.22 For these reasons, we propose not to require BT to revert to the cost allocation bases used in the 2011/12 Regulatory Financial Statements for 2014/15 (and subsequent) Regulatory Financial Statements.
- 4.23 The absolute impacts of BT's changes in allocation bases from 2011/12 to 2012/13 are set out in the 2013 Reconciliation Report. Going forward, until our review of the bases of BT's cost allocations is completed and our Regulatory Accounting Guidelines are published in 2016 stakeholders will be able to use the reconciliation reports,<sup>33</sup> published alongside the Regulatory Financial Statements, to gain an understanding of the impact of the changes in allocation bases since 2011/12 for each reported year.

#### Should this be included in the in the additional reporting of BT's financial performance?

- 4.24 In light of our proposal not to require BT to revert to the 2011/12 allocation bases in its 2014/15 Regulatory Financial Statements, we have considered whether we should require BT to illustrate the effect of changes since 2011/12 in the Adjusted Financial Performance Schedules.

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<sup>32</sup> Fixed Access Statement, Annexes, paragraph A22.39.

<sup>33</sup> The 2013/14 Reconciliation Report was published on the 2<sup>nd</sup> October 2014.

<http://www.btplc.com/Thegroup/RegulatoryandPublicaffairs/Financialstatements/2014/ReportrequestedyOfcomfortheyearended31March2014.pdf>

- 4.25 Specifically, we considered whether it would be appropriate to require BT to illustrate the impact on reported returns of reverting back to the allocation rules in effect at the time when the most recent regulatory decisions were made. In the case of the Fixed Access markets for example, this might involve restating the returns reported in these markets in 2014/15 as if they had been calculated using the cost allocation bases in effect in 2011/12.
- 4.26 BT has said that would be unable to meet such a requirement. BT has explained that there has been a significant reorganisation of the divisional structure of BT since 2011/12, and a requirement for today's costs to be re-allocated as if the group still had the old structure would be difficult if not impossible. BT also noted in other respects that the requirement would mean that BT would have to allocate costs using data sources that are no longer maintained.
- 4.27 We therefore considered whether it would instead be possible to estimate the impact of the allocation changes and require BT to adjust the reported returns to reflect these estimates.
- 4.28 BT has argued that it would be impossible to generate reliable estimates of the impact of reverting to old allocation bases without maintaining and re-running the cost allocation system on the old basis. Maintaining and updating the cost allocation system on the old basis to provide us with the impact estimates would not be proportionate. We therefore considered whether there might be a simpler way to provide a high level understanding of the impact of changes in allocation rules. Specifically, we considered whether it would be helpful to include market-level data taken from previous annual reconciliation reports to approximate the effect of restating current year returns on the 2011/12 basis. We considered that such analysis may give an indication of the impact of allocation changes over recent years but would only ever provide a rough approximation of the impact of restating current year costs on the old allocation bases. We do not therefore consider that it would be appropriate to require BT to estimate and report the impact of these changes in the Adjusted Financial Performance Schedules.
- 4.29 In any case, given that this information is already publicly available in the reconciliation reports, it would be relatively straightforward for interested parties to assess the impact of recent allocation changes in this way, if they considered it informative to do so.
- 4.30 Therefore, we do not propose to require BT to estimate and report the impact of these changes in this way in the Adjusted Financial Performance Schedules.

### **Internal SMPF volumes<sup>34</sup>**

#### The market review decision

- 4.31 In the Fixed Access market review we set prices for Shared Metallic Path Facility (SMPF) Rentals, SMPF Migrations, SMPF New Provides and Tie Cables using the unit costs which we estimated from the external costs and volumes for SMPF as a proxy for all SMPF (internal and external).<sup>35</sup> As we noted in the Fixed Access market

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<sup>34</sup> Fixed Access Statement, Annexes, paragraphs A11.20 - A11.32.

<sup>35</sup> Fixed Access Statement, Annex 11, paragraph A11.27.

review “WLA services reported in the RFS, exclude internal costs and volumes (including equivalence of input (EOI) volumes).”<sup>36</sup> These SMPF internal costs and volumes are currently included in the Wholesale Residual market.

#### Should this be reflected in the Regulatory Financial Statements?

- 4.32 We consider that the reporting of internal SMPF costs and volumes in the WLA market will increase the transparency and understanding of BT’s Regulatory Financial Reporting and make the Regulatory Financial Statements consistent with our decision. As the majority of SMPF volumes are sold internally, the results in the WLA market as it is currently reported are different to that we modelled when we set the LLU WLR charge controls. As noted in Section 3, we consider that regulatory decisions should be reflected in the Regulatory Financial Statements unless there are good reasons not to. We do not consider that there are any such reasons in relation to this adjustment. Therefore we propose that the Regulatory Financial Statements should disclose the impact of SMPF internal costs and volumes.

#### How should this be reflected in the Regulatory Financial Statements?

- 4.33 We propose to direct BT to disclose the internal costs and volumes of SMPF Rentals, SMPF Migrations, SMPF Connections and Tie Cables within the WLA market.
- 4.34 We propose that BT must remove the internal costs and volumes for SMPF Rentals, SMPF Migrations, SMPF New Provides and Tie Cables from the Wholesale Residual market and include them within the WLA market in the Regulatory Financial Statements.

### **Telephone directories<sup>37</sup>**

#### The market review decision

- 4.35 BT provides printed telephone directories to almost all residential and business premises in the UK. An element of these costs is recovered from Analogue Core WLR Rentals (“WLR Rentals”). In the Fixed Access market review we decided that costs associated with telephone directories should not be recovered through the WLR wholesale charges. We therefore excluded these costs for WLR Rentals in our decision.

#### Should this be reflected in the Regulatory Financial Statements?

- 4.36 This adjustment excludes the cost of printed telephone directories from WLR Rentals. When we set the charge for WLR Rentals we excluded the telephone directories costs from our cost base. In line with our proposed approach set out in section 3, we do not consider that there are any reasons not to reflect the adjustment in the Regulatory Financial Statements. We therefore propose that the Regulatory Financial Statements must include this adjustment.

#### How should this be reflected in the Regulatory Financial Statements?

- 4.37 We propose that BT must allocate the cost of printed telephone directories to the Wholesale Residual market in its Regulatory Financial Statements.

<sup>36</sup> Fixed Access Statement, Annex 11, paragraph A11.20.

<sup>37</sup> Fixed Access Statement, Annexes, paragraphs A13.301 - A13.333



## Digital subscriber line access multiplexer (DSLAM) capital/ maintenance<sup>38</sup>

### The market review decision

- 4.38 In the Fixed Access market review we decided that “that 70% of the inappropriately named ‘DSLAM capital/maintenance’ cost actually related to special fault investigations (SFI) and the remaining 30% was related to broadband faults”.<sup>39</sup>
- 4.39 In addition we decided “to allocate the remaining 30% to the main rental services in accordance with the relative fault rates and service level differential”<sup>40</sup> which is reproduced in table 1.

Table 1. Allocation of fault rate and service level allocations

	WLR Rentals	MPF Rentals	SMPF Rentals
<b>Fault rate allocation</b>	0.83	1.00	0.17
<b>Service level allocation</b>	1.00	1.21	1.21
<b>Combined usage factor</b>	0.83	1.21	0.21

### Should this be reflected in the Regulatory Financial Statements?

- 4.40 The DSLAM capital maintenance cost within WLR Rentals, MPF Rentals and SMPF Rentals in our decision all changed as a result of this adjustment. In line with our proposed approach set out in section 3, we do not consider that there are any reasons why this adjustment should not be included in the Regulatory Financial Statements. Therefore we propose that the Regulatory Financial Statements must include this adjustment.

### How should this be reflected in the Regulatory Financial Statements?

- 4.41 We propose that BT must allocate 70% of total DSLAM capital/maintenance costs to SFIs, and the remaining 30% of DSLAM capital/maintenance costs must be allocated to WLR Rentals, MPF Rentals and SMPF Rentals using the combined usage factor set out in table 1 (reproduced from the Fixed Access market review).<sup>41</sup>

<sup>38</sup> Fixed Access Statement, Annexes, paragraphs A13.263- A13.278.

<sup>39</sup> Fixed Access Statement, Annexes, paragraph A13.266.

<sup>40</sup> Fixed Access Statement, Annexes, paragraph A13.278.

<sup>41</sup> Fixed Access Statement, Annex 13, paragraph A13.278.

## Group Overheads<sup>42</sup>

### The market review decision

4.42 Group overheads include costs such as ‘Strategy’, ‘Tax/Treasury’, and ‘Group Financial Control’ that sit within BT’s Group Functions. BT allocates these costs to services using various allocation rules. In the course of the Fixed Access market review we found that the allocation rules did not allocate the ‘Strategy’ ‘Tax/Treasury’, and ‘Group Finance Control’ subcategories of group overheads to overseas subsidiaries when it would have been reasonable to expect an element of the activity to be driven and consumed by overseas subsidiaries. We therefore estimated the proportion of the total ‘Group Functions’ cost (‘Strategy’ ‘Tax/Treasury’, and Group Finance Control’) that we considered it was reasonable to assume would be consumed by overseas subsidiaries and allocated those costs using the total average employees within the respective BT subsidiaries.<sup>43</sup>

### Should this be reflected in the Regulatory Financial Statements?

4.43 This adjustment reduced the cost of regulated services in the Fixed Access markets by £[£] by re-allocating some of the underlying group overheads costs away from the regulated services in the Fixed Access markets to the Wholesale and Retail Residual markets (where overseas subsidiaries are included). In line with our proposed approach set out in Section 3, we do not consider that there are any reasons why this adjustment should not be included in the Regulatory Financial Statements. We therefore propose that the Regulatory Financial Statements must include this adjustment.

### How should this be reflected in the Regulatory Financial Statements?

4.44 We propose that BT must allocate, in its Regulatory Financial Statements, the ‘Tax/Treasury’, ‘Group Finance Control’ and ‘Strategy’ subgroups of ‘Group Functions’ costs in proportion to the total average employees employed by each respective BT subsidiary.

## Deafness Provision<sup>44</sup>

### The market review decision

4.45 BT’s 2012/13 Regulatory Financial Statements included a “Specific Group Provision” relating to claims for deafness arising from the historical use of copper line testing equipment previously used by BT’s engineers. In the Fixed Access market review we decided that as BT could not provide an explicit efficiency justification for this provision and it did not therefore represent an efficiently incurred forward looking cost, this provision should not be allocated to regulated services within the Fixed Access market review for the purpose of the charge control.

### Should this be reflected in the Regulatory Financial Statements?

4.46 This adjustment reduced costs in the Fixed Access markets by £[£] by re-allocating the non-forward looking deafness provisions to the Wholesale Residual market. In

<sup>42</sup> Fixed Access Statement, Annex 13, paragraphs A13.64 - A13.72.

<sup>43</sup> Fixed Access Statement, Annex 13, paragraph A13.71.

<sup>44</sup> Fixed Access Statement, Annexes, paragraph A13.73 – A13.81.

order to make the reporting of the deafness provisions within regulated products in the Regulatory Financial Statements consistent with our decision, we propose that the deafness provision must only be allocated to the Wholesale Residual market within the Regulatory Financial Statements.

#### How should this be reflected in the Regulatory Financial Statements?

4.47 We propose that BT must only allocate its provision for deafness to the Wholesale Residual market.

### **Cumulo rates<sup>45</sup>**

#### The market review decision

4.48 Cumulo rates are the non-domestic (business) rates that BT pays on the rateable assets within its UK network. In the Fixed Access market review we reviewed BT's allocation of its Cumulo assets across regulated markets. We noted that BT allocated any incremental rates associated with NGA assets directly to NGA products and services.<sup>46</sup> For the charge control we concluded that, for non NGA related costs, we would adopt a variant of the Profit Weighted Net Replacement Costs (PWNRC) method with base-year allocations determined according to BT's Regulatory Financial Statements but with allocations determined by Ofcom.<sup>47</sup>

4.49 Under this method all net non-NGA costs, i.e. after rebates, were allocated in a consistent way with the profit weights being the relevant market regulatory costs of capital. We noted that the way BT allocated rebates led to an increasing proportion of non-NGA Cumulo costs being allocated to Openreach and in particular to MPF Rentals and WLR Rentals, and that the current allocation methods would lead to a discontinuity in the way Cumulo costs were allocated when there was a new rating list. We considered that the allocation method set out above results in allocations which are broadly stable over time.<sup>48</sup> We decided to embed Cumulo costs within the components costs in our cost model. Our cost model projected component costs including Cumulo costs using consistent assumptions about efficiency and other key parameters.<sup>49</sup>

#### Should this be reflected in the Regulatory Financial Statements?

4.50 This adjustment allocated the Cumulo rebate cost in line with the way Cumulo costs are allocated in respect of non-NGA assets. In line with our proposed approach set out in section 3, we do not consider that there are any reasons why this adjustment should not be included in the Regulatory Financial Statements. Therefore we propose that the Regulatory Financial Statements must include this adjustment.

#### How should this be reflected in the Regulatory Financial Statements?

4.51 We propose that all non NGA related Cumulo costs shall be assessed and allocated in the same way, i.e. all non NGA related costs should be allocated on the same

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<sup>45</sup> Fixed Access Statement, Annexes, paragraph A26.4 and A26.5.

<sup>46</sup> Fixed Access Statement, Annexes, paragraph A26.15.

<sup>47</sup> Fixed Access Statement, Annexes, paragraph A26.4 and A26.5.

<sup>48</sup> Fixed Access Statement, Annex 26, paragraph A26.3.

<sup>49</sup> Fixed Access Statement, Annex 26, paragraph A26.6.

profit weighted Net Replacement Cost basis.<sup>50</sup> The net replacement costs (NRCs) used should be those for the rateable assets in the relevant financial year. The profit weights should be the relevant weighted average cost of capital for each market. We propose that BT must reflect this treatment in its Regulatory Financial Statements.

- 4.52 Specifically, we propose that BT shall first attribute the NGA related Cumulo costs to the NGA network components. BT should then attribute the non NGA related Cumulo costs to the non NGA network components on the basis of profit weighted NRCs in accordance with the proposed formula which we set out in our proposal for direction at annex 5.

## **Test Access Matrix (TAMs) Costs<sup>51</sup>**

### The market review decision

- 4.53 TAMs equipment is installed on MPF lines to connect them to BT's line test equipment to enable line testing. The TAM is an integral part of the provision of MPF Rentals, but is not used by WLR Rentals or SMPF Rentals. Therefore, the use of MPF Rentals can be regarded as causing TAM costs. MPF Rentals is also the only service that is likely to benefit from the line capability of TAMs.<sup>52</sup>
- 4.54 In the Fixed Access market review we recalculated TAMs costs and made two adjustments in our decision:
- We extended the time period over which TAMs were depreciated from five years to seven years reflecting the asset life used in the Single Jumper MPF dispute.<sup>5354</sup>
  - We allocated TAMs costs to MPF Rentals only.<sup>55</sup>
- 4.55 When investigating EvoTAM costs (see below) we also found that costs relating to the installation of Tie Cables that should have been allocated to EvoTAMs had been incorrectly allocated to TAMs.

### Should this be reflected in the Regulatory Financial Statements?

- 4.56 This combined adjustment extends the asset life of TAMs and allocates the cost of TAMs only to the services that use them. The adjustment changed the costs for MPF Rentals, WLR Rentals and SMPF Rentals that we used to determine the prices of these services. In line with our proposed approach set out in section 3, we do not consider that there are any reasons why this adjustment should not be included in the Regulatory Financial Statements. Therefore we propose that the Regulatory Financial Statements must include this adjustment.

<sup>50</sup> Fixed Access Statement, Annexes, paragraph A2.5.

<sup>51</sup> Fixed Access Statement, Annexes, paragraphs A13.126 – A13.141 and A13.148.

<sup>52</sup> Fixed Access Statement, Annexes, paragraphs A13.126.

<sup>53</sup> Dispute between TalkTalk and Openreach relating to single jumpered MPF – Annexes, paragraphs A2.142 – A2.144 [http://stakeholders.ofcom.org.uk/binaries/enforcement/competition-bulletins/open-cases/all-open-cases/cw\\_01019/Provisional\\_Conclusions\\_nonconfidential\\_v2\\_1\\_Oct\\_13.pdf](http://stakeholders.ofcom.org.uk/binaries/enforcement/competition-bulletins/open-cases/all-open-cases/cw_01019/Provisional_Conclusions_nonconfidential_v2_1_Oct_13.pdf)

<sup>54</sup> Fixed Access Statement, Annexes, paragraph A13.128.

<sup>55</sup> Fixed Access Statement, Annexes, paragraph A13.126.

### How should this be reflected in the Regulatory Financial Statements?

- 4.57 We propose that BT must depreciate TAMs over a seven year period and must only allocate TAMs costs to MPF Rentals in its Regulatory Financial Statements. Tie Cable installation costs incorrectly allocated to TAMs should be allocated to EvoTAMs.

### **Evolutionary Test Access Matrix (EvoTAMs) Costs<sup>56</sup>**

#### The market review decision

- 4.58 EvoTAMs are installed on SMPF lines to test SMPF lines that are supplied internally to provide Wholesale Broadband Connect services. Externally consumed SMPF lines do not currently use EvoTAMs and are not expected to do so in the future.
- 4.59 We noted that recovering of EvoTAMs from all SMPF lines is a particular concern because the only SMPF lines that are connected to EvoTAMs are internal SMPF lines, that is those used by BT Wholesale. This meant that CPs other than BT are paying for EvoTAMs that are used by BT Wholesale. We therefore decided that it was not appropriate to recover EvoTAM cost from SMPF lines that do not use EvoTAMs.<sup>57</sup> When we set the price of SMPF Rental we decided that the charge should not recover any EvoTam costs.<sup>58</sup>
- 4.60 In the Fixed Access market review we noted that there were some EvoTAM costs relating to the installation of Tie Cables that were incorrectly being allocated to TAMs.<sup>59</sup> We allocated these Tie Cable installation costs to EvoTAMs.

### Should this be reflected in the Regulatory Financial Statements?

- 4.61 This adjustment allocated the costs of EvoTAMs away from SMPF Rentals when we set the SMPF Rental prices. In line with our proposed approach set out in section 3, we do not consider that there are any reasons why this adjustment should not be included in the Regulatory Financial Statements. Therefore we propose that the Regulatory Financial Statements must include this adjustment.

### How should this be reflected in the Regulatory Financial Statements?

- 4.62 We propose that BT must allocate EvoTAM costs away from SMPF Rentals to the Wholesale Residual market.
- 4.63 In relation to the costs relating to the installation of Tie Cables, as noted above, we propose that the costs relating to the installation of Tie Cables should be allocated to EvoTAMs.

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<sup>56</sup>Fixed Access Statement, Annex 13, paragraphs A13.142 – A13.147 and A13.149.

<sup>57</sup> Fixed Access Statement, Annex 13, paragraph A13.144.

<sup>58</sup> Fixed Access Statement, Annex 13, paragraph A13.149.

<sup>59</sup> Fixed Access Statement, Annex 13, paragraphs A13.131.

## Simultaneously provided services<sup>60</sup>

### The market review decision

- 4.64 Where two migration/connection services are provided at the same time, the cost of jointly providing the services can be lower than providing them on a separate basis. In the Fixed Access market review we “set the charge controls so as to require a discount on the simultaneous provision of (i) WLR Conversion and SMPF New Provide (the “WLR+SMPF Simultaneous Migration” service), and (ii) WLR Connections and SMPF New Provide (the “WLR+SMPF Simultaneous Connection” service) such that charges for these services reflect the efficiencies associated with their simultaneous provision.”<sup>61</sup>
- 4.65 Our estimate of the result of this allocation of cost savings was to decrease the costs of WLR+SMPF Simultaneous Migrations and Connections by nearly 50% over the charge control period and increase the costs of the remaining services by approximately 15%.<sup>62</sup>

### Should this be reflected in the Regulatory Financial Statements?

- 4.66 In the Fixed Access market review we created two new charge controlled services which were not in the Regulatory Financial Statements. In order to ensure the Regulatory Financial Statements contain information on the products subject to a charge control we propose that BT must include information on these new products within the Regulatory Financial Statements. Therefore we propose that the Regulatory Financial Statements must include this adjustment.

### How should this be reflected in the Regulatory Financial Statements?

- 4.67 We propose that BT must disclose the information for the simultaneously provided services and separately attribute the costs to these services.

## Combined fault and Service level allocations<sup>63</sup>

### The market review decision

- 4.68 In the Fixed Access market review we determined a combined fault rate and service level usage factor for allocating the cost of repairing faults on copper lines to services based on how often on average that service develops a fault, and on average how quickly that fault is fixed. In the Fixed Access market review our usage factor was applied to the five faults and service related cost components to allocate the costs to the WLR Rentals, MPF Rentals and SMPF Rentals. These components were D-side Copper Current, E-side Copper Current, Local Exchanges, Residential PSTN drop maintenance and DSLAM capital/maintenance.

<sup>60</sup> Fixed Access Statement, Annex 8.

<sup>61</sup> Fixed Access Statement, Volume 2, para 4.2

<http://stakeholders.ofcom.org.uk/binaries/telecoms/ga/fixed-access-market-reviews-2014/statement-june-2014/volume2.pdf>

<sup>62</sup> Fixed Access Statement, Annexes, paragraph A8.30.

<sup>63</sup> Fixed Access Statement, Annex 13, paragraphs A13.56 – A13.63

### Should this be reflected in the Regulatory Financial Statements?

- 4.69 Applying our combined fault rate and service level usage factor to the cost components for WLR Rentals, MPF Rentals and SMPF Rentals in our cost model changed the level of cost allocated to those services. In line with our proposed approach set out in Section 3, we do not consider that there are any reasons why this adjustment should not be included in the Regulatory Financial Statements. We therefore propose that the Regulatory Financial Statements must include this adjustment.

### How should this be reflected in the Regulatory Financial Statements?

- 4.70 We propose to direct BT to allocate the cost components to WLR Rentals, MPF Rentals and SMPF Rentals using the combined usage factor. The allocations used in our decision were set out in table A13.2 of the Fixed Access market review<sup>64</sup> which is reproduced in table 1.

### **TAMs Mark Up<sup>65</sup>**

#### The market review decision

- 4.71 When we determined the MPF Rental price in the Fixed Access market review, we did not use the FAC of TAMs from the Regulatory Financial Statements, but instead used a LRIC for TAMs. In our decision we determined that the LRIC of a TAM was £3.75 per MPF line, which was constant over the charge control.
- 4.72 The common costs which exceeded the LRIC were allocated to WLR Rentals and MPF Rentals to maintain the LRIC differential. We describe this LRIC adjustment below.

### Should this be reflected in the Regulatory Financial Statements?

- 4.73 We note that in line with the SMP cost accounting conditions, BT prepares the Regulatory Financial Statements on the current cost (FAC) basis, and this adjustment does not change the underlying FAC cost of TAMs used in MPF Rentals. We consider that if included this adjustment would undermine the integrity of the Regulatory Financial Statements as a whole, decreasing transparency and stakeholder understanding. This is because including this adjustment would require BT to report the costs of TAMs on a different basis (LRIC) than the basis on which other services and components are reported in the Regulatory Financial Statements (FAC). It would also require BT to allocate the common cost of TAMs to other MPF Rental and WLR Rental services and other cost components which would then change the basis on which such products and components are reported in the Regulatory Financial Statements (FAC+).
- 4.74 Therefore, we do not propose that the Regulated Financial Statements should include this adjustment.

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<sup>64</sup> Fixed Access Statement, Annex 13, Table A13.2.

<sup>65</sup> Fixed Access Statement, Annex 13, paragraph A13.141.

Should this be included in the additional reporting of BT's financial performance?

- 4.75 This adjustment provides us with information on BT's financial performance, in particular how the aggregate LRIC of TAMs, based on our charge control decisions, compares to the aggregate FAC of TAMs. This adjustment is practicable and proportionate for BT to calculate. Therefore we propose that the Adjusted Financial Performance Schedules must include this adjustment.

How should this be reflected in the additional reporting?

- 4.76 For the purposes of the Adjusted Financial Performance Schedules, we propose that BT must estimate the impact of calculating the LRIC of TAMs for MPF Rentals at a constant £3.75 per MPF line. The common costs relating to TAMs which exceed the LRIC must be recovered from WLR Rentals and MPF Rentals to maintain the LRIC differential as set out in the 'LRIC Adjustments and Recovery of Common Costs' section below.

**Line cards<sup>66</sup>**The market review decision

- 4.77 PSTN line cards (the "line cards") are the electrical interfaces used to connect the twisted pair copper cable of the local loop to the public switched telephone network (PSTN) via the DSLAM. Combi cards Voice ("combi cards") perform the same tasks on MSANs. The line cards have been largely depreciated in the Regulatory Financial Statements and have very low net replacement costs (NRC).
- 4.78 In the Fixed Access market review, when we calculated the cost of WLR Rentals we made an adjustment to uplift the NRCs of line cards to produce an annual line card FAC of £11<sup>67</sup> per line for 2014/15 within our cost model. We did this within our cost model by increasing the base year NRC for line cards (which was supplied from BT's 2011/12 Regulatory Financial Statements) to £715m and at the same time reducing the NRC of combi cards to zero. In our decision we determined that the LRIC of a line card was £7.40 per WLR Rental Line.<sup>68</sup> The common costs which exceeded the LRIC were then allocated to WLR Rentals and MPF Rentals to maintain the LRIC differential.

Should this be reflected in the Regulatory Financial Statements?

- 4.79 During the consultation process we identified certain adjustments to uplift asset values as an example of a type of adjustment we would not expect to see reflected in the Regulatory Financial Statements.
- 4.80 We consider that reflecting the line cards asset uplift in the Regulatory Financial Statements would decrease the usefulness of those statements as a source of data for future decisions, while reducing their transparency to stakeholders, as it would replace BT's incurred costs with a subjective economic estimate of the costs and asset values under different assumptions. It could therefore leave to BT's judgement and discretion how to reflect an adjustment that by its nature may need to be re-

<sup>66</sup> Fixed Access Statement, Annexes, paragraph A13.101 A13.110.

<sup>67</sup> This was the combined cost of PSTN Line cards and Combi cards.

<sup>68</sup> Fixed Access Statement, Annexes, paragraph A9.27



considered by Ofcom at a later date depending on the market circumstances and policy objectives at the time.

- 4.81 Our proposal is that the line cards asset uplift should not be included in the Regulatory Financial Statements.

Should this be included in the additional reporting of BT's financial performance?

- 4.82 This adjustment could have a significant impact at a market review level. We therefore consider that it is important for stakeholders to understand its impact.

How should this be reflected in the additional reporting?

- 4.83 As noted, this asset adjustment would impact on returns at a market review level. We therefore propose that BT must calculate the combined impact of uplifting the NRC of PSTN line cards whilst at the same time reducing the NRC for combi cards to zero. In relation to PSTN line cards, we propose that BT must uplift their NRC to £715m in 2011/12 and then adjust this NRC in subsequent years to reflect changes in volumes and efficiency. To reflect changes in volumes, BT is required to use the Local Exchange Asset Volume Elasticity from BT's LRIC model.<sup>69</sup> To reflect changes in efficiency we propose that BT must reduce the volume adjusted NRC by 5% cumulatively from 2011.<sup>70</sup> We propose that the common costs relating to line cards which exceed the LRIC must be recovered from WLR Rentals and MPF Rentals to maintain the LRIC differential as set out below.

## **LRIC differential**

### The market review decision

- 4.84 In the Fixed Access market review, we did not consider it was necessary or desirable to set charges to promote MPF-based competition over other forms of competition. We said that this meant that to promote efficiency the relative charges of each of WLR and MPF; and WLR + SMPF and MPF were equal to our estimate of the LRIC differential for providing these services. We said that this implied that MPF and WLR would contribute equally to common cost recovery on a per line basis<sup>71</sup> and that SMPF would be set at LRIC.<sup>72</sup>
- 4.85 For prices regulated at LRIC, the unrecovered common cost was then recovered over the main rental services. This was done in such a way so as to ensure that the price differentials for the main rental services reflected the LRIC differential.<sup>73</sup>

### Should this be reflected in the Regulatory Financial Statements?

- 4.86 We consider that the adjustment does not change the underlying FAC of WLR Rental, MPF Rental or SMPF Rental. For the reasons given above in connection with the TAM's Mark Up including the adjustment is likely to decrease transparency and stakeholder understanding of the Regulatory Financial Statements.

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<sup>69</sup> We used 0.51 in the Fixed Access Market decision as set out in Table A13.15.

<sup>70</sup> Fixed Access Statement, volume 2, para 1.17

<sup>71</sup> We describe this adjustment in paragraphs 4.105 to 4.112

<sup>72</sup> We describe this adjustment in paragraphs 4.113 to 4.116

<sup>73</sup> Fixed Access Statement, Annex 11, paragraph A11.46.

- 4.87 Therefore we do not propose to require BT to reflect this adjustment in the Regulatory Financial Statements.

Should this be included in the additional reporting of BT's financial performance?

- 4.88 In the Fixed Access market review we set WLR Rental, SMPF Rental and MPF Rental prices using a LRIC differential of £1.79. The adjustment therefore provides us with information about the impact of this LRIC adjustment on BT's financial performance in the WLA and WAEL markets on an ongoing basis. This adjustment is practicable and proportionate to calculate. Therefore we propose that the Adjusted Financial Performance Schedules must include this adjustment.

How should this be reflected in the additional reporting?

- 4.89 For the purposes of the Adjusted Financial Performance Schedules, we propose that BT must calculate the difference between the LRIC of WLR Rentals; and the LRIC of MPF Rentals (the LRIC differential). When subsequently spreading the common costs of Caller Display, Migrations and WLR Transfer we propose that BT must maintain the LRIC differential.

**Caller Display<sup>74</sup>**

The market review decision

- 4.90 Caller Display is an add-on service provided alongside WLR Rentals. In the course of the Fixed Access market review we found that the cost of providing the service was close to zero, whilst BT was charging £6 per line per year.<sup>75</sup> In light of this, we decided to impose a charge control on Caller Display and set the charge at "£0.45, to reflect our estimate for the LRIC of this service". In order to enable BT to recover costs which are currently allocated to Caller Display, we decided to reallocate £4.8m to all rentals, and £5.0m to WLR charges."<sup>76</sup>
- 4.91 In our cost model, common costs previously allocated to Caller Display were reallocated across MPF Rental and WLR Rental lines.<sup>77</sup> This was done in such a way so as to ensure the price differentials for the main rental services reflected the LRIC differential.

Should this be reflected in the Regulatory Financial Statements?

- 4.92 We consider that this adjustment does not change the underlying FAC of Caller Display service. For the reasons given above in connection with the TAM's Mark Up including the adjustment is likely to decrease transparency and stakeholder understanding of the Regulatory Financial Statements.
- 4.93 Therefore we do not propose that the Regulated Financial Statement should include this adjustment.

<sup>74</sup>Fixed Access Statement, Volume 2, paragraphs 4.200 – 4.257.

<sup>76</sup> Fixed Access Statement, Volume 2, paragraphs 4.216 – 4.217.

<sup>76</sup> Fixed Access Statement, Volume 2, paragraph 4.257.

<sup>78</sup> Fixed Access Statement, Annex 8

### Should this be included in the additional reporting of BT's financial performance?

- 4.94 In the Fixed Access market review we allocated £4.8m of costs from Caller Display to the WLA and WAEL markets and a further £5.0m allocated to WAEL market when determining the charge controls. The adjustment therefore provides us with information about the impact of this LRIC adjustment on BT's financial performance in the WLA and WAEL markets on an ongoing basis. We consider that it is practicable and proportionate to calculate. Therefore we propose that the Adjusted Financial Performance Schedules must include this adjustment.

### How should this be reflected in the additional reporting?

- 4.95 For the purposes of the Adjusted Financial Performance Schedules, we propose that BT must calculate the impact of setting the costs of the Caller Display product at LRIC and spreading the common costs of Caller Display (i.e. the difference between FAC and LRIC) to WLR Rentals and MPF Rentals so that the LRIC differential is maintained.

## **Migrations<sup>78</sup> and WLR Transfer**

### The market review decision

- 4.96 Migration charges arise when an end user switches from one CP to another. There are a number of different charges which depend on whether the end user is switching services as well as CP. WLR Transfers are systems updates made when end customers change their WLR provider.
- 4.97 In the Fixed Access market review, we decided to align the charges of all Migrations involving jumpering and set the aligned charge to the volume weighted average of the LRICs.<sup>79</sup> We set the prices of MPF Bulk Migration and SMPF Bulk Migrations in line with a single target charge based on the volume weighted average of their LRICs<sup>80</sup> and set the WLR Transfer Charge to its LRIC.<sup>81</sup>
- 4.98 We decided that the common costs no longer recovered from these services should be recovered through MPF Rental and WLR Rental charges on an equal per line basis.<sup>82</sup>

### Should this be reflected in the Regulatory Financial Statements?

- 4.99 For the reasons given above in connection with the TAM's Mark-up including these adjustments do not change the underlying FAC of these products and is likely to decrease transparency and stakeholder understanding of the Regulatory Financial Statements. For these reasons we do not propose that the Regulatory Financial Statements should reflect these adjustments.

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<sup>78</sup> Fixed Access Statement, Annex 8.

<sup>79</sup> Fixed Access Statement, Volume 2, paragraphs 4.90-4.103.

<sup>80</sup> Fixed Access Statement, Volume 2, paragraphs 4.111- 4.119.

<sup>81</sup> Fixed Access Statement, Volume 2, paragraphs 4.106- 4.110.

<sup>82</sup> Fixed Access Statement, Volume 2, paragraphs 5.60 ii) and iii).

Should this be included in the additional reporting of BT's financial performance?

4.100 In the Fixed Access market review we set the price of these products at LRIC. Our adjustment was to recover from MPF Rental and WLR Rental charges the common costs which were no longer recovered from the Migrations and WLR Transfers. The adjustment was made on an equal per line basis and had the impact of moving costs between the WAEL and WLA markets. These cost movements will vary in line with the volumes of the Migrations, WLR Transfers as well as the volumes of WLR Rentals and MPF Rentals. This adjustment would provide us with information about the impact of these LRIC adjustments on BT's financial performance in the WLA and WAEL markets on an ongoing basis. We consider that this adjustment is practicable and proportionate to calculate.

How should this be reflected in the additional reporting?

4.101 For the purposes of the Adjusted Financial Performance Schedules, we propose that BT must calculate the impact setting the costs for the Migrations and WLR Transfers at LRIC and spreading the common costs of Migrations and WLR Transfers (i.e. the difference between FAC and LRIC) as set out in the LRIC adjustments and recovery of common costs adjustment explained below.

**LRIC adjustments and recovery of common costs**The market review decision

4.102 As set out in the Fixed Access Market, we set the cost of a number of services to LRIC. These included:

- Caller Display;
- Migrations; and
- WLR Transfers.

4.103 We decided that WLR Rental and MPF Rental would contribute equally to common cost recovery for the Caller Display, Migrations and WLR Transfers. For prices regulated at LRIC, the unrecovered common cost was then recovered over the main rental services. This was done in such a way so as to ensure the price differentials for the main rental services reflected the LRIC differential.<sup>83</sup>

Should this be reflected in the Regulatory Financial Statements?

4.104 The adjustments to recover the common costs from WLR and MPF Rentals arising out of the decision to set Caller Display, Migrations and WLR Transfers at LRIC does not change the underlying FAC cost of WLR and MPF Rental services. For the reasons given above in relation to the TAM Mark Up, we consider that including these adjustments is likely to decrease transparency and stakeholder understanding of the Regulatory Financial Statements.

4.105 Therefore we do not propose that the Regulatory Financial Statements should include these adjustments.

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<sup>83</sup> Fixed Access Statement, Annexes, paragraph A11.46.

Should this be included in the additional reporting of BT's financial performance?

4.106 In the Fixed Access market review the adjustment for recovering the common costs through MPF Rental and WLR Rental charges on an equal per line basis had the impact of moving costs between the WAEL and WLA markets. These cost movements will vary in line with the volumes of the Caller Display, Migrations and WLR Transfers as well as the volumes of WLR Rentals and MPF Rentals. This adjustment would provide us with information about the impact of these LRIC adjustments on BT's financial performance in the WLA and WAEL markets on an ongoing basis. This adjustment is practicable and proportionate to calculate.

How should this be reflected in the additional reporting?

4.107 For the purpose of the Adjusted Financial Performance Schedules, we propose that BT must allocate the common costs of Caller Display, Migrations and WLR Transfers from WLR Rentals and MPF Rentals so that the LRIC differential is maintained.

**SMPF**

The market review decision

4.108 In the Fixed Access market review, we decided that ultimately common costs should be recovered equally from MPF Rental and WLR Rental lines, with SMPF Rentals making no contribution to common cost recovery. This was to enable both the difference in charges between MPF Rentals and WLR Rentals and the difference between MPF Rentals and WLR Rentals + SMPF Rentals to be equal to the respective differences in LRICs.<sup>84 85</sup> The common cost of SMPF Rentals was allocated to WLR Rentals and MPF Rentals to ensure this differential was maintained.

Should this be reflected in the Regulatory Financial Statements?

4.109 As noted above in connection with the TAM Mark Up, the setting of SMPF Rentals at LRIC and the allocation of common costs to WLR Rentals and MPF Rentals in order to maintain the LRIC differential does not change the underlying FAC cost of these products and would require WLR Rentals and MPF Rentals to be reported on a different basis (FAC+). Therefore, we do not propose that the Regulatory Financial Statements should include this adjustment.

Should this be included in the additional reporting of BT's financial performance?

4.110 In the Fixed Access market review setting SMPF Rentals at LRIC and the allocation of common costs to WLR Rentals and MPF Rentals in order to maintain the LRIC differential moved common costs between the WAEL and WLA markets and had an impact on the returns. These common cost movements will vary in line with changes in the volumes of these services. This adjustment would provide us with information about the impact of this LRIC adjustment on BT's financial performance in the WLA and WAEL markets on an ongoing basis. This adjustment is practicable and proportionate to calculate.

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<sup>84</sup> Fixed Access Statement, Volume 2, paragraphs 3.67 - 3.109

<sup>85</sup> We calculated this to be £1.79 based on SMPF charge being equivalent to its LRIC which we estimated to be £2.61.

How should this be reflected in the additional reporting?

- 4.111 For the purposes of the Adjusted Financial Performance Schedules, we propose that BT must estimate the impact of the SMPF Rental service being priced at LRIC instead of FAC with the SMPF common costs being allocated to WLR Rentals and MPF Rental services so as to maintain the LRIC differential.

**Absolute valuation of copper**The market review decision

- 4.112 In the Fixed Access Statement we decided to derive the CCA value of the access copper on the basis of BT's 2011/12 absolute valuation. We then adjusted this to calculate the value of copper on a RAV basis.<sup>86</sup>
- 4.113 In 2012/13, BT changed its method of estimating the CCA value of copper, from an absolute valuation to a valuation based on capital expenditure indexed by RPI. However, for the reasons set out in the Fixed Access Statement, we continued to use the 2011/12 valuation as the starting point for our assessment of BT's costs.

Should this be reflected in the Regulatory Financial Statements?

- 4.114 As explained above, the value of copper should be valued on a RAV basis. However, as most of the copper assets included in the Regulatory Financial Statements were acquired after 1997, the valuation of most of the assets will reflect the CCA basis.
- 4.115 We have considered whether we should extend the requirement for consistency, beyond the general principle of reporting copper on a RAV basis, to also include the basis of estimation of the value of copper. This could mean a requirement to estimate the RAV of copper based on an absolute valuation of the copper network, as BT did in 2011/12.
- 4.116 However, in the past, we have chosen not to mandate how BT should estimate the value of its copper network. BT has been valuing access copper on the basis of capital expenditure indexed by RPI for the past two years and no longer produces an absolute valuation for copper. Given the challenges faced by BT in deriving robust estimates of the cost of replacing its copper network previously, the extent to which such estimates rely on BT's judgement and the scope for them to introduce new volatility in the asset values, we do not consider it appropriate to require BT to estimate the cost of rebuilding its copper network afresh.
- 4.117 We have already started our work on the BCMR where the starting point is the copper valuation as reflected in the 2013/14 Regulatory Financial Statements. We consider that requiring BT to produce a copper valuation on a different basis to that which may be used in forthcoming regulation is not only potentially confusing but may also not produce a robust outcome, nor do we consider it would be proportionate given the complexities involved.
- 4.118 In light of the above, we do not propose that BT reflect our decision on copper valuation in the Regulatory Financial Statements.

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<sup>86</sup> Fixed Access Statement, Annexes, paragraph A6.73.

Should this be included in the additional reporting of BT's financial performance?

4.119 Given the challenges faced by BT in deriving robust estimates of the cost of replacing its copper network on the previous basis, for little obvious benefit in terms of more robust estimates, we do not consider it would be appropriate to require BT to attempt to replicate its previous methodology to estimate the cost of rebuilding its copper network on that basis, nor do we consider it would be proportionate given the complexities involved. Therefore we do not propose that the Adjusted Financial Reporting Schedules should include this adjustment.

**ISDN30 pricing**

The market review decision

4.120 In setting the ISDN30 charge control, we decided it would be proportionate and appropriate to simply cap charges at their current levels.<sup>87</sup> In the absence of a need for future investment in ISDN30 assets,<sup>88</sup> we considered that it may be unnecessary for future charges to reflect a hypothetical ongoing network in a steady state. Rather, we considered it may be efficient for ISDN30 prices to be below the steady state level. This would align charges more closely to forward looking incremental costs, given that no significant new investment was foreseen.<sup>89</sup>

4.121 We considered it likely that BT will have recovered its past investments if charges remain at the level imposed by the 2012 charge control during the market review period.<sup>90</sup> We also considered that it may not be efficient or in consumers' interests for charges to fall materially. Materially lower charges may risk that cost recovery is not achieved and may therefore undermine future investment incentives in other products. Also with substantially lower prices, the decline in ISDN30 volumes may reverse, which would then require new ISDN30 investment which the charge control may not be sufficient to cover. Materially lower ISDN30 charges may also undermine recent investment in IP-based services, which could create a perception of regulatory uncertainty (which may again damage investment incentives in the longer term, harming efficiency). The ISDN30 charge control was therefore set so that charges were constant in nominal terms for the relevant basket of services.<sup>91</sup>

Should this be reflected in the Regulatory Financial Statements?

4.122 We note that the ISDN30 charge control was set to hold charges constant in nominal terms. It was therefore not based directly on BT's actual costs and did not involve calculating any adjustment to the underlying FAC of ISDN30 services. We therefore do not propose to make any adjustment in the Regulated Financial Statements in relation to ISDN30 services.

Should this be included in the additional reporting of BT's financial performance?

4.123 Given the way the ISDN30 charge control was set, including the impact of ISDN30 adjustment in the Adjusted Financial Performance Schedules would not reflect our view of BT's costs and returns it makes from those set out in the Regulatory Financial

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<sup>87</sup> Fixed Access Statement, Volume 1 paragraph 17.53.

<sup>88</sup> Fixed Access Statement, Volume 1 paragraph 17.57.

<sup>89</sup> Fixed Access Statement, Volume 1, paragraph 17.57.

<sup>90</sup> Fixed Access Statement, Volume 1 paragraph 17.62.

<sup>91</sup> Fixed Access Statement, Volume 1, paragraph 17.65.

Statements. We therefore do not consider there should be any adjustment for ISDN30 in the Adjusted Financial Performance Schedules.

## **ISDN2 pricing**

### The market review decision

4.124 When we determined the ISDN2 charge control, we considered that the assets used to provide ISDN2 rental services were heavily depreciated.<sup>92</sup> We considered that this was a similar issue we had in connection to ISDN30 services. We concluded as with ISDN30 that ISDN2 rentals and connections should be charged in a similar manner with a cap set on average charges based on their current levels.<sup>93</sup> In connection with ISDN2 transfers, we determined that they should be charged at LRIC, which we estimated to be £9 per line (or £4.50 per channel). We did not consider it necessary to allow other ISDN2 charges to rise as a result of reducing the ISDN2 transfer charges.<sup>94</sup>

### Should this be reflected in the Regulatory Financial Statements?

4.125 We note that most of the ISDN2 charge controls were set to hold charges constant in nominal terms, and the ISDN2 transfer charge was set based on a benchmark rather than BT's reported costs for ISDN2 transfers. The charges therefore did not involve calculating any adjustment to the underlying FAC of ISDN2 services. We therefore do not propose to make any adjustment in the Regulated Financial Statements in relation to ISDN2 services.

### Should this be included in the additional reporting of BT's financial performance?

4.126 Given the way the ISDN2 charge controls were set, including the impact of ISDN2 adjustment in the Adjusted Financial Performance Schedules would not reflect our view of BT's costs and returns it makes from those set out in the Regulatory Financial Statements. We therefore do not consider there should be any adjustment for ISDN2 in the Adjusted Financial Performance Schedules.

## **Adjustments made in the 2014 WBA charge control**

### **Consistency with the 2011/12 cost allocation bases**

#### The market review decision

4.127 We have explained the approach that we take to forecasting costs in our market reviews. We have also explained that in the WBA market review we used the 2012/13 data restated using the 2011/12 allocations set out in the reconciliation report.

#### Should this be reflected in the Regulatory Financial Statements?

4.128 We do not propose to include this adjustment that we made in relation to the WBA market review in the Regulatory Financial Statements for the same reasons that we have already explained in relation to the Fixed Access market review.

<sup>92</sup> Fixed Access Statement, Volume 1 paragraph 17.121.

<sup>93</sup> Fixed Access Statement, Volume 1 paragraph 17.120.

<sup>94</sup> Fixed Access Statement, Volume 1 paragraph 17.142.



Should this be included in the additional reporting of BT's financial performance?

- 4.129 We do not propose to include this adjustment that we made in relation to the WBA market review in the Adjusted Financial Performance Schedules for the same reasons that we have already explained in relation to the Fixed Access market review.
- 4.130 We have explained that it would be relatively straightforward for interested parties to assess the impact of recent allocation changes through the information that is already made public in the reconciliation reports.

**SG&A Broadband, ATM customer interface, ATM network interface, ATM network switching, and Inter ATM transmissions<sup>95</sup>**

The market review decision

- 4.131 In the WBA market review we said that in setting prices we had made adjustments where BT's allocations were inconsistent with our modelling approach.<sup>96</sup> This included SG&A Broadband, ATM customer interface (2Mbit/s, 34Mbit/s, >155Mbit/s), ATM network interface, ATM network switching and Inter ATM transmissions which are cost components used by WBA services.
- 4.132 We noted that in the Regulatory Financial Statements BT had allocated 2012/13 restated costs using forecasts of revenues and volumes rather than actual revenues and volumes, which we considered to be the appropriate basis for allocation.<sup>97</sup> We therefore updated data provided by BT for both cost components for "actual revenues and volumes".<sup>98</sup>

Should this be reflected in the Regulatory Financial Statements?

- 4.133 The adjustment we made to use actual revenues and volumes to allocate the SG&A Broadband component reduced Market A operating costs by £1.5m and MCE by £2m. The use of actual data to allocate the ATM cost components reduced Market A operating costs by £1.3m and MCE by £5m.<sup>99</sup> In line with our proposed approach set out in Section 3, we do not consider that there are any reasons why this adjustment should not be included in the Regulatory Financial Statements. We therefore propose that BT must include this adjustment in the Regulatory Financial Statements.

How should this be reflected in the Regulatory Financial Statements?

- 4.134 We propose that BT must allocate the SG&A Broadband, ATM customer interface (2Mbit/s, 34Mbit/s, >155Mbit/s), ATM network interface, ATM network switching and Inter ATM transmissions using actual revenues and volumes instead of forecast revenues and volumes information.

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<sup>95</sup>WBA Statement, paragraph 7.186 <http://stakeholders.ofcom.org.uk/binaries/consultations/review-wba-markets/statement/WBA-Statement.pdf>

<sup>96</sup>WBA Statement, paragraph 7.8.

<sup>97</sup>WBA Statement, paragraph 7.182.

<sup>98</sup>WBA Statement, paragraph 7.186.

<sup>99</sup>WBA Statement, paragraph 7.186.

## **Allocation of IPstream costs between Market A and Market B<sup>100</sup>**

### The market review decision

- 4.135 IPstream is a wholesale service that delivers a managed internet access of up to 8 Megabits per second. It uses the legacy Time Division Multiplexing (TDM) network to provide ADSL in conjunction with DSLAMs that are installed in BT's exchanges.<sup>101</sup> IPStream is being replaced in Market B by Wholesale Broadband Connectivity (WBC). As end users in Market B are increasingly being migrated to WBC, a static allocation of fixed costs between Market A and B would allocate too much cost to Market B.
- 4.136 In the WBA market review we decided that the allocation of costs should be on a dynamic basis. We decided that BT must apportion the costs of IPstream between Market A and Market B according to measures of IPstream usage such as the number of end users, the bandwidth they consume and/or direct asset volumes used to serve those customers.<sup>102</sup> We said that it was not appropriate to allow BT to recover costs from Market A which were incremental to providing IPStream in Market B. In particular we did not consider it was appropriate for BT to recover from Market A the costs of any DSLAMs which, due to the migration to WBC in Market B, are no longer in use.<sup>103</sup> We did not adopt the revised methodology that BT had applied in its 2013 Regulatory Financial Statements. In applying this decision we allocated DSLAM costs which are used to provide services to end users according to the methodology that BT had applied in its 2012 Regulatory Financial Statements.

### Should this be reflected in the Regulatory Financial Statements?

- 4.137 The allocation of DSLAM costs in the Regulatory Financial Statements is inconsistent with the allocations that we used when setting the charge control. In line with our proposed approach set out in Section 3, we do not consider that there are any reasons why this adjustment should not be included in the Regulatory Financial Statements. We therefore propose that the Regulatory Financial Statements must include this adjustment.

### How should this be reflected in the Regulatory Financial Statements?

- 4.138 We propose that BT must allocate DSLAM capital maintenance costs which are used to provide services to end users according to the actual volumes of DSLAMs in Markets A and B.

## **Market A market size adjustment<sup>104</sup>**

### The market review decision

- 4.139 In the WBA market review we ensured that input cost data for Market A reflected the current services being provided within it. In the WBA market review we made an

<sup>100</sup>WBA Statement, paragraphs 7.177 -7.181.

<sup>101</sup> Asymmetric Digital Subscriber Line (ADSL) technology which provides standard broadband speed services of up to 8 Mbit/s per second. ADSL2+ technology provides faster broadband speed services of up to 24Mbit/s

<sup>102</sup> WBA Statement, paragraph 7.177.

<sup>103</sup> WBA Statement, paragraph 7.180.

<sup>104</sup>WBA Statement, paragraphs 7.197 -7.205.

adjustment to ensure that the costs of serving WBA fibre customers within Market A who are served by exchanges in Market B, were allocated to the correct market - Market B.

### Should this be reflected in the Regulatory Financial Statements?

4.140 For the same reason as the allocation of IPStream costs between Market A and B, the costs of providing services to end users in Market A and Market B in the Regulatory Financial Statements may not be cost causal and may be inconsistent with how we set the charge control. In line with our proposed approach set out in Section 3, we do not consider that there are any reasons why this adjustment should not be included in the Regulatory Financial Statements. We therefore propose that the Regulatory Financial Statements must include this adjustment.

### How should this be reflected in the Regulatory Financial Statements?

4.141 To be consistent with this regulatory decision, we propose that BT must allocate the cost of serving WBA customers to markets on the basis of the location of the exchange from which they receive service. This may be different to the exchange area in which they are located. For example the costs for a customer who resides in a Market A exchange area but whose broadband services are provided from a Market B exchange should be allocated to Market B.

## **21CN Costs and the future benefits principle<sup>105</sup>**

### The market review decision

4.142 21CN costs relate to the capital and operating costs of installing and maintaining BT's 21CN Network. Originally BT planned to replace its legacy TDM voice and data networks with a single IP network. For example BT planned to replace DSLAM equipment with MSAN equipment. WBC services have been available in some parts of the UK since 2008 and BT has deployed MSANs in many exchange areas to provide WBC WBA services.

4.143 In the WBA market review we found that BT had allocated some 21CN costs to WBA services, notably IPstream services, which did not use 21CN equipment, on the basis of "future benefits."<sup>106</sup> The future benefits principle assumed that, as IPstream users might migrate to WBC services in the future, they should pick up a share of the costs of establishing the 21CN platform before they migrate.

4.144 Within the charge control model we decided that this was not appropriate and we excluded the costs of 21CN equipment that were not used to supply IPstream services.<sup>107</sup> We also did not include EOI charges that BT had allocated within its Regulatory Financial Statements on a future benefits basis within the compliance formulae.<sup>108</sup>

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<sup>105</sup> WBA Statement, paragraphs 7.213 – 7.221.

<sup>106</sup> This allocated costs relating to new 21CN technology to legacy services, such as IPstream Connect, on the basis that 21CN based services might replace these legacy technologies in the future. This is based on the idea that customers who currently use legacy services will benefit from investments in new 21CN technology once they switch to services based on the new technology – see WBA Statement, paragraph 7.219.

<sup>107</sup> WBA Statement, paragraph 7.221.

<sup>108</sup> WBA statement, Annex 2 Legal Instruments, Annex to Condition 7, Part C.

### Should this be reflected in the Regulatory Financial Statements?

4.145 We do not consider the ‘future benefits’ principle is appropriate for allocating costs to regulated services. As we set out in the 2014 Statement “we consider that we need a record of BT’s actual costs.”<sup>109</sup> The ‘future benefits’ principle moves away from actual costs to hypothetical costs based on customers potentially migrating to new technology in the future. Therefore we propose that BT must not allocate costs on a future benefits basis within its Regulatory Financial Statements.

### How should this be reflected in the Regulatory Financial Statements?

4.146 To be consistent with this regulatory decision we propose that BT must only allocate 21CN costs to services that currently use that technology, such as WBC. We propose that 21CN costs must not be allocated using the ‘future benefits’ principle to IPstream Connect or to any other services that are not provided using 21CN technology. This principle should apply to all 21CN costs including CCA adjustments such as holding gains and losses, and equivalence of input charges.

4.147 We expect that the costs of at least the following WBC components<sup>110</sup> will be affected by not allocating 21CN costs using the ‘future benefits’ principle:

- i) Combi Card Broadband Access;
- ii) 21CN Backhaul Link and Length;
- iii) Core/Metro (broadband); and
- iv) Edge Ethernet Ports.

4.148 We would expect that:

- i) Combi Card Broadband Access component costs are allocated to WBC end-user rentals services in each of Markets A and B on the basis of MSANs installed and the number of end-users.
- ii) Core/Metro (broadband) and Edge Ethernet Ports component costs are allocated using measures of relative bandwidth use to WBC bandwidth services in Markets A and B and to SFBB and other services within Wholesale Residual Markets that use these components.
- iii) 21CN Backhaul Link and Length component costs are allocated according to measures of relative bandwidth use to WBC bandwidth services in Markets A and B, to services within BCMR markets, and to SFBB bandwidth and other services within Wholesale Residual Markets that use the relevant components to deliver services.

4.149 We are aware that the ‘future benefits principle’ is used to allocate costs in other markets and we expect BT to no longer use the ‘future benefit’s’ principle to allocate costs in other markets.<sup>111</sup>

<sup>109</sup> 2014 Statement, paragraph 3.23.

<sup>110</sup> Strictly speaking these are supercomponents that may comprise more than one network component. The way the supercomponents listed here are currently allocated to provide services in WBA markets in 2013/14 is given on pages 105 and 111 of BT’s 2014 Regulatory Financial Statements.

## **Hypothetical ongoing network<sup>112</sup>**

### The market review decision

4.150 In the WBA Statement we explained that we had made a hypothetical ongoing network (HON) adjustment, consistent with our anchor pricing approach. This adjustment increases BT's actual costs by adding capital employed and depreciation into the model.<sup>113</sup>

### Should this be reflected in the Regulatory Financial Statements?

4.151 During the consultation process we identified the HON adjustment as an example of the sort of adjustment we would not expect to see reflected in the Regulatory Financial Statements.

4.152 We consider that reflecting the HON adjustment in the Regulatory Financial Statements would decrease the usefulness of those statements as a source of data for future decisions, while reducing their transparency to stakeholders, as it would replace BT's incurred costs with a hypothetical estimate of the costs and asset values under different assumptions. It could therefore leave to BT's judgement and discretion how to reflect an adjustment that by its nature may need to be re-considered by Ofcom at a later date depending on the market circumstances and policy objectives at the time. Our view therefore remains that the HON adjustment should not be included in the Regulatory Financial Statements.

### Should this be included in the additional reporting of BT's financial performance?

4.153 This adjustment could have a significant impact at a market review level. We therefore consider that it is important for stakeholders to understand its impact.

### How should this be reflected in the additional reporting?

4.154 For the purposes of the Adjusted Financial Performance Schedules, we propose that BT must calculate the aggregate impact of the three changes on the Returns and MCE in the WBA market review and in WBA Market A and B as follows:

- firstly BT must set the Gross Replacement Cost (GRC) of DSLAMs at their current average costs of DSLAMs;
- secondly BT must uplift and maintain the NRC:GRC ratio (Net Replacement Cost: GRC) at 50% for ATM, SDH and DSLAM assets;
- thirdly BT must use an asset life of 13 years when depreciating these assets.

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<sup>111</sup> 2013 BCMR, Annex 19, paragraphs 19.196 – 19.200.

<http://stakeholders.ofcom.org.uk/binaries/consultations/business-connectivity/statement/Sections17-24.pdf>

<sup>112</sup> WBA Statement, paragraphs 7.226 – 7.235.

<sup>113</sup> WBA Statement, paragraph 7.8.

## Other CCA adjustments

### The market review decision

4.155 BT's Regulatory Financial Statements are prepared on a CCA basis. CCA depreciation includes supplementary depreciation and holding gains and losses as a result of the revaluation of assets. However, occasionally there are also some one-off, non-recurring adjustments made by BT. These are referred to as 'Other CCA adjustments' in BT's Regulatory Financial Statements.<sup>114</sup> In the WBA market review we excluded these 'Other CCA adjustments' from the base year data so that we could forecast IPStream Connect CCA operating costs in Market A using the CCA adjustments that would be typically reoccurring each year.<sup>115</sup>

### Should this be reflected in the Regulatory Financial Statements?

4.156 BT's inclusion of 'Other CCA adjustments' within the Regulatory Financial Statements complies with CCA accounting principles and we therefore consider that it is for BT to decide whether or not they should be included. Therefore, we do not propose that the Regulatory Financial Statements should reflect our decision made in the WBA market review that the 'Other CCA adjustments' should be excluded.

### Should this be included in the additional reporting of BT's financial performance?

4.157 Requiring BT to calculate the impact of removing 'Other CCA adjustments' from the WBA markets provides us and stakeholders with information about how the costs of Market A services are affected by one off CCA adjustments on annual basis. We propose that BT must calculate the impact of removing 'Other CCA adjustments' from the WBA markets. The adjustment is practicable and proportionate to calculate. Therefore we propose that the additional reporting of BT's financial performance must include this adjustment.

### How should this be reflected in the additional reporting?

4.158 For the purposes of the Adjusted Financial Performance Schedules, we propose that BT must recalculate the impact of removing 'Other CCA adjustments' in the Regulatory Financial Statements as if these adjustments had not been made.

## Summary of proposals and legal tests

4.159 In summary, we propose that the regulatory decisions made in the Fixed Access Statement should be reflected in BT's Regulatory Financial Reporting as follows:

**Table 2. Summary of proposals for adjustments in the Fixed Access Statement**

Market Review Adjustment	Required in Regulatory Financial Statements	Required in additional reporting	Not included in Regulatory Financial Statements or additional reporting
2011/12 cost allocation rules			X

<sup>114</sup> Current Cost Financial Statements for 2014 including Openreach Undertakings. Section 5.1. <http://www.btplc.com/Thegroup/RegulatoryandPublicaffairs/Financialstatements/2014/index.htm>

<sup>115</sup> WBA Statement, paragraph 7.194.

<b>Internal SMPF volumes</b>	X	
<b>Telephone Directories</b>	X	
<b>DSLAM capital/maintenance</b>	X	
<b>Group overheads</b>	X	
<b>Deafness provision</b>	X	
<b>Cumulo rates</b>	X	
<b>Test Access Matrix Costs</b>	X	
<b>Evolutionary Test Access Matrix Costs</b>	X	
<b>Simultaneously provided services</b>	X	
<b>Combined fault and service level allocations</b>	X	
<b>Test Access Matrix Mark up</b>		X
<b>Line cards</b>		X
<b>LRIC differential</b>		X
<b>Caller Display</b>		X
<b>Migrations and WLR Transfers</b>		X
<b>LRIC adjustments and recovery of common cost</b>		X
<b>SMPF</b>		X
<b>Absolute valuation of Copper</b>		X
<b>ISDN30 pricing</b>		X
<b>ISDN2 pricing</b>		X

4.160 In summary, we propose that the regulatory decisions made in the WBA Statement should be reflected in BT's regulatory reporting as follows:

Table 3. Summary of proposals for adjustments in the WBA Statement

Market Review Adjustment	Required in Regulatory Financial Statements	Required in additional reporting	Not included in Regulatory Financial Statements or additional reporting
2011/12 cost allocation rules			X
SG&A Broadband, ATM customer interface, ATM network interface, ATM network switching, and Inter ATM network transmissions	X		
Allocation of IPStream costs between Market A and Market B	X		
Market A market size adjustment	X		
21 CN Costs and the future benefits principle	X		
Hypothetical ongoing network		X	
Other CCA adjustments		X	

4.161 We have considered our proposals about the Consistency with Regulatory Decisions Direction against the tests set out in section 49(2) of the Act and have concluded that they are:

- Objectively justifiable because we have previously established the need for the Regulatory Financial Statements to be consistent with regulatory decisions and these proposals specify the regulatory decisions with which the Regulatory Financial Statements need to be consistent. The proposed Consistency with Regulatory Decisions Direction will establish further detail and will also provide BT with clarity as to the implementation of Principle 4 of the Regulatory Accounting Principles until the Regulatory Accounting Guidelines have been established.
- Not unduly discriminatory because KCOM is the only other SMP provider which has regulatory accounting obligations, but we have not at present established the need for such regulation. We will however keep under review whether any of the changes that we are proposing may be appropriate to apply to KCOM in due course.
- Proportionate because our proposals which see us specifying the regulatory decisions with which the Regulatory Financial Statements need to be consistent, are no more than is required to ensure consistency with regulatory decisions. While we are specifying the regulatory decisions with which the Regulatory Financial Statements need to be consistent, BT retains an important role in determining the basis of preparation of the Regulatory Financial Statements.



- Transparent because it is clear that the intention of our proposals is to ensure that the Regulatory Financial Statements are consistent with regulatory decisions.

4.162 We have considered our proposals about the Adjusted Financial Performance Schedules against the tests set out in section 49(2) of the Act and have concluded that they are:

- Objectively justifiable because we have previously established that some disclosure of BT's financial performance from a regulatory perspective is appropriate and these proposals specify the detail which will enable BT to produce the additional statement.
- Not unduly discriminatory because KCOM is the only other SMP provider which has regulatory accounting obligations, but we have not at present established the need for such regulation.
- Proportionate because our proposals which see us specifying the detailed requirements which will enable BT to produce the additional statements, are no more than is required to provide stakeholders with a better understanding of BT's financial performance from a regulatory perspective.
- Transparent because it is clear that the intention of our proposals is to ensure that stakeholders can gain a better understanding of BT's financial performance from a regulatory perspective.

4.163 We have also considered how our proposals meet the tests in Section 3, 4 and 4A of the Act.

4.164 Our proposals concerning consistency with regulatory decisions are designed to ensure that the Regulatory Financial Statements are aligned with Ofcom's regulatory decisions. They seek to ensure that decisions taken in the Fixed Access and the WBA market reviews are reflected in the accounts where appropriate. The proposals thereby seek to ensure the Regulatory Financial Statements remain relevant, thereby increasing transparency. Ultimately, this promotes competition.

4.165 Our proposals concerning BT's additional reporting are designed to give stakeholders a better understanding of BT's financial performance from a regulatory perspective. The proposals thereby seek to ensure that the Regulatory Financial Statements remain relevant, thereby increasing transparency. Ultimately, this promotes competition.

4.166 As noted above, in proposing these changes we have taken into account all applicable recommendations issued by the European Commission under Article 19(1) of the Framework Directive, in particular Commission Recommendation of 19 September 2005 on accounting separation and cost accounting systems under the regulatory framework for electronic communications.

4.167 In consequence Ofcom believes the proposed directions meet the tests in Sections 3, 4 and 4A.

## Consultation Question

*4.1 Do you agree with our proposals in relation to the adjustments to be made to BT's data for inclusion in the Regulatory Financial Statements and the Adjusted Financial Performance Schedules?*

## Section 5

# VULA Reporting

## Introduction

5.1 In this section we set out for consultation the regulatory reporting requirements that we propose to impose on BT in connection with Virtual Unbundled Local Access (VULA<sup>116</sup>) products. We set out why we need this information and what we propose is to be provided.

## Background

5.2 In the Fixed Access market review we found BT to have SMP in the WLA market. As a result of BT's SMP in this market, we required BT to provide VULA on fair and reasonable terms, conditions and charges,<sup>117</sup> and on a non-discriminatory basis.<sup>118</sup> We also imposed cost accounting and accounting separation conditions in the WLA market which apply to VULA services.<sup>119</sup>

5.3 We decided to continue to allow BT pricing flexibility on VULA prices in general<sup>120</sup> on the basis that the risk of excessive pricing was constrained by the retail prices of standard broadband services and services available from Virgin Media and that any risk was outweighed by the potential impact on investment were we to regulate VULA prices using a cost-based charge control, the need for regulatory consistency and the risks of regulatory failure.<sup>121</sup> We noted that although BT has flexibility on the level of VULA prices, this would be within the constraints imposed by the fair and reasonable terms, conditions and charges and non-discrimination obligations that we had imposed. We did however impose a charge control on GEA migrations.<sup>122</sup> We also noted that going forward, it was important that VULA is separately identified in BT's cost allocation, to ensure that common costs are correctly allocated across the suite of regulated services which are subject to pricing obligations. However, we also said that BT would not be publically required to report these.<sup>123</sup>

5.4 In the VULA Margin Consultation<sup>124</sup> we have set out that the current WLA market review period (2014-2017) is likely to be an important period in the transition from

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<sup>116</sup> VULA provides access to BT's NGA network in a way that is similar to how LLU provides access on its current Copper Access network. However, rather than providing a physical line, VULA provides a virtual connection that gives CPs a direct link to their customers and provides flexibility over how this link is integrated into their network and over product offerings.

<sup>117</sup> With the exception of the GEA migration charge.

<sup>118</sup> SMP conditions 1.1. and 1.2 – Network access on reasonable request, condition 4 – No undue discrimination and condition 5 – Equivalence of Inputs basis, Fixed Access Statement, Annex 29;

<sup>119</sup> Fixed Access Statement, Volume 1, paragraphs 10.216 – 10.223 set out our decisions on accounting separation obligations and paragraphs 10.363 – 10.373 set out our decisions on cost accounting obligations; SMP condition – Regulatory Financial Reporting imposed these obligations on BT.

<sup>120</sup> Paragraph 12.149 of the Fixed Access Statement; Volume 1.

<sup>121</sup> Fixed Access Statement, Volume 1 paragraphs 12.147 - 12.150.

<sup>122</sup> Fixed Access Statement, Volume 1 paragraphs 12.210 - 12.218.

<sup>123</sup> Fixed Access Statement, Volume 1, paragraph 12.213.

<sup>124</sup> Fixed Access Market Reviews: Approach to the VULA margin – paragraph 1.5.

[http://stakeholders.ofcom.org.uk/binaries/consultations/VULA-margin/summary/VULA\\_Margin\\_Consultation.pdf](http://stakeholders.ofcom.org.uk/binaries/consultations/VULA-margin/summary/VULA_Margin_Consultation.pdf)

standard to superfast broadband as take up of superfast broadband services increases.<sup>125</sup> We have noted that while there is clearly a degree of uncertainty, we expect the number of superfast broadband subscribers to grow significantly over the period covered by the current WLA market review period.<sup>126</sup> Superfast broadband services are expected to be highly important in the future for which CPs, who with the exception of Virgin and those with niche fibre networks, will be dependent on BT's VULA product. Therefore, we expect during this period that there will be a shift from LLU to VULA by those CPs that provide services using BT's network.

## Information for effective regulation

- 5.5 In the 2014 Statement we set out our assessment of the objectives of Regulatory Financial Reporting. In doing so, we acknowledged that Regulatory Financial Reporting alone cannot always provide all the information necessary to demonstrate BT's compliance with its SMP conditions. We also accepted that on its own the information provided in any one year might not provide a sufficient basis on which to judge the effectiveness of incentive-based regulation.<sup>127</sup>
- 5.6 However, while recognising the limitations of any regulatory reporting requirements and the extent to which they can demonstrate compliance with and the effectiveness of SMP conditions, we confirmed our view that appropriately specified reporting requirements can and should make a significant contribution to our understanding of both. We said that the Regulatory Financial Statements are a useful source of information and serve as an anchor point to reconcile other data with, which we are able to request through our formal information gathering powers in order to support our decision making. We considered that it is important that information which informs any assessment of compliance or effectiveness is captured in a timely manner.<sup>128</sup>
- 5.7 We concluded that "Regulatory Financial Reporting should provide us with the information necessary to make informed regulatory decisions, monitor compliance with SMP conditions, ensure that those SMP conditions continue to address the underlying competition issues and investigate potential breaches of SMP conditions and anti-competitive practices."<sup>129</sup>

## The purpose of VULA reporting

- 5.8 Given that we consider that the current WLA market review period is likely to be important for competition in superfast broadband, we consider that it is important that BT maintains appropriate and reliable accounts that capture information on an ongoing basis relevant to its provision of VULA. In addition, we consider that it is important that we are provided with additional information in order to monitor the compliance with and the effectiveness of the remedies imposed, particularly our decisions to provide BT with pricing flexibility and to require fair and reasonable VULA charges on a non-discriminatory basis.

<sup>125</sup> VULA Margin Consultation, paragraph 3.41.

<sup>126</sup> VULA Margin Consultation, paragraph 3.44.

<sup>127</sup> 2014 Statement, paragraph 2.26.

<sup>128</sup> 2014 Statement, paragraph 2.27.

<sup>129</sup> 2014 Statement, paragraph 2.28.

- 5.9 This information will also provide transparency to us regarding how BT has allocated costs across services and mitigates against the risk of double recovery of costs or that costs might be unreasonably allocated to particular services.
- 5.10 We also consider that this information will be a useful source of information and will serve as an anchor point to reconcile other data with in order to support our decision making in relation to VULA.
- 5.11 For the above reasons, we consider that additional VULA reporting is required to implement the outcome of the Fixed Access market review and to provide further information to us in private.

## The information we require

### Public information

- 5.12 We propose that BT must disclose the revenue, volume, average price and FAC of each of VULA and VULA Migrations (market summary in the Regulatory Financial Statements).
- 5.13 In addition, we propose that BT must disclose all network components and FAC of VULA Migrations (calculation of FAC based on component costs and usage factors for the WLA market in the Regulatory Financial Statements).

### Private information

- 5.14 We require additional information to be provided to us in private. We propose that BT should provide three new schedules as part of its Regulatory Financial Reporting. We outline below what we are proposing they should include.
- 5.15 The first schedule will set out the revenues, volumes and fully allocated costs on a CCA basis of connections, rentals, migrations and other VULA services for both FTTC and FTTP. The revenues and costs should, in total, be reconciled to the revenues and costs included within the publicly reported totals for the WLA market.
- 5.16 The second schedule is proposed to set out the calculation of FAC based on component costs and usage factors for all services reported under the first schedule except the other VULA services. The fully allocated service unit costs should reconcile to those given in the first schedule.
- 5.17 The third schedule will set out how BT has allocated the government grants, for example from BDUK, for the rollout of superfast broadband services to provide VULA services.

## Summary of proposals and legal tests

- 5.18 In summary we propose that:
- BT must report in the Published Regulated Financial Statements the revenue, volume, average price and FAC of VULA and VULA Migrations. For the purposes of the calculation of FAC based on component costs and usage factors for the WLA market, BT must also disclose all network components and FAC of VULA Migrations.

- BT must provide to Ofcom annually , in private three new schedules as part of the Regulatory Financial Statements.
- 5.19 We have considered our proposals against the tests set out in section 49(2) of the Act and have concluded that they are:
- Objectively justifiable because by amending reporting requirements we reflect the decisions of the Fixed Access market review and recognise the growing importance of VULA over this market review period. Our proposals concerning the additional information to be provided to us in private seek to ensure that we have the information which we need to carry out our functions.
  - Not unduly discriminatory because BT is the only SMP provider who has SMP obligations in relation to VULA services.
  - Proportionate because the changes are no more than is required in order to implement the decisions of the Fixed Access market review and to ensure that we have the information which we need to carry out our functions, and do not extend beyond these.
  - Transparent because it is clear that the intention is to make sure that the Regulatory Financial Statements remain fit for purpose and adequately reflect the outcomes of the Fixed Access market review and that we have the information which we need to carry out our functions.
- 5.20 We have also considered how our proposals meet the tests in Section 3, 4 and 4A of the Act. Our proposals relating to reporting of the VULA services seek to ensure that decisions taken in the Fixed Access market review are reflected in the Regulatory Financial Statements, and that Ofcom has the information it needs to carry out its functions. The proposals therefore increase transparency vis-à-vis other stakeholders, ultimately promoting competition.
- 5.21 As noted above, in proposing these changes we have taken into account all applicable recommendations issued by the European Commission under Article 19(1) of the Framework Directive, in particular Commission Recommendation of 19 September 2005 on accounting separation and cost accounting systems under the regulatory framework for electronic communications.
- 5.22 In consequence Ofcom believes the proposed directions meet the tests in Sections 3, 4 and 4A.

## Consultation Question

*5.1 Do you think that the proposed revisions to the scope, form and content of the Regulatory Financial Statements fairly reflected the decisions of the Fixed Access market review and are necessary to ensure that we have the information which we need to carry out our functions?*

## Section 6

# Electricity Reporting

## Introduction

6.1 In this section we set out for consultation the regulatory reporting requirements that we propose to impose on BT in connection with electricity charges (rate for usage per kWh<sup>130</sup>), setting out why we need the information and what will be provided.

## Background

6.2 In the Fixed Access market review we found BT to have SMP in the WLA market<sup>131</sup>. We decided to impose a basis of charges obligation that requires BT to set electricity charges that are reasonably derived from its relevant electricity purchase costs plus an appropriate mark-up to reflect BT's own costs related to its wholesale purchase of electricity and the setting of the electricity charge.<sup>132</sup> We stated this obligation will use a FAC based approach.<sup>133</sup> We also imposed cost accounting and accounting separation conditions in the WLA market which apply to the electricity charges.<sup>134</sup>

6.3 We said in the Fixed Access Statement that “costs which underpin the electricity charge may be confidential and commercially sensitive as they relate to charges negotiated by BT with its energy suppliers.” We added that where this is the case, we would not expect these to be published. We explained that we would aim to require the publication of such other information as is needed for the purposes of providing transparency.

6.4 We also said that whether or not published, BT would need to demonstrate to us that its charges are reasonably derived from the costs of provision and therefore meet the basis of charges obligation. For this purpose, we said that we are likely to require that BT provides Ofcom with its methodology for how charges have been derived and a compliance statement on an annual basis. We noted BT's comments as to what other information could be reported which is not commercially sensitive. We said that we would consider this further before issuing a cost accounting direction setting out the form of reporting for the Regulatory Financial Statements<sup>135</sup>.

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<sup>130</sup> Local Loop Unbundling Pricing.

<http://www.openreach.co.uk/orpg/home/products/pricing/loadProductPriceDetails.do?data=MLMNXwvAwKCugz8d0%2FWCctZyZbQnOgNEcYi%2FuDLUJWkiMnGHsgdC0vzO163bJmh34D91D7M0q8u%2FIISqtIFAKw%3D%3D>

<sup>131</sup> Fixed Access Statement, Volume 1 paragraph 7.91.

<sup>132</sup> SMP Condition 6.1 provides: “Unless OFCOM directs otherwise from time to time, [BT] must secure, and must be able to demonstrate to the satisfaction of OFCOM, that the Electricity Charge when averaged over each Relevant Year is reasonably derived from the costs of provision based on the wholesale electricity charges paid by the Dominant Provider plus an appropriate mark-up to reflect the [BT]'s costs related to its wholesale purchase of electricity and the setting of the Electricity Charge.”

<sup>133</sup> Fixed Access Statement, Volume 1 paragraph 13.65.

<sup>134</sup> Fixed Access Statement, Volume 1, paragraphs 10.216 – 10.223 set out our decisions on accounting separation obligations and paragraphs 10.363 – 10.373 set out our decisions on cost accounting obligations; SMP condition – Regulatory Financial Reporting imposed these obligations on BT.

<sup>135</sup> Fixed Access Statement, Volume 1 paragraphs 13.82.

## Information for effective regulation

- 6.5 We have summarised our conclusions which we reached in the 2014 Statement about the purpose of the Regulatory Financial Reporting in the section concerning VULA reporting in paragraphs 5.5 – 5.7 above. In addition to these points, we also note that we considered in the 2014 Statement that the Regulatory Financial Statements should provide “reasonable confidence of compliance with cost orientation obligations and monitoring compliance with cost orientation is an important consideration.”<sup>136</sup>

## The purpose of electricity reporting

- 6.6 We continue to believe that some limited publication of non-confidential information is needed to provide to stakeholders transparency as to the methodology which BT uses to set the electricity charges.
- 6.7 In addition, we consider that it is important that we are provided with additional information in order to monitor the compliance with and the effectiveness of the remedies imposed, particularly our decisions to impose a basis of charges obligation in relation to the electricity charges.
- 6.8 This information will also provide further information and transparency to us regarding how BT sets the electricity charges including the mark-up to reflect BT’s own costs related to its wholesale purchase of electricity and the setting of the electricity charges.
- 6.9 We also consider that this information will be a useful source of information and will serve as an anchor point to reconcile other data with in order to support our decision making in relation to the electricity charges.
- 6.10 For the above reasons, we consider that the proposed reporting of the electricity charges is required to provide further information to stakeholders and to us in private about the methodology which BT uses to set the electricity charges.

## The information we require

### Public information

- 6.11 Given the confidential nature of BT’s wholesale electricity contracts, we propose that BT should set out and explain its methodology of setting the electricity charges in the Detailed Attribution Methods . We do not propose that such explanation contain specific financial information, for example about the precise level of BT’s mark up on the purchase electricity costs. We consider that including such information could allow third parties to derive the underlying purchase costs which we consider are likely to be confidential and commercially sensitive.
- 6.12 Nevertheless, we consider that a detailed explanation of the methodology in accordance with which the electricity charges are calculated by BT will provide transparency and give stakeholders a better understanding of how BT sets these charges. We therefore propose to require BT to explain the methodology in the

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<sup>136</sup> 2014 Statement, paragraph 2.63.



Detailed Attribution Methods. The detail of the proposed reporting requirement is set out in the schedule to the proposed direction which is included in Annex 9.<sup>137</sup>

## Private information

- 6.13 We propose that BT must provide us with additional information in relation to its electricity charges. We propose that BT must provide a new AFI as part of its Regulatory Financial Reporting. We outline below what we are proposing this AFI should include.
- 6.14 The statement will set out the revenues, volumes and FAC on a CCA basis of each electricity charge. We propose that the revenues and costs must, in total, be reconcilable to the revenues and costs included within the publicly reported totals for the WLA market.

## Summary of proposals and legal tests

- 6.15 In summary we propose that:
- BT must set out the methodology in accordance with which the electricity charges on an AFI and should publish this methodology in the Detailed Attribution Methods.
  - BT must provide to Ofcom annually, in private an AFI with additional information in relation to its electricity charges.
- 6.16 We have considered our proposals against the tests set out in section 49(2) of the Act and have concluded that they are:
- Objectively justifiable because our proposals concerning the additional information to be provided in the Detailed Attribution Methods seek to ensure that BT provides to stakeholders transparency as to the methodology which it uses to set the electricity charges. Our proposals concerning the additional information to be provided to us in private seek to ensure that we have the information which we need to carry out our functions.
  - Not unduly discriminatory because BT is the only SMP provider which has SMP obligations in relation to the electricity charges.
  - Proportionate because the changes are no more than is required in order to achieve transparency and give us the information we need to carry out our functions, and in particular does not require BT to publish information which may be commercially sensitive.
  - Transparent because it is clear that the intention is to make sure that the Regulatory Financial Statements remain fit for purpose and adequately reflect the outcomes of the Fixed Access market review, that BT provides to stakeholders transparency as to the methodology which it uses to set the electricity charges, and that we have the information which we need to carry out our functions.
- 6.17 We have also considered how our proposals meet the tests in Section 3, 4 and 4A of the Act. Our proposals relating to reporting of the electricity charges seek to ensure that decisions taken in the Fixed Access market review are reflected in the

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<sup>137</sup> Proposal for direction – Attribution Methods in relation to the Electricity Charge.

Regulatory Financial Statements, to achieve transparency and to ensure that Ofcom has the information it needs to carry out its functions. The proposals therefore ultimately promote competition.

- 6.18 As noted above, in proposing these changes we have taken into account all applicable recommendations issued by the European Commission under Article 19(1) of the Framework Directive, in particular Commission Recommendation of 19 September 2005 on accounting separation and cost accounting systems under the regulatory framework for electronic communications.
- 6.19 In consequence Ofcom believes the proposed directions meet the tests in Sections 3, 4 and 4A.

### Consultation Question

*6.1 Do you think that the proposed revisions to the scope, form and content of the Regulatory Financial Statements fairly reflected the decisions of the Fixed Access market review and are necessary to ensure that we have the information which we need to carry out our functions?*

## Annex 1

# Responding to this consultation

## How to respond

- A1.1 Ofcom invites written views and comments on the issues raised in this document, to be made **by 5pm on 26 January 2015**.
- A1.2 Ofcom strongly prefers to receive responses using the online web form at <http://stakeholders.ofcom.org.uk/consultations/bt-transparency/howtorespond/form>, as this helps us to process the responses quickly and efficiently. We would also be grateful if you could assist us by completing a response cover sheet (see Annex 3), to indicate whether or not there are confidentiality issues. This response coversheet is incorporated into the online web form questionnaire.
- A1.3 For larger consultation responses - particularly those with supporting charts, tables or other data - please email [gary.carey@ofcom.org.uk](mailto:gary.carey@ofcom.org.uk) attaching your response in Microsoft Word format, together with a consultation response coversheet.
- A1.4 Responses may alternatively be posted or faxed to the address below, marked with the title of the consultation.
- Gary Carey  
Floor 4  
Competition Finance  
Riverside House  
2A Southwark Bridge Road  
London SE1 9HA
- Fax: 020 7783 4103
- A1.5 Note that we do not need a hard copy in addition to an electronic version. Ofcom will acknowledge receipt of responses if they are submitted using the online web form but not otherwise.
- A1.6 It would be helpful if your response could include direct answers to the questions asked in this document, which are listed together at Annex 4. It would also help if you can explain why you hold your views and how Ofcom's proposals would impact on you.

## Further information

- A1.7 If you want to discuss the issues and questions raised in this consultation, or need advice on the appropriate form of response, please contact Gary Carey on 020 7783 4393.

## Confidentiality

- A1.8 We believe it is important for everyone interested in an issue to see the views expressed by consultation respondents. We will therefore usually publish all responses on our website, [www.ofcom.org.uk](http://www.ofcom.org.uk), ideally on receipt. If you think your response should be kept confidential, can you please specify what part or whether

all of your response should be kept confidential, and specify why. Please also place such parts in a separate annex.

- A1.9 If someone asks us to keep part or all of a response confidential, we will treat this request seriously and will try to respect this. But sometimes we will need to publish all responses, including those that are marked as confidential, in order to meet legal obligations.
- A1.10 Please also note that copyright and all other intellectual property in responses will be assumed to be licensed to Ofcom to use. Ofcom 's approach on intellectual property rights is explained further on its website at <http://www.ofcom.org.uk/about/accoun/disclaimer/>

## Next steps

- A1.11 Following the end of the consultation period, Ofcom intends to publish a statement in spring 2014.
- A1.12 Please note that you can register to receive free mail updates alerting you to the publications of relevant Ofcom documents. For more details please see: [http://www.ofcom.org.uk/static/subscribe/select\\_list.htm](http://www.ofcom.org.uk/static/subscribe/select_list.htm)

## Ofcom's consultation processes

- A1.13 Ofcom seeks to ensure that responding to a consultation is easy as possible. For more information please see our consultation principles in Annex 2.
- A1.14 If you have any comments or suggestions on how Ofcom conducts its consultations, please call our consultation helpdesk on 020 7981 3003 or e-mail us at [consult@ofcom.org.uk](mailto:consult@ofcom.org.uk) . We would particularly welcome thoughts on how Ofcom could more effectively seek the views of those groups or individuals, such as small businesses or particular types of residential consumers, who are less likely to give their opinions through a formal consultation.
- A1.15 If you would like to discuss these issues or Ofcom's consultation processes more generally you can alternatively contact Graham Howell, Secretary to the Corporation, who is Ofcom's consultation champion:

Graham Howell  
Ofcom  
Riverside House  
2a Southwark Bridge Road  
London SE1 9HA

Tel: 020 7981 3601

Email [Graham.Howell@ofcom.org.uk](mailto:Graham.Howell@ofcom.org.uk)

## Annex 2

# Ofcom's consultation principles

A2.1 Ofcom has published the following seven principles that it will follow for each public written consultation:

### Before the consultation

A2.2 Where possible, we will hold informal talks with people and organisations before announcing a big consultation to find out whether we are thinking in the right direction. If we do not have enough time to do this, we will hold an open meeting to explain our proposals shortly after announcing the consultation.

### During the consultation

A2.3 We will be clear about who we are consulting, why, on what questions and for how long.

A2.4 We will make the consultation document as short and simple as possible with a summary of no more than two pages. We will try to make it as easy as possible to give us a written response. If the consultation is complicated, we may provide a shortened Plain English Guide for smaller organisations or individuals who would otherwise not be able to spare the time to share their views.

A2.5 We will consult for up to 10 weeks depending on the potential impact of our proposals.

A2.6 A person within Ofcom will be in charge of making sure we follow our own guidelines and reach out to the largest number of people and organisations interested in the outcome of our decisions. Ofcom's 'Consultation Champion' will also be the main person to contact with views on the way we run our consultations.

A2.7 If we are not able to follow one of these principles, we will explain why.

### After the consultation

A2.8 We think it is important for everyone interested in an issue to see the views of others during a consultation. We would usually publish all the responses we have received on our website. In our statement, we will give reasons for our decisions and will give an account of how the views of those concerned helped shape those decisions.

## Annex 3

# Consultation response cover sheet

- A3.1 In the interests of transparency and good regulatory practice, we will publish all consultation responses in full on our website, [www.ofcom.org.uk](http://www.ofcom.org.uk).
- A3.2 We have produced a coversheet for responses (see below) and would be very grateful if you could send one with your response (this is incorporated into the online web form if you respond in this way). This will speed up our processing of responses, and help to maintain confidentiality where appropriate.
- A3.3 The quality of consultation can be enhanced by publishing responses before the consultation period closes. In particular, this can help those individuals and organisations with limited resources or familiarity with the issues to respond in a more informed way. Therefore Ofcom would encourage respondents to complete their coversheet in a way that allows Ofcom to publish their responses upon receipt, rather than waiting until the consultation period has ended.
- A3.4 We strongly prefer to receive responses via the online web form which incorporates the coversheet. If you are responding via email, post or fax you can download an electronic copy of this coversheet in Word or RTF format from the 'Consultations' section of our website at [www.ofcom.org.uk/consult/](http://www.ofcom.org.uk/consult/).
- A3.5 Please put any parts of your response you consider should be kept confidential in a separate annex to your response and include your reasons why this part of your response should not be published. This can include information such as your personal background and experience. If you want your name, address, other contact details, or job title to remain confidential, please provide them in your cover sheet only, so that we don't have to edit your response.

## Cover sheet for response to an Ofcom consultation

### BASIC DETAILS

Consultation title:

To (Ofcom contact):

Name of respondent:

Representing (self or organisation/s):

Address (if not received by email):

### CONFIDENTIALITY

Please tick below what part of your response you consider is confidential, giving your reasons why

Nothing	<input type="checkbox"/>	Name/contact details/job title	<input type="checkbox"/>
Whole response	<input type="checkbox"/>	Organisation	<input type="checkbox"/>
Part of the response	<input type="checkbox"/>	If there is no separate annex, which parts?	

If you want part of your response, your name or your organisation not to be published, can Ofcom still publish a reference to the contents of your response (including, for any confidential parts, a general summary that does not disclose the specific information or enable you to be identified)?

### DECLARATION

I confirm that the correspondence supplied with this cover sheet is a formal consultation response that Ofcom can publish. However, in supplying this response, I understand that Ofcom may need to publish all responses, including those which are marked as confidential, in order to meet legal obligations. If I have sent my response by email, Ofcom can disregard any standard e-mail text about not disclosing email contents and attachments.

Ofcom seeks to publish responses on receipt. If your response is non-confidential (in whole or in part), and you would prefer us to publish your response only once the consultation has ended, please tick here.

Name

Signed (if hard copy)

## Annex 4

# Consultation questions

Questions requiring responses by 26 January 2014

*3.1 Do you agree with our proposals to give stakeholders a better understanding of BT's financial performance?*

*4.1 Do you agree with our proposals in relation to the adjustments to be made to BT's data for inclusion in the Regulatory Financial Statements and the Adjusted Financial Performance Schedules?*

*5.1 Do you think that the proposed revisions to the scope, form and content of the Regulatory Financial Statements fairly reflected the decisions of the Fixed Access market review and are necessary to ensure that we have the information which we need to carry out our functions?*

*6.1 Do you think that the proposed revisions to the scope, form and content of the Regulatory Financial Statements fairly reflected the decisions of the Fixed Access market review and are necessary to ensure that we have the information which we need to carry out our functions?*



## Annex 5

# Proposal for direction – consistency with regulatory decisions

### Notification of proposal under sections 49 and 49A of the Communications Act 2003 and SMP Services Condition 13A.4 and 8A.4 specifying the requirements in relation to consistency with regulatory decisions

#### Background

1. On 20 May 2014, Ofcom published a policy statement entitled “Regulatory Financial Reporting – Final Statement” (the “May 2014 Statement”), which set out Ofcom’s conclusions on the requirements for regulatory financial reporting that Ofcom considered should be applied to BT in markets in which BT has SMP. Ofcom decided among others to introduce new Regulatory Accounting Principles which principles will include a requirement for “Consistency with regulatory decisions” (“Principle 4”).
2. On 26 June 2014, Ofcom published a statement entitled “Fixed access market reviews: wholesale local access, wholesale fixed analogue exchange lines, ISDN2 and ISDN30” (the “FAMR Statement”). At Annex 29 of the FAMR Statement, Ofcom imposed, among others, SMP services conditions with respect to regulatory accounting on BT (condition 13A) in relation to the following markets:
  - The supply of copper loop-based, cable-based and fibre-based wholesale local access at a fixed location in the United Kingdom excluding the Hull Area;
  - Wholesale fixed analogue exchange line services in the United Kingdom excluding the Hull Area;
  - Wholesale ISDN30 exchange line services in the United Kingdom excluding the Hull Area;
  - Wholesale ISDN2 exchange line services in the United Kingdom excluding the Hull Area.
3. On 26 June 2014, Ofcom published a statement entitled “Review of the wholesale broadband access markets: Statement on market definition, market power determinations and remedies” (the “WBA Statement”). At Annex 2 of the WBA Statement, Ofcom imposed, among others, SMP services conditions with respect to regulatory accounting on BT (condition 8A) in relation to the following market:
  - Wholesale broadband access provided in Market A.
4. Under condition 13A.8 set out at Annex 29 of the FAMR Statement and condition 8A.8 set out at Annex 2 of the WBA Statement, BT is required to comply with, among others, the Regulatory Accounting Principles.

5. Under condition 13A.4 set out at Annex 29 of the FAMR Statement and condition 8A.4 set out at Annex 2 of the WBA Statement, Ofcom may from time to time make such directions as they consider appropriate in relation to BT's obligations under the respective conditions.
6. This Notification relates to the proposals in relation to Principle 4 of the Regulatory Accounting Principles.

#### **Proposal to give direction**

7. Ofcom is proposing to make the direction set out in the Schedule to this Notification.
8. The effect of and reasons for giving the proposed direction are set out in the accompanying consultation.

#### **Ofcom's duties and legal tests**

9. Ofcom considers that the proposed direction referred to in paragraph 7 complies with the requirements of section 49(2) of the Communications Act 2003 (the "Act").
10. In making the proposal referred to in paragraph 7, Ofcom has considered and acted in accordance with its general duties set out in section 3 of the Act, the six community requirements in section 4 of the Act and the duty to take account of European Commission recommendations for harmonisation in section 4A of the Act.

#### **Making representations**

11. Representations may be made to Ofcom about the proposals set out in this Notification and the accompanying consultation by no later than 26 January 2015.
12. In accordance with section 49C(1)(a) of the Act, a copy of the Notification, together with the Schedules, has been sent to the Secretary of State.

#### **Interpretation**

13. Except as otherwise defined, words or expressions used shall have the same meaning as they have been ascribed in the conditions set out in Annex 29 of the FAMR Statement and Annex 2 of the WBA Statement and otherwise any word or expression shall have the same meaning as it has in the Act.

Signed

David Brown

Director of Competition Finance, Ofcom

A person duly authorised in accordance with paragraph 18 of the Schedule to the Office of Communications Act 2002

10 December 2014

## Schedule

### Part 1: Definitions and Interpretation

In this Schedule:

'21CN' means BT's next generation network upgrade;

'Cumulo costs' means the non-domestic (business) rates that BT pays on its Cumulo Rateable Assets within the United Kingdom;

'Cumulo Rateable Assets' means the assets that make up BT's Cumulo non domestic rating assessments in the United Kingdom as defined for England in The Central Rating List (England) Regulations 2005 (SI 2005/551), as amended by The Central Rating List (Amendment) (England) Regulations 2006 (SI 2006/495) and The Central Rating List (Amendment) (England) Regulations 2008 (SI 2008/429), and the analogous legislation that define these assets in Wales, Scotland and Northern Ireland;

'Digital Subscriber Line or DSL' means the family of technologies generically referred to as DSL, or xDSL, which are capable of transforming ordinary local loops into high-speed digital lines and of supporting advanced services;

'Digital Subscriber Loop Access Multiplexer or DSLAM' means the apparatus used to terminate DSL enabled local loops, which comprises a bank of DSL modems and a multiplexer which combines many local loops into one data path;

'Evolutionary Test Access Matrices' or 'evoTAMs' means the equipment used by some SMPF Rental lines which is installed to conduct broadband line testing;

'Future Benefits Principle' means the principle in accordance with which costs relating to new 21CN technology are allocated to legacy services on the basis that 21CN based services might replace these legacy technologies in the future;

'Gross Replacement Cost or GRC' means the cost of replacing an existing tangible fixed asset with an identical or substantially similar new asset having a similar production or service capacity;

'Main Distribution Frame or MDF' means the equipment where local loops terminate and cross connection to competing providers' equipment can be made by flexible jumpers;

'Net Replacement Cost' means the Gross Replacement Cost less accumulated depreciation based on Gross Replacement Cost;

'Next Generation Access or NGA' means the wired access networks which consist wholly or in part of optical elements and which are capable of delivering broadband access services with enhanced characteristics as compared to those provided over already existing copper networks;

'NGA related Cumulo costs' means the element of BT's Cumulo costs within the United Kingdom that is directly attributable to NGA Network Components;

'NGA Network Components' means the Network Components which are used solely to supply VULA services;

'Non-NGA Network Components' means the Network Components other than the NGA Network Components;

'Non-NGA related Cumulo costs' means the Cumulo costs excluding the NGA related Cumulo costs;

'Shared Metallic Path Facility or SMPF' means the provision of access to the copper wires from the customer's premises to a BT MDF that allows a competing provider to provide the customer with broadband services, while BT continues to provide the customer with conventional narrowband communications;

'Test Access Matrices or TAMs' means the equipment used by every MPF Rental line which is installed to conduct broadband line testing;

'Wholesale Residual Market' means the primarily unregulated products, services and components currently referred to as 'Wholesale Residual Market' in the Regulatory Financial Statements;

'WLR + SMPF Simultaneous Connections' means, in the case of:

WLR Start of Stopped MPF Line; or

WLR Standard Connection,

when that service or product is ordered simultaneously with SMPF New Provide but excluding instances in which the relevant service or product is not provided simultaneously as a consequence of a request made by the requesting third party;

'WLR + SMPF Simultaneous Migrations' means, in the case of WLR Conversion, when that service or product is ordered simultaneously with SMPF New Provide but excluding instances in which the relevant service or product is not provided simultaneously as a consequence of a request made by the requesting third party;

## Part 2: Direction

### **Requirements to ensure the Regulatory Financial Statements are consistent with specified regulatory decisions made by Ofcom in the FAMR Statement**

1. BT shall prepare the Regulatory Financial Statements in accordance with the requirements set out in paragraphs 1.1 – 1.10 below. BT shall give priority to the requirements set out in paragraphs 1.1 – 1.10 in the order in which they are set out below.
  - 1.1. In the case of internal Shared Metallic Path Facilities, BT shall:
    - 1.1.1. separately identify each of the following Network Services in the Regulatory Financial Statements:
      - a) SMPF Rentals;
      - b) SMPF New Provides;
      - c) SMPF Single Migrations;
      - d) SMPF Bulk Migrations; and
      - e) Tie Cables.

1.1.2. separately attribute the costs and volumes of each of the Network Services set out in paragraphs 1.1.1(a) – 1.1.1(e).

1.2. BT shall attribute the costs of Directories to the Wholesale Residual Market.

1.3. In the case of DSLAM capital/maintenance, BT shall:

1.3.1. attribute 70 per cent of the costs of DSLAM capital/maintenance to Special Fault Investigation Services;

1.3.2. attribute 30 per cent of the costs of DSLAM capital/maintenance to each of Analogue Core WLR Rentals, MPF Rentals and SMPF Rentals using the combined usage factor set out in Table 1 below.

Table 1

	Analogue Core WLR Rentals	MPF Rentals	SMPF Rentals
Combined usage factor	0.83	1.21	0.21

1.4. BT shall attribute the costs of each of the following sub-groups of BT's group functions:

1.4.1. Tax/Treasury;

1.4.2. Group Finance Control; and

1.4.3. Strategy

to each of BT's UK subsidiaries and BT's overseas subsidiaries according to the total average number of employees employed by each subsidiary.

1.5. BT shall attribute the costs of the provision for deafness claims arising from the past use of copper line testing equipment to the Wholesale Residual Market.

1.6. In the case of Cumulo costs, BT shall follow the requirements set out in paragraphs 1.6.1 – 1.6.2 in the order in which these requirements are set out below:

1.6.1. BT shall attribute the NGA related Cumulo costs to the NGA Network Components;

1.6.2. BT shall attribute the Non-NGA related Cumulo costs to the Non-NGA Network Components on the basis of profit weighted Net Replacement Costs in accordance with the following formula:

$$Cum_{all\ i=N}NGACC \times \left( \frac{\sum_{j=1}^m nrc_{ij} \text{ land}\%_j wacc_i}{\sum_{i=1}^n \sum_{j=1}^m nrc_{ij} \text{ land}\%_j wacc_i} \right)$$

Where

$Cumall_i$  = the allocation of the Non-NGA related Cumulo costs to component  $i$

NNGACC = Non-NGA related Cumulo costs

$nrc_{ij}$  = the Net Replacement Costs of the Cumulo Rateable Asset  $j$  that has been attributed to component  $i$

$land\%_j$  = the percentage of the Cumulo Rateable Asset  $j$  that is regarded as being a landlord asset within the most recent rating model used by the Valuation Office Agency in England and Wales to value BT's Cumulo assessment

$wacc_i$  = the weighted average cost of capital that is applicable for component  $i$

$m$  = the number of the Cumulo Rateable Asset categories

$n$  = the number of the Non-NGA Network Components

1.7. In the case of TAMs, BT shall:

- 1.7.1. depreciate the costs of TAMs over a seven year period;
- 1.7.2. attribute the costs of TAMs to MPF Rentals; and
- 1.7.3. attribute the costs of installation of Tie Cables to EvoTAMs.

1.8. In the case of EvoTAMs, BT shall attribute the costs of EvoTAMs to the Wholesale Residual Market.

1.9. BT shall:

- 1.9.1. separately identify each of WLR + SMPF Simultaneous Connections and WLR + SMPF Simultaneous Migrations; and
- 1.9.2. separately attribute the costs of each of WLR + SMPF Simultaneous Connections and WLR + SMPF Simultaneous Migrations.

1.10. In the case of Analogue Core WLR Rentals, MPF Rentals and SMPF Rentals, BT shall attribute the costs of each of the following Network Components:

- 1.10.1. D-side Copper Current;
- 1.10.2. E-side Copper Current;
- 1.10.3. Local Exchanges General Frames Current;
- 1.10.4. Residential PSTN drop maintenance; and
- 1.10.5. DSLAM capital/maintenance

using the combined usage factor set out in Table 1 above.

## **Requirements to ensure the Regulatory Financial Statements are consistent with specified regulatory decisions made by Ofcom in the WBA Statement**

2. BT shall prepare the Regulatory Financial Statements in accordance with the requirements set out in paragraphs 2.1 – 2.4 below. BT is required to give priority to the requirements set out in paragraphs 2.1 – 2.4 in the order in which they are set out below.

2.1. BT shall attribute the costs of each of the following Network Components:

- 2.1.1. ATM customer interface 2Mbit/s;
  - 2.1.2. ATM customer interface 34Mbit/s;
  - 2.1.3. ATM customer interface >155Mbit/s;
  - 2.1.4. ATM network interface;
  - 2.1.5. ATM network switching;
  - 2.1.6. Inter ATM transmissions; and
  - 2.1.7. SG&A Broadband
- according to the actual revenues and volumes.

2.2. The costs of DSLAM capital/maintenance which are used to provide the Network Services to the End Users shall be attributed to each of Market A and Market B according to the actual volume of DSLAM in each of Market A and Market B.

2.3. BT shall attribute the costs of the Network Services provided to the End Users in Market A and Market B to each of Market A and Market B according to the location of the exchange from which the End User receives the Network Services.

2.4. BT shall not attribute the costs of 21CN in accordance with the Future Benefits Principle to the Network Services which do not use 21CN.

## Annex 6

# Proposal for directions - Adjusted Financial Performance

**Notification of proposal under sections 49 and 49A of the Communications Act 2003 and SMP Services Condition OA2, 13A.4 and 8A.4 specifying the requirements in relation to additional reporting of information relating to BT's adjusted financial performance**

### Background

1. On 22 July 2004, Ofcom published a statement entitled "The regulatory financial reporting obligations on BT and Kingston Communications Final statement and notification – Accounting separation and cost accounting: Final Statement and notification" (the "July 2004 Statement"). At Annex 2 of this statement, Ofcom imposed SMP services conditions with respect to regulatory accounting on BT in markets in which BT had been found to have significant market power in previously concluded market reviews.
2. On 26 June 2014, Ofcom published a statement entitled "Fixed access market reviews: wholesale local access, wholesale fixed analogue exchange lines, ISDN2 and ISDN30" (the "FAMR Statement"). At Annex 29 of the FAMR Statement, Ofcom imposed, among others, SMP services conditions with respect to regulatory accounting on BT (condition 13A) in relation to the following markets:
  - The supply of copper loop-based, cable-based and fibre-based wholesale local access at a fixed location in the United Kingdom excluding the Hull Area;
  - Wholesale fixed analogue exchange line services in the United Kingdom excluding the Hull Area;
  - Wholesale ISDN30 exchange line services in the United Kingdom excluding the Hull Area;
  - Wholesale ISDN2 exchange line services in the United Kingdom excluding the Hull Area.
3. On 26 June 2014, Ofcom published a statement entitled "Review of the wholesale broadband access markets: Statement on market definition, market power determinations and remedies" (the "WBA Statement"). At Annex 2 of the WBA Statement, Ofcom imposed, among others, SMP services conditions with respect to regulatory accounting on BT (condition 8A) in relation to the following market:
  - Wholesale broadband access provided in Market A.



4. Under condition OA2 set out at Annex 2 of the July 2004 Statement, condition 13A.4 set out at Annex 29 of the FAMR Statement and condition 8A.4 set out at Annex 2 of the WBA Statement, Ofcom may from time to time make such directions as they consider appropriate in relation to BT's obligations under conditions OA5, 13A.8(i) and 8A.8(i) respectively.
5. This Notification relates to proposals in relation to the Regulatory Financial Statements which BT is required to prepare, and in particular BT's reporting of information relating to its adjusted financial performance.

### **Proposal to give direction**

6. Ofcom is proposing to make the direction set out in the Schedule to this Notification.
7. The effect of and reasons for giving the proposed direction are set out in the accompanying consultation.

### **Ofcom's duties and legal tests**

8. Ofcom considers that the proposed direction referred to in paragraph 6 complies with the requirements of section 49(2) of the Communications Act 2003 (the "Act").
9. In making the proposal referred to in paragraph 6, Ofcom has considered and acted in accordance with its general duties set out in section 3 of the Act, the six community requirements in section 4 of the Act and the duty to take account of European Commission recommendations for harmonisation in section 4A of the Act.

### **Making representations**

10. Representations may be made to Ofcom about the proposals set out in this Notification and the accompanying consultation by no later than 26 January 2015.
11. In accordance with section 49C(1)(a) of the Act, a copy of the Notification, together with the Schedules, has been sent to the Secretary of State.

## **Interpretation**

12. Except as otherwise defined, words or expressions used shall have the same meaning as they have been ascribed in the conditions set out in Annex 2 of the July 2004 Statement, Annex 29 of the FAMR Statement and Annex 2 of the WBA Statement and otherwise any word or expression shall have the same meaning as it has in the Act.

Signed

David Brown

Director of Competition Finance, Ofcom

A person duly authorised in accordance with paragraph 18 of the Schedule to the Office of Communications Act 2002

10 December 2014

## Schedule

### Part 1: Definitions and Interpretation

In this Schedule:

'Asynchronous Transfer Mode or ATM' means the network technology that uses asynchronous time division multiplexing techniques and which supports data transmissions at up to 622Mbit/s;

'Asset Volume Elasticity or AVE' means the percentage increase in capital costs required for a 1% increase in volume;

'Digital Subscriber Loop Access Multiplexer or DSLAM' means the apparatus used to terminate DSL enabled local loops, which comprises a bank of DSL modems and a multiplexer which combines many local loops into one data path;

'Fully Allocated Cost or FAC' means an accounting approach under which all the costs of the company are distributed between its various products and services. The fully allocated cost of a product or service may therefore include some common costs that are not directly attributable to the service;

'Gross Replacement Cost or GRC' means the cost of replacing an existing tangible fixed asset with an identical or substantially similar new asset having a similar production or service capacity;

'Long Run Incremental Cost or LRIC' means the cost caused by the provision of a defined increment of output given the costs can, if necessary, be varied and that some level of output is already produced;

'Net Replacement Cost or NRC' means the Gross Replacement Cost less accumulated depreciation based on Gross Replacement Cost;

'Other CCA Adjustments' means the one-off, non-recurring adjustments made by BT when preparing the Regulatory Financial Statements and which are referred to by BT as 'Other CCA adjustments' in BT's Regulatory Financial Statements;

'Synchronous Digital Hierarchy or SDH' means the digital transmission standard that is widely used in communications networks;

'Test Access Matrices or TAMs' means the equipment used by every MPF line which is installed to conduct broadband line testing.

## Part 2: Direction

BT shall prepare the Annex "Adjusted Financial Performance" of the Regulatory Financial Statements as referred to in the Direction relating to the Preparation, audit, delivery and publication of the Regulatory Financial Statements to show the impact on the Regulatory Financial Statements of the adjustments set out below in aggregate.

1. BT shall give priority to the requirements set out in paragraphs 1.1 – 1.7 in the order in which they are set out below.

1.1. BT shall calculate the difference between:

- 1.1.1.1. the LRIC of Analogue Core WLR Rentals; and
- 1.1.1.2. the LRIC of MPF Rentals,  
(the "WLR Minus MPF LRIC Differential").

1.2. In the case of TAMs, BT shall:

- 1.2.1. set the LRIC of TAMs per line used by MPF Rentals at £3.75; and
- 1.2.2. attribute the common costs of TAMs which exceed LRIC to each of Analogue Core WLR Rentals and MPF Rentals so that the WLR Minus MPF LRIC Differential remains as calculated in paragraph 1.1.

1.3. In the case of PSTN Line Cards, BT shall:

- 1.3.1. increase the NRC of the assets of PSTN Line Cards to £715 million in the Financial Year ending on 31 March 2011;
- 1.3.2. adjust the NRC identified in point 1.3.1 in each subsequent Financial Year by complying with the following requirements in the order in which they are set out below:
  - i. applying the Asset Volume Elasticity for the local exchange asset sector derived from BT's Long Run Incremental Cost Methodology; and
  - ii. reducing the resultant NRC identified in point 1.3.2(i) by a cumulative 5 per cent per year starting with the Financial Year 2012;
- 1.3.3. set the NRC of PSTN Line Cards at LRIC and attribute the common costs of PSTN Line Cards which exceed LRIC to each of Analogue Core WLR Rentals and MPF Rentals so that the WLR Minus MPF LRIC Differential remains as calculated in paragraph 1.1.

1.4. In the case of Combi Card Voice, BT shall reduce the NRC of the assets of Combi Card Voice to £0.

1.5. BT shall set the costs of the following Network Services at LRIC:

- 1.5.1. Caller Display;
- 1.5.2. MPF Single Migration;

- 1.5.3. MPF Bulk Migration;
- 1.5.4. SMPF Single Migration;
- 1.5.5. SMPF Bulk Migration; and
- 1.5.6. WLR Transfer.

1.6. BT shall:

- 1.6.1. identify the common costs of the Network Services set out in paragraphs 1.5.1 – 1.5.6 which exceed their respective LRICs; and
- 1.6.2. attribute the common costs identified in paragraph 1.6.1 to Analogue Core WLR Rentals and MPF Rentals so that the WLR Minus MPF LRIC Differential remains as calculated in paragraph 1.1.

1.7. In the case of SMPF Rentals, BT shall:

- 1.7.1. set the costs of SMPF Rentals at LRIC;
- 1.7.2. identify the common costs of SMPF Rentals which exceed LRIC; and
- 1.7.3. attribute the common costs identified in paragraph 1.7.2 to Analogue Core WLR Rentals and MPF Rentals so that the WLR Minus MPF LRIC Differential remains as calculated in paragraph 1.1.

2. BT shall give priority to the requirements set out in paragraphs 2.1 – 2.2 in the order in which they are set out below.

2.1. BT shall:

- 2.1.1. set the GRC of DSLAM at the average current cost of DSLAM;
- 2.1.2. set and maintain the NRC:GRC ratio at 50% in relation to the following assets:
  - 2.1.2.1. ATM;
  - 2.1.2.2. SDH; and
  - 2.1.2.3. DSLAM;
- 2.1.3. depreciate the assets set out in paragraphs 2.1.2(a) – 2.1.2(c) over a thirteen year period.

2.2. BT shall remove the Other CCA Adjustments in the Regulatory Financial Statements by presenting the figures in the Regulatory Financial Statements as if the Other CCA adjustments had not been made.



Annex to proposed  
direction on adjusted

## Annex 7

# Proposal for direction modifying requirements set out in Direction 3 and setting requirements giving effect to SMP Services Conditions imposed in the FAMR Statement and the WBA Statement

## Notification of proposal under sections 49 and 49A of the Communications Act 2003 and SMP Services Condition OA2, 13A.4 and 8A.4 modifying and setting the requirements in relation to preparation, audit, delivery and publication of the Regulatory Financial Statements

### Background

1. On 22 July 2004, Ofcom published a statement entitled “The regulatory financial reporting obligations on BT and Kingston Communications Final statement and notification – Accounting separation and cost accounting: Final Statement and notification” (the “July 2004 Statement”). At Annex 2 of this statement, Ofcom imposed SMP services conditions with respect to regulatory accounting on BT in markets in which BT had been found to have significant market power in previously concluded market reviews.
2. At Annex 4 of the July 2004 Statement, Ofcom published various directions for BT given under the SMP services conditions. These included a direction relating to the Preparation, audit, delivery and publication of the Regulatory Financial Statements (“Direction 3”).
3. Direction 3 was subsequently modified by:
  - a. the Direction published at Annex 2 of the regulatory statement “Changes to BT’s regulatory financial reporting framework” of 31 August 2005;
  - b. the Direction published at Annex 2 of the regulatory statement “Changes to BT’s regulatory financial reporting and audit requirements” of 16 August 2006;
  - c. the Direction published at Annex 4 of the regulatory statement “Changes to BT’s regulatory financial reporting and audit requirements” of 30 May 2007;
  - d. the Direction published at Annex 4 of the regulatory statement “Changes to BT’s 2007/08 regulatory financial statements” of 26 June 2008;
  - e. the Direction published at Annex 4 of the regulatory statement “Changes to BT and KCOM’s regulatory financial reporting – 2008/09 update” of 15 June 2009;
  - f. the Direction published at Annex 3 of the regulatory statement “Changes to BT and KCOM’s regulatory and financial reporting 2009/10 update” of 4 June 2010;





- Wholesale ISDN30 exchange line services in the United Kingdom excluding the Hull Area;
  - Wholesale ISDN2 exchange line services in the United Kingdom excluding the Hull Area.
8. On 26 June 2014, Ofcom published a statement entitled “Review of the wholesale broadband access markets: Statement on market definition, market power determinations and remedies” (the “WBA Statement”). At Annex 2 of the WBA Statement, Ofcom imposed, among others, SMP services conditions with respect to regulatory accounting on BT (condition 8A) in relation to the following market:
- Wholesale broadband access provided in Market A.
9. Under conditions 13A.1 to 13A.37 set out at Annex 29 of the FAMR Statement and conditions 8A.1 to 8A.37 set out at Annex 2 of the WBA Statement, and in particular conditions 13A.8 and 8A.8, BT is required to prepare, deliver to Ofcom and publish the Regulatory Financial Statements as directed by Ofcom from time to time.
10. Under conditions OA2 set out at Annex 2 of the July 2004 Statement, condition 13A.4 set out at Annex 29 of the FAMR Statement and condition 8A.4 set out at Annex 2 of the WBA Statement, Ofcom may from time to time make such directions as they consider appropriate in relation to BT’s obligations under conditions OA5, 13A.8 and 8A.8 respectively.
11. This Notification sets out proposals for further requirements in relation to the preparation, delivery and publication of the Regulatory Financial Statements.

### **Proposal to give direction**

12. Ofcom is proposing to make the direction set out in the Schedule to this Notification.
13. The effect of and reasons for giving the proposed direction are set out in the accompanying consultation.

### **Ofcom’s duties and legal tests**

14. Ofcom considers that the proposed direction referred to in paragraph 12 complies with the requirements of section 49(2) of the Communications Act 2003 (the “Act”).
15. In making the proposals referred to in paragraph 12, Ofcom has considered and acted in accordance with its general duties set out in section 3 of the Act, the six community requirements in section 4 of the Act and the duty to take account of European Commission recommendations for harmonisation in section 4A of the Act.

### **Making representations**

16. Representations may be made to Ofcom about the proposals set out in this Notification and the accompanying consultation document by no later than 26 January 2015.
17. In accordance with section 49C(1)(a) of the Act, a copy of the Notification, together with the Schedules, has been sent to the Secretary of State.

### **Interpretation**

18. Except as otherwise defined, words or expressions used shall have the same meaning as they have been ascribed in the conditions set out in Annex 2 of the July 2004 Statement, Annex 29 of the FAMR Statement and Annex 2 of the WBA Statement and otherwise any word or expression shall have the same meaning as it has in the Act.

Signed

David Brown

Director of Competition Finance, Ofcom

A person duly authorised in accordance with paragraph 18 of the Schedule to the Office of Communications Act 2002

10 December 2014

## Schedule

1. The information set out in the Annex to Direction 3 is modified by adding the following statements to the list of statements to be produced, provided to Ofcom and published as indicated:

- a) Adjusted financial performance at a market review level – to be produced, provided to Ofcom and published; and
- b) Adjusted financial performance at a market level – to be produced and provided to Ofcom.

2. BT shall, for the purposes of conditions 13A.8 and/or 8A.8, prepare, deliver to Ofcom and publish as indicated the following statements:

- a) Adjusted financial performance at a market review level – to be prepared, delivered to Ofcom and published;
- b) Adjusted financial performance at a market level – to be prepared and delivered to Ofcom;
- c) Market summary of individual VULA services – to be prepared and delivered to Ofcom;
- d) Calculation of FAC based components costs and usage factors of individual VULA services – to be prepared and delivered to Ofcom;
- e) VULA allocation of government grants – to be prepared and delivered to Ofcom; and
- f) Additional financial information for Electricity Charges – to be prepared and delivered to Ofcom.

## Annex 8

# Proposal for direction modifying requirements set out in Direction 4 and setting requirements giving effect to SMP Services Conditions imposed in the FAMR Statement and the WBA Statement

## Notification of proposal under sections 49 and 49A of the Communications Act 2003 and SMP Services Condition OA2, 13A.4 and 8A.4 modifying and setting the requirements in relation to the form and content of the Regulatory Financial Statements

### Background

1. On 22 July 2004, Ofcom published a statement entitled “The regulatory financial reporting obligations on BT and Kingston Communications Final statement and notification – Accounting separation and cost accounting: Final Statement and notification” (the “July 2004 Statement”). At Annex 2 of this statement, Ofcom imposed SMP services conditions with respect to regulatory accounting on BT in markets in which BT had been found to have significant market power in previously concluded market reviews.
2. At Annex 4 of the July 2004 Statement, Ofcom published various directions for BT given under the SMP services conditions. These included a direction relating to the form and content of the Regulatory Financial Statements (“Direction 4”).
3. Direction 4 was subsequently modified by:
  - a. the Direction published at Annex 3 of the regulatory statement “Changes to BT’s regulatory financial reporting framework” of 31 August 2005;
  - b. the Direction published at Annex 3 of the regulatory statement “Changes to BT’s regulatory financial reporting and audit requirements” of 16 August 2006;
  - c. the Direction published at Annex 5 of the regulatory statement “Changes to BT’s regulatory financial reporting and audit requirements” of 30 May 2007;
  - d. the Direction published at Annex 5 of the regulatory statement “Changes to BT’s 2007/08 regulatory financial statements” of 26 June 2008;
  - e. the Direction published at Annex 5 of the regulatory statement “Changes to BT and KCOM’s regulatory financial reporting – 2008/09 update” of 15 June 2009;
  - f. the Direction published at Annex 4 of the regulatory statement “Changes to BT and KCOM’s regulatory and financial reporting 2009/10 update” of 4 June 2010;

- g. the Direction published at Annex 5 of the regulatory statement “Changes to BT and KCOM’s regulatory and financial reporting 2010/11 update” of 2 June 2011;
    - h. the Direction published at Annex 2 of the regulatory statement “Changes to BT and KCOM’s regulatory and financial reporting 2011/12 update” of 17 April 2012; and
    - i. the Direction published at Annex 1 of the regulatory statement “Changes to BT and KCOM’s regulatory and financial reporting 2012/13 update” of 25 April 2013; and
    - j. the Direction published at Annex 4 of the regulatory statement “Changes to BT and KCOM’s regulatory and financial reporting 2013/14 update” of 3 April 2014.
4. The SMP services conditions set out at Annex 2 of the July 2004 Statement and Direction 4 continue to apply in relation to the markets in which BT was found to have SMP and regulatory reporting requirements were imposed at Annex 7 of a statement entitled “Business Connectivity Market Review: Review of retail leased lines, wholesale symmetric broadband origination and wholesale trunk segments” published on 28 March 2013, and at Annex 1 of a statement entitled “Review of the fixed narrowband services markets: Statement on the proposed markets, market power determinations and remedies” published on 26 September 2013.
5. On 20 December 2013, Ofcom published a consultation entitled “Regulatory Financial Reporting – a review” (the “2013 Consultation”), which set out proposals for SMP services conditions relating to regulatory financial reporting to be imposed in the following markets:
  - The supply of copper loop-based, cable-based and fibre-based wholesale local access at a fixed location in the United Kingdom excluding the Hull Area;
  - Wholesale fixed analogue exchange line services in the United Kingdom excluding the Hull Area;
  - Wholesale ISDN30 exchange line services in the United Kingdom excluding the Hull Area;
  - Wholesale ISDN2 exchange line services in the United Kingdom excluding the Hull Area;
  - Wholesale broadband access provided in Market A.
6. The proposals set out in the 2013 Consultation also set out proposals for requirements to be imposed by direction in relation to the form and content of the Regulatory Financial Statements in relation to the markets referred to in paragraph 5.
7. On 26 June 2014, Ofcom published a statement entitled “Fixed access market reviews: wholesale local access, wholesale fixed analogue exchange lines, ISDN2 and ISDN30” (the “FAMR Statement”). At Annex 29 of the FAMR Statement, Ofcom imposed, among others, SMP services conditions with respect to regulatory accounting on BT (condition 13A) in relation to the following markets:

- The supply of copper loop-based, cable-based and fibre-based wholesale local access at a fixed location in the United Kingdom excluding the Hull Area;
  - Wholesale fixed analogue exchange line services in the United Kingdom excluding the Hull Area;
  - Wholesale ISDN30 exchange line services in the United Kingdom excluding the Hull Area;
  - Wholesale ISDN2 exchange line services in the United Kingdom excluding the Hull Area.
8. On 26 June 2014, Ofcom published a statement entitled “Review of the wholesale broadband access markets: Statement on market definition, market power determinations and remedies” (the “WBA Statement”). At Annex 2 of the WBA Statement, Ofcom imposed, among others, SMP services conditions with respect to regulatory accounting on BT (condition 8A) in relation to the following market:
- Wholesale broadband access provided in Market A.
9. Under conditions OA2 set out at Annex 2 of the July 2004 Statement, condition 13A.4 set out at Annex 29 of the FAMR Statement and condition 8A.4 set out at Annex 2 of the WBA Statement, Ofcom may from time to time make such directions as they consider appropriate in relation to BT’s obligations under the respective conditions.
10. This Notification sets out proposals for further requirements in relation to the form and content of the Regulatory Financial Statements.

### **Proposal to give direction**

11. Ofcom is proposing to make the direction set out in the Schedule to this Notification.
12. The effect of and reasons for giving the proposed direction are set out in the accompanying consultation.

### **Ofcom’s duties and legal tests**

13. Ofcom considers that the proposed modification and direction referred to in paragraph 11 complies with the requirements of section 49(2) of the Communications Act 2003 (the “Act”).
14. In making the proposals referred to in paragraph 11, Ofcom has considered and acted in accordance with its general duties set out in section 3 of the Act, the six community requirements in section 4 of the Act and the duty to take account of European Commission recommendations for harmonisation in section 4A of the Act.

### **Making representations**

15. Representations may be made to Ofcom about the proposals set out in this Notification and the accompanying consultation document by no later than 26 January 2015.
16. In accordance with section 49C(1)(a) of the Act, a copy of the Notification, together with the Schedules, has been sent to the Secretary of State.

### **Interpretation**

17. Except as otherwise defined, words or expressions used shall have the same meaning as they have been ascribed in the conditions set out in Annex 2 of the July 2004 Statement, Annex 29 of the FAMR Statement and Annex 2 of the WBA Statement and otherwise any word or expression shall have the same meaning as it has in the Act.

Signed

David Brown

Director of Competition Finance, Ofcom

A person duly authorised in accordance with paragraph 18 of the Schedule to the Office of Communications Act 2002

10 December 2014

## Schedule

1. The form and content of the Regulatory Financial Statements required under condition OA5 at Annex 2 of the July 2004 Statement and Direction 3 at Annex 4 of the July 2004 Statement and set out in Direction 4 at Annex 4 of the July 2004 Statement is modified in that BT shall prepare the statement “Adjusted financial performance at a market review level” as shown in the Annex to this Schedule.
2. BT shall prepare the Regulatory Financial Statements required under conditions 13A.8 at Annex 29 of the FAMR Statement and 8A.8 at Annex 2 of the WBA Statement and under any direction setting out requirements of statements to be prepared, delivered to Ofcom and published, in accordance with the following form and content requirements:
  - 2.1. In relation to the market summary for the supply of copper loop-based, cable-based and fibre-based wholesale local access at a fixed location in the United Kingdom excluding the Hull Area, BT shall disclose the revenue, volume, average price and FAC of the following services:
    - a) Virtual Unbundled Local Access; and
    - b) Virtual Unbundled Local Access Migrations.
  - 2.2. In relation to the calculation of FAC based on component costs and usage factors for the supply of copper loop-based, cable-based and fibre-based wholesale local access at a fixed location in the United Kingdom excluding the Hull Area, BT shall disclose all Network Components and FAC of the service Virtual Unbundled Local Access Migrations;
  - 2.3. In relation to the Adjusted financial performance at a market review level, BT shall prepare the statement as shown in the Annex to this Schedule.



## Annex 9

# Proposal for direction – Attribution Methods in relation to the Electricity Charge

## Notification of proposal under sections 49 and 49A of the Communications Act 2003 and SMP Services Condition 13A.4 specifying the requirements in relation to reporting of information relating to BT's Attribution Methods in relation to the Electricity Charge

### Background

1. On 26 June 2014, Ofcom published a statement entitled “Fixed access market reviews: wholesale local access, wholesale fixed analogue exchange lines, ISDN2 and ISDN30” (the “FAMR Statement”). At Annex 29 of the FAMR Statement, Ofcom imposed, among others, SMP services conditions with respect to regulatory accounting on BT (condition 13A) in relation to the following markets:
  - The supply of copper loop-based, cable-based and fibre-based wholesale local access at a fixed location in the United Kingdom excluding the Hull Area;
  - Wholesale fixed analogue exchange line services in the United Kingdom excluding the Hull Area;
  - Wholesale ISDN30 exchange line services in the United Kingdom excluding the Hull Area;
  - Wholesale ISDN2 exchange line services in the United Kingdom excluding the Hull Area.
2. Under condition 13A.18 set out at Annex 29 of the FAMR Statement BT must prepare, maintain and keep up-to-date the Accounting Methodology Documents.
3. Under condition 13A.20 BT must deliver an up-to-date version of the Accounting Methodology Documents to Ofcom when it delivers the Regulatory Financial Statements to Ofcom and publish such up-to-date version on or before the day of publication of the Regulatory Financial Statements which have been prepared in accordance with such version.
4. Under condition 13A.4 Ofcom may from time to time make such directions as they consider appropriate in relation to BT's obligations under conditions 13A.
5. This Notification relates to the proposals in relation to the Accounting Methodology Documents which BT is required to prepare, maintain, keep up-to-date, deliver to Ofcom and publish, and in particular BT's Attribution Methods in relation to the Electricity Charge.

**Proposal to give direction**

6. Ofcom is proposing to make the direction set out in the Schedule to this Notification.
7. The effect of and reasons for giving the proposed direction are set out in the accompanying consultation.

**Ofcom's duties and legal tests**

8. Ofcom considers that the proposed direction referred to in paragraph 6 complies with the requirements of section 49(2) of the Communications Act 2003 (the "Act").
9. In making the proposal referred to in paragraph 6, Ofcom has considered and acted in accordance with its general duties set out in section 3 of the Act, the six community requirements in section 4 of the Act and the duty to take account of European Commission recommendations for harmonisation in section 4A of the Act.

**Making representations**

10. Representations may be made to Ofcom about the proposals set out in this Notification and the accompanying consultation by no later than 26 January 2015.
11. In accordance with section 49C(1)(a) of the Act, a copy of the Notification, together with the Schedules, has been sent to the Secretary of State.

**Interpretation**

12. Except as otherwise defined, words or expressions used shall have the same meaning as they have been ascribed in the conditions set out in Annex 29 of the FAMR Statement and otherwise any word or expression shall have the same meaning as it has in the Act.

Signed

David Brown

Director of Competition Finance, Ofcom

A person duly authorised in accordance with paragraph 18 of the Schedule to the Office of Communications Act 2002

10 December 2014

## **Schedule**

1. BT shall, for the purposes of conditions 13A.18 to 13A.20, include in the Accounting Methodology Documents a description of the Attribution Methods in relation to the Electricity Charge.

