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## **Regulatory Financial Reporting**

Consultation on proposed directions to BT arising from the Wholesale Local Access and Wholesale Broadband Access market reviews

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### **CONSULTATION:**

**Publication Date:** 24 November 2017

**Closing Date for Responses:** 15 January 2018

# About this document

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In this document we consult on a set of draft directions relating to BT's Regulatory Financial Reporting obligations. These implement and support the proposals we made in our ongoing reviews of the Wholesale Local Access and Wholesale Broadband Access markets, including those set out in our:

- March 2017 WLA Consultation<sup>1</sup>;
- April 2017 Duct and Pole Access ("DPA") DPA Consultation<sup>2</sup> and the August 2017 DPA Pricing Consultation<sup>3</sup>;
- WLA Network Expansion Consultation<sup>4</sup>;
- September 2017 WLA Consultation<sup>5</sup>; and
- 2017 WBA Consultation<sup>6</sup>.

This document also sets out a proposal to modify the current direction we imposed in the 2014 Fixed Access Review for the purposes of preparing the 2017/18 RFS in relation to the attribution of cumulo rates (business rates charged by the UK rating authorities on BT's network assets). This is in light of the fact that a new rating valuation will be in place for 2017/18, so that BT would no longer be able to comply with the current direction should it remain in its current form. We will take all responses

We invite responses to this consultation by 15 January 2018.

We will take all responses to this consultation into account before reaching our final conclusions which we plan to publish in a statement early next year.

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<sup>1</sup> We refer to the Ofcom, 2017. *Wholesale Local Access Market Review – Consultation on the proposed market, market power determinations and remedies – Volume 1* and Ofcom, 2017. *Wholesale Local Access Market Review – Consultation on proposed charge control designs and implementation – Volume 2*. <https://www.ofcom.org.uk/consultations-and-statements/category-1/wholesale-local-access-market-review>.

<sup>2</sup> Ofcom, 2017. *Wholesale Local Access Market Review: Consultation on Duct and Pole Access remedies*, [https://www.ofcom.org.uk/data/assets/pdf\\_file/0008/101051/duct-pole-access-remedies-consultation.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0008/101051/duct-pole-access-remedies-consultation.pdf).

<sup>3</sup> Ofcom, WLA market review: *Consultation on pricing proposals for Duct and Pole Access remedies*, August 2017 <https://www.ofcom.org.uk/consultations-and-statements/category-2/pricing-proposals-duct-pole-access>.

<sup>4</sup> Ofcom, 2017. *Wholesale Local Access Market Review: Consultation on Recovering the cost of investment in network expansion*, [https://www.ofcom.org.uk/data/assets/pdf\\_file/0022/105682/Recovering-the-costs-of-investment-in-network-expansion.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0022/105682/Recovering-the-costs-of-investment-in-network-expansion.pdf).

<sup>5</sup> Ofcom, 2017. *Wholesale Local Access Market Review: Further consultation on proposed charge control for wholesale standard and superfast broadband* <https://www.ofcom.org.uk/consultations-and-statements/category-2/wla-market-review-further-consultation-on-charge-control>.

<sup>6</sup> Ofcom, 2017. *Wholesale Broadband Access Market Review* <https://www.ofcom.org.uk/consultations-and-statements/category-1/wholesale-broadband-access-market-review>.

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# 1. Executive Summary

## Introduction

- 1.1 In the 2014 Regulatory Financial Reporting Statement<sup>7</sup> we explained that BT's regulatory financial reporting should provide us with the information that we need to make informed regulatory decisions, monitor BT's compliance with regulatory obligations, ensure that obligations address underlying competition issues and investigate potential breaches of obligations. It should also provide reasonable confidence to stakeholders that BT has complied with its SMP conditions while adding credibility to the regulatory financial reporting regime.

## The purpose of this consultation

- 1.2 We are currently undertaking reviews of the Wholesale Local Access ("WLA") and Wholesale Broadband Access ("WBA") markets. In those market reviews (see the March 2017 WLA Consultation<sup>8</sup>, the April 2017 DPA Consultation<sup>9</sup> and the August 2017 DPA Pricing Consultation<sup>10</sup>, the 2017 WBA Consultation<sup>11</sup>, the WLA Network Expansion Consultation<sup>12</sup> and the September 2017 WLA Consultation<sup>13</sup>), we have proposed various SMP remedies to address BT's market power in the corresponding markets, including regulatory financial reporting requirements.
- 1.3 In respect of the WLA market, we made regulatory financial reporting proposals in the March 2017 WLA Consultation and the August 2017 DPA Pricing Consultation. We subsequently issued a further consultation containing further proposals in the September 2017 WLA Consultation, stating that we would follow up with a further consultation on

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<sup>7</sup> Ofcom, 2014. *Regulatory Financial Reporting Statement*, <https://www.ofcom.org.uk/consultations-and-statements/category-2/bt-transparency>

<sup>8</sup> We refer to the Ofcom, 2017. *Wholesale Local Access Market Review – Consultation on the proposed market, market power determinations and remedies – Volume 1* and Ofcom, 2017. *Wholesale Local Access Market Review – Consultation on proposed charge control designs and implementation – Volume 2*. <https://www.ofcom.org.uk/consultations-and-statements/category-1/wholesale-local-access-market-review>.

<sup>9</sup> Ofcom, 2017. *Wholesale Local Access Market Review: Consultation on Duct and Pole Access remedies*, [https://www.ofcom.org.uk/data/assets/pdf\\_file/0008/101051/duct-pole-access-remedies-consultation.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0008/101051/duct-pole-access-remedies-consultation.pdf)

<sup>10</sup> Ofcom, WLA market review: *Consultation on pricing proposals for Duct and Pole Access remedies*, August 2017 <https://www.ofcom.org.uk/consultations-and-statements/category-2/pricing-proposals-duct-pole-access>.

<sup>11</sup> Ofcom, 2017. *Wholesale Broadband Access Market Review* <https://www.ofcom.org.uk/consultations-and-statements/category-1/wholesale-broadband-access-market-review>

<sup>12</sup> Ofcom, 2017. *Wholesale Local Access Market Review: Consultation on Recovering the cost of investment in network expansion*, [https://www.ofcom.org.uk/data/assets/pdf\\_file/0022/105682/Recovering-the-costs-of-investment-in-network-expansion.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0022/105682/Recovering-the-costs-of-investment-in-network-expansion.pdf)

<sup>13</sup> Ofcom, 2017. *Wholesale Local Access Market Review: Further consultation on proposed charge control for wholesale standard and superfast broadband* <https://www.ofcom.org.uk/consultations-and-statements/category-2/wla-market-review-further-consultation-on-charge-control>

regulatory reporting aspects. In respect of the WBA market, we made regulatory proposals in the 2017 WBA Consultation and said that we would consult separately on the detail of certain regulatory financial reporting aspects.

- 1.4 This document sets out our proposals (including amendments to draft directions) necessary to implement our latest proposals for regulatory reporting in the WLA and WBA markets.
- 1.5 We are also consulting on a specific change to a direction we imposed in 2015 following the 2014 Fixed Access Market Reviews ("FAMR"), to ensure that BT's reporting requirements in respect of Cumulo costs remain appropriate.

## Proposals

- 1.6 We summarise our regulatory financial reporting proposals below by reference to the original consultation that included the proposals for the underlying SMP remedy. In respect of the WLA Market Review, these were the DPA Consultations, the WLA Network Expansion Consultation, the September 2017 WLA Consultation and the March 2017 WLA Consultation) and also the 2017 WBA Consultation in respect of the WBA Market Review. Following the analysis carried out during the WLA Market Review, we also propose a change to a regulatory financial reporting direction imposed following to the 2014 Fixed Access Market Review.

## The DPA Consultations

- 1.7 As explained further in Section 3, we proposed remedies on physical infrastructure access including a non-discrimination obligation in the April 2017 DPA Consultation. In the August 2017 DPA Pricing Consultation we proposed a pricing remedy in the form of a charge control on physical infrastructure access, with some regulatory financial reporting proposals.
- 1.8 We do not consider that current regulatory reporting provides the information we need to assess the effectiveness of our proposed charge control or to monitor compliance with the proposed non-discrimination obligation.
- 1.9 We propose that BT:
  - creates ten new network components that allow for the relevant and reliable reporting of DPA costs for both DPA services and the other network access services that consume them.
  - reconciles its physical asset inventory to its duct and pole financial records within the Regulatory Financial Statements ("RFS") on a basis consistent with the proposed network components.

- 1.10 We propose that BT must start using the new network components from 1 April 2020 for them to be reflected in the 2020/21 RFS. This will give BT the time to implement all the required changes.

## The WLA Network Expansion Consultation

- 1.11 In the WLA Network Expansion Consultation, we consulted on proposals to amend the WLA charge controls to include the additional relevant network expansion costs that BT would incur should it enter a clear and public agreement with Government to make an investment in universal broadband.
- 1.12 In Section 4 we explain that BT is not currently required to report the costs associated with Network Expansion.
- 1.13 As explained in Section 4, we propose that BT:
- creates a new network component that allows for the relevant and reliable reporting of Network Expansion.
  - provides granular reporting of the cost of Network Expansion to us on a confidential basis.

## The September 2017 WLA Consultation

- 1.14 In the September 2017 WLA Consultation, we consulted on proposals relating to standard and superfast broadband that had the effect of changing the charge control ranges we consulted on in the March 2017 WLA Consultation<sup>14</sup>. Within these were certain ancillary services<sup>15</sup> where our analysis highlighted issues in the way BT reported their costs.
- 1.15 In Section 5 we explain that BT's current reporting of certain WLA ancillary services does not provide the information we need to carry out our regulatory duties. Specifically, we found that the information was not reliable enough to use for our proposed charge control or to provide information to other telecoms providers concerning the regulated services that they will buy during the market review period.
- 1.16 As explained in Section 5, we propose that BT:
- changes the way it reports the costs of certain ancillary services to be consistent with how we considered them in the September 2017 WLA Consultation when revising our charge control proposals; and
  - publishes information for certain ancillary services at the level that they are regulated.

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<sup>14</sup> See Section 4 of the September 2017 WLA Consultation.

<sup>15</sup> These are additional services that are required alongside the provision of MPF and GEA Rentals

## The March 2017 WLA Consultation

- 1.17 Section 6 covers four distinct aspects of BT's reporting that we consider need improvement arising out of the WLA market review, these relate to;
- The Consistency of regulatory decisions and RAV direction (including cumulo costs);
  - Equivalence of Input ("EOI") reporting;
  - BT's reconciliation report; and
  - Network components.

### Cumulo rates

- 1.18 In the March 2017 WLA Consultation we proposed that BT makes a small change to the cumulo attribution methodology in relation to GEA related cumulo costs and that the rest of the provisions dealing with cumulo attributions in the current consistency direction would remain unchanged. While we reflected the first aspect of our proposals in the draft legal instruments at Annex 23 of the March 2017 WLA Consultation (changes to GEA related cumulo cost attributions), we did not reflect the second aspect, namely that there was no change in relation to non-GEA related cumulo cost attributions.
- 1.19 This is now clarified by way of amendments to the proposed consistency direction, along with minor changes to the wording relating to NGA related cumulo costs to ensure the proposed requirements are clear.

### EOI reporting

- 1.20 In the March 2017 WLA Consultation we proposed an EOI remedy. We did not propose any regulatory financial reporting requirements to monitor BT's compliance with that remedy<sup>16</sup>.
- 1.21 In Section 6 we explain that to monitor BT's compliance with the proposed WLA EOI obligation, we need EOI input information in respect of services in the WBA market that rely on WLA EOI inputs.
- 1.22 In Section 6 we propose that the information BT should publish in relation to the EOI remedy should be similar to that which is currently published in relation to the WBA Market. We consider this information should be provided to stakeholders to give them confidence that BT is complying with the EOI obligation.

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<sup>16</sup> In the 2017 WBA Consultation we proposed the removal of the WBA Charge Control. This meant that as well as no longer being required to publish FAC component information, BT would no longer publish EOI information.

### BT's reconciliation report

- 1.23 In the March 2017 WLA Consultation we proposed a regulatory financial reporting remedy; that BT is required to produce a reconciliation report setting out the impact of any methodology changes made to the RFS, together with information showing the impact of correcting any material errors identified in the RFS.
- 1.24 In Section 6 we explain that the reporting proposal in the March 2017 WLA Consultation included a requirement for BT to publish annexes that would mean that BT would have to produce another two versions of the RFS. In Section 6 we explain that producing these annexes involves an onerous level of resource for BT.
- 1.25 In Section 6, we propose revising our March 2017 proposal to no longer require the production of the annexes. We also propose that the remainder of what is now BT's reconciliation report should be incorporated within the RFS with no loss of detail to reduce the amount of duplicated information.

### Network components

- 1.26 In the March 2017 WLA Consultation we proposed a regulatory financial reporting remedy; specifying the list of network components to be used by BT when preparing the RFS.
- 1.27 In Section 6 we explain that following discussions with BT, it has come to our attention that one of the proposed components has a misleading name, eleven components on that proposed list are no longer relevant and our proposed list omits two components.
- 1.28 In Section 6 we explain how we are proposing to update the list of network components in the draft direction in the March 2017 WLA Consultation to ensure the list remains up to date.

### The 2014 Fixed Access Market Review

- 1.29 In the March 2017 WLA Consultation we proposed to change the way BT attributes its cumulo rates (business rates charged by the UK rating authorities on BT's network assets) to reflect their new rating valuation in the forthcoming charge control. We also proposed a regulatory financial reporting direction in relation to cumulo rates.
- 1.30 In Section 7 we explain that as the new rating valuation would be in place for 2017/18, BT would no longer be able to comply with the current cumulo direction we imposed in the 2014 Fixed Access Review for the purposes of preparing the 2017/18 RFS.
- 1.31 In Section 7 we propose to amend the cumulo regulatory financial reporting direction we imposed in 2014 so that it is in the same form as that which we are now proposing for the WLA market.



## The 2017 WBA Consultation

- 1.32 In the 2017 WBA Consultation we did not set out regulatory financial reporting proposals specifying the list of network components or BT's reconciliation report. We explained in the 2017 WBA Consultation that we would be developing proposals for both these areas and we would consult on them later.
- 1.33 As explained in Section 8, for the purposes of regulatory financial reporting in the WBA market, we need to specify a single list of network components that is consistent across all regulated markets. In Section 8 we also explain that the reconciliation report requirements need to be applied consistently across all markets.
- 1.34 In Section 8, we propose that:
- in relation to network components, we propose giving a direction specifying the list of network components which reflects our proposals in Sections 3 to 6 in this consultation and which is in the same form as that we are now proposing for the WLA market; and
  - in relation to the reconciliation report, we propose BT publishes the reconciliation report which reflects our proposals in Section 6 in this consultation and which is in the same form as that we are now proposing for the WLA market.

## Consultation and next steps

- 1.35 We invite comments on the proposals in this document. The consultation runs for 6 weeks and the deadline for responses is 15 January 2018. Annex 1 provides further details of how to respond. We aim to publish our overall conclusions on the WLA and WBA markets in early 2018.
- 1.36 The proposals set out in this Consultation form part of our overall proposals for the WLA market and the WBA market. We have not at this stage taken any decisions in relation to other aspects of the proposals set out in our March 2017 WLA Consultation, April 2017 DPA Consultation and August 2017 DPA Pricing Consultation, 2017 WBA Consultation, WLA Network Expansion Consultation and the September 2017 WLA Consultation. We are currently considering all consultation responses and undertaking further analysis and information gathering before deciding on appropriate next steps. We therefore invite comments from stakeholders on the proposals in this Consultation and their impact on our proposals set out in the previous consultations listed above. However, we are not in this document seeking further representations on the broader proposals set out in these consultations.

## 2. Introduction

### The purpose of regulatory financial reporting

- 2.1 In the 2014 Regulatory Financial Reporting Statement we explained that BT's "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>17</sup>
- 2.2 We also said, "Published Regulatory Financial Reporting should provide reasonable confidence to stakeholders that the SMP provider has complied with its SMP conditions and add credibility to the Regulatory Financial Reporting Regime." <sup>18</sup>
- 2.3 We explained in the 2014 Regulatory Financial Reporting Statement that "effective Regulatory Financial Reporting should have the following attributes:
- Relevance. The information needs to answer the right questions, in the right way and at the right time.
  - Reliability. The underlying data must be reliable, suitable rules for treatment of those data must be chosen and those rules need to be followed.
  - Transparency. The basis of preparation should be understood by the users of the reports and the presentation of the data should be clear.
  - Proportionality. The reporting requirements should be proportionate to the benefits." <sup>19</sup>
- 2.4 In the 2014 Regulatory Reporting Statement we set out the SMP Conditions that sought to ensure that the basis of preparation of the RFS and the scope and format of reporting continued to provide the information we need and that it had the attributes of good reporting.

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<sup>17</sup> Paragraph 2.28 page 12, 2014 Regulatory Financial Reporting Statement.

<sup>18</sup> Paragraph 2.41 page 14, 2014 Regulatory Financial Reporting Statement.

<sup>19</sup> Paragraph 2.42 page 14, 2014 Regulatory Financial Reporting Statement.

- 2.5 In the 2014 Regulatory Reporting Statement we set out the Regulatory Accounting Principles.<sup>20</sup> These are fundamental reporting principles with which BT's Regulatory Financial Reporting must comply. The Regulatory Accounting Principles establish the basic attributes for BT's Regulatory Financial Reporting and provide a necessary reference point in the absence of more specific guidance.
- 2.6 In the 2015 Directions Statement<sup>21</sup> we set out a set of detailed SMP directions, including the Regulatory Accounting Principles direction, that sought to ensure that the basis of preparation of the RFS and the scope and format of reporting continued to provide the information we needed and that it had the attributes of good reporting. These directions were imposed in BT in relation to the 2014 WLA and WBA markets.

## The need to keep regulatory reporting up to date

- 2.7 The purposes and attributes of BT's Regulatory Financial Reporting as set out in the 2014 Regulatory Financial statements continue to remain relevant when considering proposals made in the course of market reviews. In the current market reviews (see the March 2017 WLA Consultation, the April 2017 DPA Consultation, the 2017 WBA Consultation, the WLA Network Expansion Consultation, the August 2017 DPA Pricing Consultation and the September 2017 WLA Consultation), we have proposed regulatory decisions and have signposted in those documents the consequential changes that would need to be made to BT's Regulatory Financial Reporting.
- 2.8 In the March 2017 WLA Consultation (as amended by the August 2017 DPA Pricing Consultation) and the 2017 WBA Consultation, we proposed a set of draft directions imposing the required SMP regulatory Reporting conditions and directions for Regulatory Accounting Principles, Transparency, Audit of RFS and the Form and Content of the RFS based on those imposed in respect of the previous WLA and WBA market reviews in the 2015 Directions Statement<sup>22</sup>.
- 2.9 We set out below further background on the directions in the 2015 Directions Statement and their relevance to our proposed decisions in ongoing market reviews.

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<sup>20</sup> 2014 Regulatory Financial Reporting Statement. Section 3 and Annex 3. The principles and the order in which they apply are: i) Completeness, ii) Accuracy, iii) Objectivity, iv) Consistency with regulatory decisions, v) Causality, and vi) Compliance with statutory accounting standards.

<sup>21</sup> Ofcom, *Directions for Regulatory Financial Reporting: Final Statement*, 30 March 2015, [https://www.ofcom.org.uk/data/assets/pdf\\_file/0018/59112/statement.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0018/59112/statement.pdf)

<sup>22</sup> Ofcom, *Directions for Regulatory Financial Reporting: Final Statement*, 30 March 2015, [https://www.ofcom.org.uk/data/assets/pdf\\_file/0018/59112/statement.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0018/59112/statement.pdf)

## Proposed Consistency with regulatory decisions and the RAV<sup>23</sup> direction

- 2.10 We proposed a consistency direction in the March 2017 WLA Consultation and amendments to that proposed direction in the August 2017 DPA Pricing Consultation. The direction was not relevant to the 2017 WBA Consultation.
- 2.11 Our proposed direction is intended to ensure that regulatory financial reporting continues to provide the information necessary for us to make informed regulatory decisions.
- 2.12 In the March 2017 WLA Consultation we reaffirmed that regulatory financial reporting should, as far as possible, be consistent with our regulatory decisions. In general terms, this means we would expect regulatory decisions to be reflected in the RFS unless we consider that there were good reasons not to.
- 2.13 However, we also explained that we do not consider that the requirement for consistency meant that all regulatory decisions must be reflected in the RFS. For example, 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), while attempting to model the impact of some could require BT to make difficult judgements about how we might approach these costs on an ongoing basis.
- 2.14 We reaffirmed in the March 2017 WLA Consultation that the identification of proposed adjustments that should or should not be reflected within regulatory financial reporting to achieve consistency and the identification of adjustments (not reflected in the RFS) that should or should not be reflected within the Adjusted Financial Performance Schedules, are matters for our judgement and should be considered on a case by case basis.
- 2.15 SMP Regulatory Reporting Conditions proposed in both March 2017 WLA Consultation and the 2017 WBA Consultation require that BT's RFS must be prepared in accordance with the Regulatory Accounting Principles. In the 2014 Regulatory Reporting Statement, we said that "where there is no clear guidance in the Regulatory Accounting guidelines, then the appropriate methodology must be determined by reference to the Regulatory Accounting Principles i.e. by going back to first principles".<sup>24</sup>

## Proposed network components direction

- 2.16 We proposed a network component direction in the March 2017 WLA Consultation based on the list of network components that existed at that time.
- 2.17 We did not propose a network component direction in the 2017 WBA Consultation. In that consultation we explained that we intended to amend the list proposed to include new

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<sup>23</sup> Regulatory Asset Value

<sup>24</sup> Paragraph 3.60 pages 39-40, 2014 Regulatory Financial Reporting Statement.

DPA components at a later date and therefore consult on this amended list as part of a future consultation. We now do so as part of this consultation.

- 2.18 This proposed direction is intended to ensure that regulatory financial reporting continues to provide information necessary for us to make informed regulatory decisions (for example we use network component inputs in our top down cost modelling in relation to charge controls). The proposed direction also intended to ensure that we obtain information to monitor compliance with proposed remedies (for example on non-discrimination, checking the attribution rules on network components allows us to see how costs are attributed to internal as well as external services).
- 2.19 The direction specifies the list of network components used by BT to prepare the RFS. To preserve the integrity and consistency of BT's Regulatory Financial Reporting it is important that there is a single list of network components used to attribute costs to services in regulated markets. In the 2015 Directions Statement, we gave a direction to BT in respect of, among others, the WLA market, specifying the network components.

### **Proposed form and content of the RFS direction**

- 2.20 We proposed Form and Content directions in both the March 2017 WLA Consultation (with amendments to the proposed direction in the August 2017 DPA Pricing Consultation) and the 2017 WBA Consultation.
- 2.21 Our proposed direction is intended to ensure that that regulatory financial reporting gives confidence to stakeholders and allows them to contribute to the regulatory regime. This direction provides details of the financial information to be included in the published RFS and therefore plays an important role in ensuring the RFS provide relevant information to stakeholders. The proposed direction is also intended to ensure that information is provided to us in the published RFS and in private that is needed for monitoring of compliance with proposed remedies, for example verifying volume weights used in compliance basket submissions.

### **Proposed reconciliation report direction**

- 2.22 We proposed the reconciliation report direction in the March 2017 WLA Consultation. We did not propose a reconciliation report direction in the 2017 WBA Consultation as we explained that following the March 2017 WLA Consultation that we had received representation from BT in connection with the report and we intended to consult on BT's representation as part of a future consultation. We now do so as part of this consultation.
- 2.23 The proposed direction also meets our requirement that regulatory financial reporting gives confidence to stakeholders and allows them to contribute to the regulatory regime. The aim of the reconciliation report is to provide stakeholders with the impact of all

material changes and material errors discovered in the RFS in order to provide stakeholders with transparency of changes that BT made to the RFS.

## Regulatory Framework

- 2.24 The regulatory framework for market reviews is set out in UK legislation and is transposed from five EU Directives. These Directives impose several obligations on relevant regulatory authorities, such as Ofcom, one of which is to carry out periodic reviews of certain electronic communications markets.
- 2.25 We have set out the relevant regulatory framework in our March 2017 WLA Consultation, the April 2017 DPA Consultation and the June 2017 WBA Consultation and reference should be made to those documents for further detail.

## Impact Assessment and Equality Impact Assessment

### Impact Assessment

- 2.26 The analysis presented in the WLA, DPA and WBA consultations<sup>25</sup> and in this consultation, constitutes an impact assessment as defined in section 7 of the Act.
- 2.27 Impact assessments provide a valuable way of assessing the options for regulation and shows why the chosen option was preferred. They form part of best practice policy-making. This is reflected in section 7 of the Act, which means that, generally, we must carry out impact assessments in cases where our conclusions would be likely to have a significant effect on businesses or the public, or where there is a major change in Ofcom's activities. However, as a matter of policy Ofcom is committed to carrying out impact assessments in relation to the great majority of our policy decisions.

### Equality Impact Assessment (EIA)

- 2.28 Annex 7 of the March 2017 WLA Consultation sets out our EIA for the WLA Market Review (including in relation to our April 2017 DPA Consultation and the August 2017 DPA Pricing Consultation) and Annex 9 of the 2017 WBA Consultation sets out our EIA for the WBA Market Review. Ofcom is 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.

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<sup>25</sup> Namely the March 2017 WLA Consultation, the April 2017 DPA Consultation, the August 2017 DPA Pricing Consultation, the WLA Network Expansion Consultation, the September 2017 WLA Consultation and the 2017 WBA Consultation.

- 2.29 It is not apparent to us that the outcome of our reviews (including the revised proposals set out in this consultation) is likely to have any particular impact on any particular equality group. More generally, we do not envisage the impact of any outcome to be to the detriment of any group of society. Nor do we consider it necessary to carry out separate EIAs in relation to equality schemes under the Northern Ireland and Disability Equality Schemes.

## Scope of this document

- 2.30 The focus of this consultation is on regulatory financial reporting in the WLA and WBA markets.
- 2.31 We do not repeat, in this document, our description or reasoning relating to the full set of proposals in the March 2017 WLA Consultation, April 2017 DPA Consultation, 2017 WBA Consultation, August 2017 DPA Pricing Consultation, WLA Network Expansion Consultation and September 2017 WLA Consultation and do not seek further responses to those proposals. Instead, we set out specific revisions on which we are seeking further responses.

## 3. Regulatory financial reporting for Duct and Pole Access

- 3.1 This section sets out our proposed amendments to the draft regulatory financial reporting directions we proposed in March 2017 to obtain and improve information in relation to DPA services which we consulted on in the April 2017 DPA Consultation and August 2017 DPA Pricing Consultation.

### Introduction

- 3.2 In the March 2017 WLA Consultation, we proposed to impose regulatory financial reporting requirements on BT in relation to the WLA market in the UK excluding the Hull area, including regulatory financial reporting SMP conditions and directions, including:
- a) the Consistency with regulatory decisions and RAV direction; and
  - b) the network components direction.
- 3.3 In the April 2017 DPA Consultation, we proposed regulatory financial reporting SMP Conditions for Duct and Pole Access services ("DPA services"), as we had already done for the wider WLA market in the March 2017 WLA Consultation. We also proposed a non-discrimination remedy in respect of DPA services. We did not make any additional proposals about DPA regulatory financial reporting but said, we would publish specific proposals for consultation later in the year, including our proposals on any necessary changes to reporting obligations.<sup>26</sup>
- 3.4 In the August 2017 DPA Pricing Consultation, we proposed to impose a DPA pricing remedy in the form of a charge control for physical infrastructure access. We also included some limited regulatory financial reporting proposals around the DPA pricing remedy and network adjustment costs<sup>27</sup>. In respect of regulatory financial reporting more generally, we explained that "we are currently conducting further work with the aim of better understanding how BT infrastructure costs are recorded and reported to allow us to further our long-term strategic aims" and that "we intend to publish a further financial reporting consultation in the Autumn that will consider financial reporting issues arising out of the WLA and WBA market reviews (including those to support our DPA proposals)"<sup>28</sup>.

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<sup>26</sup> Paragraph 1.40, page 7, April 2017 DPA Consultation.

<sup>27</sup> The costs that both other telecoms provider's and BT are required to pay where it is necessary for Openreach to make adjustments to its duct and pole infrastructure to fulfil DPA orders where the cost of these adjustments are above a financial limit of £4,000 to £6,000 per km, paragraph 1.14, page 3, August 2017 DPA pricing Consultation.

<sup>28</sup> Paragraphs 5.30 and 5.31, page 52, August 2017 DPA Pricing Consultation.



- 3.5 We have not considered regulatory financial reporting around DPA ancillary services at this stage.

## Summary

- 3.6 In summary we propose to:
- Specify ten new network components for BT that capture the capital and maintenance costs of its duct and pole assets base. We propose to implement this by way of an amendment to our March 2017 proposal for a direction specifying network components. These new network components would appear in the public version of the RFS; and
  - Require BT to reconcile its fixed asset register in respect of duct, copper and fibre assets to its physical inventory. We propose to implement this by way of an amendment to our March 2017 proposal (as amended in the August 2017 DPA Pricing Consultation<sup>29</sup>) for a direction specifying the requirements in relation to consistency with regulatory decisions and regulatory asset value.
- 3.7 We set out below our rationale for proposing to impose regulatory financial requirements on BT in relation to duct and pole access, followed by a description of our proposed amendments to the two March 2017 WLA Consultation directions.
- 3.8 The amendments to the directions that we propose are included in Annex 6 (see Schedules 1 and 2 to the Notification respectively). These should be read in conjunction with the proposed directions set out at Annex 23 of the March 2017 WLA Consultation and the amendments to these proposals set out at Annex 6 of the August 2017 DPA Pricing Consultation. We envisage that these proposals will take time to implement and propose an extended implementation timetable.

## Market review proposals

- 3.9 In the March 2017 WLA Consultation, we proposed, among others, a no undue discrimination requirement on BT in respect of the WLA market.
- 3.10 The April 2017 DPA Consultation set out how we intend to apply this proposed 'no undue discrimination' requirement in respect of physical infrastructure access ("PIA") services<sup>30</sup>. We explained that while this condition does permit discrimination in certain circumstances, we propose to interpret the condition as requiring strict equivalence in respect of all processes and sub-products that contribute to the supply and consumption of duct access,

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<sup>29</sup> The proposals set out in this section should be read in conjunction with the proposed directions set out at Annex 23 of the March 2017 WLA Consultation and the amendments to these proposals set out at Annex 6 of the August 2017 DPA Pricing Consultation.

<sup>30</sup> Section 5, April 2017 DPA Consultation.

unless BT can demonstrate that a difference in respect of a specific process step or sub-product is justified.

- 3.11 In the August 2017 DPA Pricing Consultation we considered several approaches to providing more certainty about DPA pricing, and provisionally concluded that imposing a cap on rental charges based on the current methodology would be an appropriate approach in this review period. This would be an effective and pragmatic means of providing certainty to investors over the market review period and would result in PIA rental charges being at a level which should avoid undermining network investment.

## **Review of the requirements for DPA regulatory financial reporting**

- 3.12 Below, we consider how well BT's current regulatory financial reporting provides us with the information we need to make informed regulatory decisions. We then consider whether the information that is provided has the attributes of effective financial reporting, as described in Section 2.

### **Information to make informed regulatory decisions**

- 3.13 We need financial information to make informed regulatory decisions. Specifically, in the context of DPA, we do not consider that current regulatory financial reporting provides the information we need to assess the effectiveness of the PIA services pricing remedy proposed in the August 2017 DPA Pricing Consultation.
- 3.14 In the August 2017 DPA Pricing Consultation, we proposed to set a cap on rental charges for PIA, but explained that it is not currently practicable to apply a price cap based on BT's fully allocated costs (as we do in some other charge controls) as the necessary cost data is not reported to the required level of granularity in BT's accounting systems<sup>31</sup>. Instead we used BT's PIA pricing model, which sits outside of BT's regulatory financial reporting system. By being outside of the Regulatory Reporting framework, the information is not covered by our requirements such as the Regulatory Accounting Principles and the audit requirement. Going forward, we will need access to audited cost data at an appropriate level of granularity to ensure our proposed pricing remedy is effective.

### **Monitoring compliance with the non-discrimination remedy**

- 3.15 We need financial information to monitor BT's compliance with the non-discrimination condition proposed in the April 2017 DPA Consultation. Specifically, we require transparency over whether there are differences in both the amount and cost of physical infrastructure Openreach attributes to PIA services and its other network access services. This to ensure that there is no discrimination as between PIA services, which are not

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<sup>31</sup> Paragraph 3.4, Page 9, August 2017 DPA Pricing Consultation.

consumed by BT, and those other network access services that consume the same physical infrastructure as PIA services, which are consumed by BT.

- 3.16 There is currently no service level reporting of duct or pole costs within BT's regulatory reporting. As explained in Annex 5, the level of reporting is based on the aggregated copper/ duct and fibre / duct network components.
- 3.17 The current network component structure which amalgamates duct and pole costs with either the copper or fibre cable costs, does not allow monitoring of non-discrimination because whilst the network components are applicable to Other network access services they are not appropriate for PIA services which do not use copper or fibre cable inputs.

### **The attributes of the information we currently get**

- 3.18 We set out in Annex 5 how BT currently accounts for duct and pole costs. There is currently no reporting of duct and pole costs within BT's RFS.
- 3.19 In the case of poles and specific types of duct, the relevant information cannot be obtained from BT's currently regulatory reporting.
- Pole capital costs are not separately identified or recorded within BT's general ledger which means it is not possible to know what the relevant pole costs are.
  - Duct costs are separately recorded but specific types of duct such as junction boxes, lead in Duct or Spine Duct, cannot or are not identified when attributed to the Plant groups. This means identifying specific duct costs, such as lead in Duct in DPA and other network access services is not currently possible.
- 3.20 The current attribution of the aggregated duct and poles costs to network components is not reliable because the attributions are based on very old data source which is not reconciled to the physical assets.
- 3.21 The issue of cost data within the general ledger data not being reconciled to the physical asset recorded held in PiPER was highlighted in the Cartesian report<sup>32</sup>. In the context of the apportionment of duct between access and backhaul, Cartesian said it "may be inaccurate

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<sup>32</sup> We engaged Cartesian, based on BT's 2013/14 financial year to investigate a defined set of cost categories (including Duct, Copper and Fibre) that provided approximately 90% coverage of costs across all regulated Markets. We asked Cartesian to develop a detailed understanding of BT costing system and methods used for cost attribution, document the description of cost attribution methodologies to facilitate our and stakeholder's understanding BT's complex cost attribution system, review the data and information provided by BT (including published information) to assess BT's cost attribution rules against the Regulatory Accounting Principles ("RAP"), provide potential alternatives to attribution bases where sensible and, estimate (where possible) the impact of BT adopting the proposed alternative attribution base. [https://www.ofcom.org.uk/data/assets/pdf\\_file/0025/83482/ofcom\\_bt\\_cost\\_attribution\\_review\\_final\\_report.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0025/83482/ofcom_bt_cost_attribution_review_final_report.pdf)

as the methodology relies on historic data. The apportionment method – using 1997 GRC [Gross Replacement Cost] plus capital spent since then – may not accurately reflect cost distribution in the network. BT has a GIS system (Network Engineering Journey, NEJ) which contains duct records. These GIS .... may provide greater accuracy in this case also”<sup>33</sup>.

- 3.22 As noted above, because pole costs cannot be identified there is no way of tracing their attribution to DPA and other network access services.
- 3.23 The aggregated duct activity group is attributed to Copper and Fibre Plant groups. This is done at an early stage in the attribution process on an averaged basis. This attribution into Copper / Fibre network components means it is not possible to identify duct costs (split from copper or fibre cable costs) in DPA and other network access services.

## The changes we propose

- 3.24 As explained above there is a lack of relevant information from the RFS in respect of duct and pole costs for regulatory purposes. We therefore do not have a source of data for DPA costs which we require for the regulatory purposes set out above. To the extent that financial information does exist, it is not transparent and is unlikely to be reliable when compared to the physical assets.
- 3.25 Whilst Cartesian could not quantify what inaccuracy might arise from attributions to different parts of the network elements using the Local Line Costing Survey (see Annex 5), in our opinion relying on a survey that is twenty years old, which does not identify the disaggregated network elements and is not reconciled back to the physical asset register, is unlikely to be inaccurate.
- 3.26 The attributions are not transparent because it is not clear how the aggregated poles and duct costs are included within regulated services using the current network component structure. The current network component structure is not appropriate to DPA services and does not allow for monitoring of non-discrimination.
- 3.27 To obtain information that is relevant, reliable and transparent to assess the effectiveness of the proposed PIA services pricing remedy, costs must be recorded and reported so that they capture the disaggregated information on poles and distinct types of duct. The way the information is attributed needs to more closely reflect the distinct types of duct and pole assets being consumed by DPA and other network services. BT therefore, needs to reconcile its physical asset register to its financial records. This needs to be done in a manner that transparently allows pole and the distinct types of duct to be identified in its financial records.

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<sup>33</sup> Paragraph 6.2.2.4, page 305, Cartesian Report.

- 3.28 To monitor compliance with the proposed non-discrimination remedy, the reporting of duct and pole input costs in both DPA and Other network services needs to be transparent. The duct and pole inputs must be capable of being identified at a more granular level within DPA and other network access services.

## **Proposed directions to implement regulatory accounting requirements in respect of duct and pole costs**

- 3.29 We have already proposed regulatory financial reporting conditions and directions in the March 2017 WLA Consultation as amended by the August 2017 DPA Pricing Consultation. These include the Consistency with Regulatory decisions direction and the network components direction. We set out below the amendments we propose to these directions to ensure that we continue to obtain appropriate regulatory financial information.

### **Proposed Consistency with Regulatory decisions direction – amendment to the basis of preparation.**

- 3.30 As we have explained above, we think BT's reporting of duct and pole costs does not provide the information we need or possess the basic attributes of good reporting. We therefore propose an amendment to the consistency with regulatory decisions direction proposed in the March 2017 WLA Consultation. The proposed amendment will require BT to reconcile its physical asset inventory with its duct and poles financial records within the RFS.
- 3.31 This proposed direction will improve the reliability of financial information we need to carry out our regulatory duties.
- 3.32 We appreciate carrying out the reconciliation will be a time-consuming exercise, and for reasons we explain later we propose that BT has no later than 1 April 2020 to comply with direction.
- 3.33 Whilst the proposals may not be fully implemented until 1 April 2020, proposed reporting requirements on BT means that they will need to have finalised the accounting methodology changes they are required to make for the 2020/21 RFS during Spring 2020 for the Change Control Notification<sup>34</sup>. In practice, BT shares information about the impact

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<sup>34</sup> The SMP Conditions and directions proposed on BT in the March 2017 WLA Consultation would require it to produce and publish the Change Control Notification on its website by 31<sup>st</sup> March 2020 in relation to the 2020/21 RFS. The notification sets out the impact of all accounting methodology changes proposed for 2020/21 based on the 2019/20 RFS. The 2016/2017 notification is published here: <http://www.btplc.com/Thegroup/RegulatoryandPublicaffairs/Financialstatements/2017/ChangeControlNotification201617.pdf>

of methodology changes in advance of the finalising the Change Control Notification. We would expect to see this information in Autumn/ Winter 2019.

### **Proposed network components direction - amendment**

- 3.34 As explained above, the current network component structure does not provide relevant or reliable financial information on duct and pole costs, neither does it facilitate monitoring compliance with proposed non-discrimination remedy.
- 3.35 In the March 2017 WLA Consultation we proposed that BT created a new Duct component by removing the cost of duct from all the network components where Duct Refine sectors<sup>35</sup> (D3 and DB) are currently attributed. At that time, we anticipated that within this new Duct component BT should be able to disaggregate costs into Plant Groups that align to the network elements utilised by DPA services.
- 3.36 We have considered the issue further and upon reflection feel that a single duct component would not provide the information we need. Therefore, we are now proposing additional network components which we consider reflect the most logical way of capturing the infrastructure elements of duct and poles consumed by DPA and other network access services.
- 3.37 On this basis we propose that BT creates ten new network components. These components map the current aggregated DPA services of the same name.
- Duct Spine capital;
  - Duct Spine maintenance;
  - Junction Boxes Capital;
  - Junction boxes maintenance;
  - Manhole Capital costs;
  - Manhole maintenance costs;
  - Pole capital costs;
  - Pole maintenance costs;
  - Lead in duct capital costs; and
  - Lead in maintenance costs.
- 3.38 Whilst these proposed network components map to the aggregated services of the same name, this does not mean that regulation follows reporting. The proposed components are required to meet our need for regulatory financial reporting information, not determine future pricing. Whilst the cost may well inform a future PIA pricing review, cost recovery

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<sup>35</sup> A sector (per Annex 1) of BT's Accounting Methodology Document 2017; can be defined as a main fixed asset underpinning BT's activity. These sectors are D3 for Access duct and DB for Core Transmission Duct) and comprise the Class of Works ("CoWs") that contain the asset and depreciation values for duct.

and prices may be set without regard for them, e.g. continued use of the PIA pricing model or the use of a bottom up model.

- 3.39 The introduction of the proposed network components for duct and pole costs will mean these costs are removed from existing network components. For the purposes of transparency, we also propose that the names of these costs components change to reflect their narrower scope, for example we propose that "D Side Copper capital" becomes "D Side Copper Cable Capital."
- 3.40 We propose to implement these changes by giving a direction in respect of the WLA market.
- 3.41 The introduction of these new duct and pole components will require BT to separately record and attribute duct and pole costs through to regulated services, which will improve the relevance and reliability of the financial information we receive.
- 3.42 We expect this information will be available to us from Autumn /Winter 2019 and will be published in the RFS for other telecoms providers in July 2021. Whilst the network component information relates to 2020/21, it will act as an important prior year comparator for DPA and other network service prices and costs.

## Legal tests

- 3.43 We consider that our proposed directions (as amended in this consultation) fulfil our general duties under section 3 of the Act and meet the Community requirements set out in section 4 of the Act for the reasons given above.
- 3.44 We consider that our proposals meet the tests set out in section 49(2) of the Act.
- 3.45 Our proposed amendments to the direction requiring BT's RFS to be consistent with Regulatory Decisions is:
- objectively justifiable because it is necessary for us to give a direction which includes specifying the accounting treatment of duct and pole costs consistent with Regulatory Accounting Principles to allow us to assess the effectiveness of the proposed PIA services pricing remedy. The amendment to the direction also provides BT with clarity as to how our proposal in the market review should be reflected in the RFS;
  - not unduly discriminatory because it reflects BT's market position in the UK excluding the Hull Area;
  - proportionate because the amendment to the direction in which we have specified the adjustments with which BT's RFS need to be consistent, is no more than is required to ensure consistency with our decisions. Further, BT retains a key role in determining the basis of preparation of the RFS; and
  - transparent because the intention of the amendment to the direction is to ensure that BT's RFS are consistent with our decisions.

- 3.46 Our proposed amendments to the direction specifying BT's list of network components is:
- objectively justifiable because it is necessary for us to give a direction specifying network components to allow us to assess the effectiveness of the proposed PIA services pricing remedy and to monitor the non-discrimination requirements, and to make the reporting of services in the WLA market consistent with our regulatory requirements;
  - not unduly discriminatory because it reflects BT's market position in the UK excluding the Hull Area;
  - proportionate because our proposal is no more than is required to specify network components and make the reporting of services in the WLA market consistent with the reporting of services in other regulated markets; and
  - transparent because it is clear that the intention of our proposal is to specify network components and to make the reporting of services in the WLA market consistent with the reporting of services in other regulated markets, and to ensure that these network components remain fit for purpose.
- 3.47 In proposing this change, we have taken due account of all applicable recommendations issued by the European Commission under Article 19(1) of the Framework Directive, in particular the 2005 EC Recommendation.

## Next steps

- 3.48 It will be for BT to determine how the appropriate costs are attributed from the general ledger through the Activity groups and Plant groups into the new network components and then onto DPA and other network access services. BT is however required to ensure that the attributions are in accordance with the Regulatory Accounting Principles.
- 3.49 We are aware from our knowledge of BT's Regulatory Financial Reporting system and from discussions with BT that these proposals will require financial data to be recorded in a substantially different way than currently which will require significant changes to BT regulatory accounting systems. Reconciling the financial data in the fixed asset register to the physical data in PiPER has, to our knowledge not been done before so would be a considerable exercise. We are also aware that in some cases, (e.g. pole capital costs), the financial data to do this does not currently exist. Therefore, as explained above, subject to responses to this consultation, we are proposing that BT must implement these proposals no later than 1 April 2020.
- 3.50 As explained in Annex 5, duct costs are also attributed to services outside of the WLA market, especially markets falling within the scope of the current BCMR. However, whilst BT has flexibility in how the proposed cost components could be implemented across such



markets, our DPA pricing proposals only impose requirements in relation to reporting in the WLA market.<sup>36</sup>

- 3.51 If we decide in a future review to extend our proposed DPA remedies into markets falling within the scope of the current BCMR, it would be necessary for us to consider how these new components might also apply to BCMR services. This could mean more significant changes to cost attribution, which may in turn have implications for how costs are recovered through the wider range of regulated services. If we propose to apply these new components to BCMR services, we will consult separately as part of a future market review.
- 3.52 We plan to consult separately on how duct and pole costs would be reported publicly in the RFS, what if any additional confidential information we would require and what reporting there should be in relation to the DPA ancillary services. We expect to consult in early 2019 to allow BT to implement any new reporting proposals by 1 April 2020.

## Consultation question

Question 3.1. Do you agree with our proposals for BT's Regulatory Financial Reporting in relation to the reporting of duct and pole costs?

Please provide reasons and evidence in support of your views.

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<sup>36</sup> Implementation could be limited to WLA, WAFEL and ISDN services with the existing combined Fibre / Duct components being used for non-WLA fibre services only. This could be done by fixing the current attribution of duct between Copper and plus WLA fibre and Other Fibre services when the new network components are created.

## 4. Recovering the costs of investment in network expansion

- 4.1 This section sets out our proposed amendments to the draft regulatory reporting directions we proposed in the March 2017 WLA Consultation to reflect the matters on which we consulted in the WLA Network Expansion Consultation.

### Introduction

- 4.2 In the March 2017 WLA Consultation, we proposed to impose regulatory financial reporting requirements on BT in relation to the WLA market in the UK excluding the Hull area, including regulatory financial reporting SMP conditions and directions, including:
- a) the Consistency with regulatory decisions and RAV direction;
  - b) the Network Components direction; and
  - c) the Form and Content of the RFS direction.
- 4.3 In the WLA Network Expansion Consultation we said that, subject to a “clear and public agreement between BT and the, committing BT to investment in network expansion to deliver its offer<sup>37</sup>, we propose to allow BT to recover relevant efficient costs<sup>38</sup> of this investment through an increase to the charges for broadband lines supplied in the WLA market”.<sup>39</sup>
- 4.4 In the WLA Network Expansion Consultation, we said that we would separately consult on regulatory financial reporting requirements to be imposed on BT we proceed with this aspect of our proposals.

### Summary

- 4.5 In summary we propose:
- To require that BT accurately records the incremental costs of the Network Expansion and attributes these costs to all broadband lines consistently with how the network expansion costs are recovered in the proposed WLA charge control. We propose to implement this by way of an amendment to our proposed Consistency with regulatory decisions and RAV direction.

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<sup>37</sup> BT's offer as set out at: <https://www.gov.uk/government/news/universal-broadband-to-reach-every-part-of-the-uk> and at: <http://openreach-comms.co.uk/t/BAK-57KRL-6FKHTQUPF8/cr.aspx>

<sup>38</sup> Our base case estimate was that it would add £1.93 to the annual costs of each Openreach broadband line in 2020/21.

<sup>39</sup> Paragraph 1.6, page 1, WLA Network Expansion Consultation.

- To require that BT establishes a new network component that captures the incremental expenditure it incurs in delivering the proposed network expansion to implement this by way of an amendment to proposed Network Components direction.
- 4.6 To require BT to publish service level information for the two GEA rental service level charge controls proposed in the WLA Network Expansion Consultation (GEA 40/10 with MPF SML1 and GEA 40/10 without MPF SML1), as well as provide to us in confidence detailed information on the costs of the proposed network expansion. We propose to implement this by way of an amendment to our proposed Form and Content of the RFS direction (which sets the requirements in relation to preparation, delivery, publication, form and content of the relevant directions included in Annex 6 (see Schedules 1, 2 and 3 the Notification respectively). These should be read in conjunction with the proposed directions set out at Annex 23 of the March 2017 WLA Consultation and the amendments to these proposals set out at Annex 6 of the August 2017 DPA Pricing Consultation.

## Market review proposals

- 4.7 In the March 2017 WLA Consultation, we proposed charge controls on WLA services including MPF rentals and GEA rentals for speeds up to 40/10 Mbit/s<sup>40</sup>. In respect of other WLA services such as SMPF rentals and GEA rentals for speeds over 40/10 Mbit/s we allowed BT 'fair and reasonable' pricing flexibility. We also proposed charge controls on certain ancillary services.
- 4.8 In the WLA Network Expansion Consultation we estimated the cost of BT's proposed Network Expansion using a bottom-up cost model. We consulted on a set of amendments to our WLA charge control proposals such that BT would recover the net cost of its proposed network expansion through a constant mark-up per line from the following services;
- WLR plus SMPF;
  - MPF;
  - WLR plus GEA;
  - MPF plus GEA; and
  - GEA Only<sup>41</sup>.
- 4.9 In the WLA Network Expansion Consultation we proposed having two GEA rental charge controls: GEA 40/10 without MPF (i.e. with WLR or on its own) and when GEA is taken with MPF,<sup>42</sup> to ensure that customers who purchase MPF with GEA do not pay for the costs of proposed network expansion twice.

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<sup>40</sup> Both GEA 40/10 (FTTC) Rentals and GEA 40/10 Other 40/10 Rentals.

<sup>41</sup> This will include all bandwidths, those above 40/10 as well as those up to and including 40/10.

<sup>42</sup> Paragraphs 6.25 – 6.26, page 39, WLA Network Expansion Consultation.

## Review of the requirements for regulatory financial reporting of network expansion costs

- 4.10 Below, we consider how well BT's current regulatory financial reporting provides us with the information we need to make informed regulatory decisions and what information we need to monitor compliance with the non-discrimination and what needs to be provided to stakeholders.

### Information to make informed regulatory decisions

- 4.11 We need financial information to make informed regulatory decisions. In particular, if this aspect of our proposals proceeds, we need information to assess the effectiveness of the charge control proposal to allow for the recovery of BT's efficiently incurred network expansion costs through regulated services. We also need a source of information for future cost modelling of network expansion costs or for calibration purposes.
- 4.12 In Section 5 of the WLA Network Expansion Consultation we explained in relation to the proposed network expansion that "this is a network that has not been deployed yet and, as such, no network cost data exists today that would allow us to analyse these costs on a top down basis"<sup>43</sup>. Because of the lack of cost information, we used a bottom up model to estimate the costs of network expansion.
- 4.13 In attempting to verify our bottom up model we said that "we consider that it is desirable to check the reasonableness of the outputs of our model. When we have built other bottom-up models in the past we have calibrated the outputs against real-world data wherever possible"<sup>44</sup> ... "For the proposed network deployment, there are no actual costs to compare the model outputs against".<sup>45</sup>

### Monitoring compliance with non-discrimination

- 4.14 We need financial information to monitor whether BT attributes the costs of its proposed network expansion on a basis consistent with the cost recovery mechanism in a non-discriminatory manner.

### Providing stakeholders with reasonable confidence

- 4.15 We need to provide stakeholders with reasonable confidence that BT has complied with the requirement to attribute the cost of network expansion in a non-discriminatory way consistent with how we modelled the costs.

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<sup>43</sup> Paragraph 5.13, page 23, WLA Network Expansion Consultation.

<sup>44</sup> Paragraph 5.63, page 32, WLA Network Expansion Consultation.

<sup>45</sup> Paragraph 5.64, page 32, WLA Network Expansion Consultation.

- 4.16 We also need to publish information that adds credibility to the regulatory financial reporting regime. That information would allow stakeholders to see how the actual cost of network expansion compared to that which we allowed for in the WLA charge control. Such information would allow stakeholders to make informed contributions in any future consultations of a similar nature.

## The changes we propose

- 4.17 To obtain information to make informed regulatory decisions we need relevant, reliable and transparent information to be recorded and reported (to us and where relevant, to stakeholders) consistent with how we considered them in the proposed charge control.

### Recording costs to be consistent with our charge control

- 4.18 In the introduction (see paragraphs 2.10 – 2.15), we set the questions we consider when deciding whether and how costs we include in the charge control should be accounted for and reported in the RFS. We have considered these questions in relation to the cost of network expansion included in our proposed charge control.
- 4.19 BT does not currently record any costs of network expansion within its statutory accounts or the RFS. When considering whether the network expansion costs in the RFS should be consistent with how we allowed them to be recovered in the WLA charge control we would normally answer two questions:
- a) Do the costs we considered as part of our cost modelling replace BT's incurred costs with an alternative estimate of cost?
  - b) Do the costs we considered as part of our cost modelling have the effect of replacing BT's incurred costs with a value that is not based on BT's network (whether actual, estimated or for forecasting purposes)?
- 4.20 It is not possible to answer these questions as BT has not yet incurred any network expansion costs. We therefore need to consider the questions on a forward-looking basis; how should we expect BT to record the costs compared we have considered them in our charge control proposals.
- 4.21 We set out below in Table 4.1 how we considered the cost of network expansion in our cost model and how we propose BT should account for them in the RFS.

**Table 4.1 Consideration of network expansion costs in our cost model and our reporting proposals**

	<b>Treatment in our bottom up cost model</b>	<b>Proposed treatment in the RFS</b>
LR-VDSL <sup>46</sup> Migrations	Our base case <sup>47</sup> assumed no use of LR-VDSL on the basis that the technology is still under trial and so the level of performance it may achieve is unclear.	Migration costs resulting from the implementation of LR-VDSL, excluding customer modem costs, should be included to the extent that BT deploys LR-VDSL technology in its network expansion.
FWA <sup>48</sup> and Satellite	The costs of the network expansion through FWA and Satellite are excluded <sup>49</sup> .	BT's offer does not include provision of wholesale access to FWA and Satellite and any costs incurred by BT in providing these services would be recovered at the retail level. As such they should be excluded.
Repair Costs	We have included incremental repair costs arising from the extra faults driven by Super-fast broadband ("SFBB") take-up.	It would be very difficult to identify incremental repair costs for SFBB faults specifically related to this network expansion. We therefore will not require BT to separately identify these costs.

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<sup>46</sup> Very high bitrate Digital Subscriber Line ("LR-VDSL").

<sup>47</sup> They were included as a sensitivity see Annex 8, WLA Network Expansion Consultation.

<sup>48</sup> Fixed Wireless Access ("FWA").

<sup>49</sup> They were included as a sensitivity see Annex 8, WLA Network Expansion Consultation.

	Treatment in our bottom up cost model	Proposed treatment in the RFS
SLGs <sup>50</sup>	We have included SLG costs on an incremental basis.	It would be very difficult to identify incremental SLG costs specifically related to this network expansion. We therefore will not require BT to separately identify these costs.
OSS/ BSS <sup>51</sup> Costs	We have included the incremental costs of a systems upgrade.	BT should be able to record and include incremental systems costs.
Other costs	Not identified so not included.	BT should be able to record and include any costs it can demonstrate are incremental to its network expansion.
Gain share <sup>52</sup>	We have excluded these costs.	BT should be recording the costs against BDUK and not the network expansion.

4.22 Our assessment of Table 4.1 above, is that BT should be able to account for most of the costs of delivering its network expansion in a manner consistent with how we have considered these costs in the WLA Network Expansion Consultation. This is particularly the case for the capital expenditure.

4.23 Whilst recording the incremental spend on network expansion will require extra effort and possibly some extra cost, in our view this is proportionate and justified given that BT estimates the total capital costs of the network expansion will be £450m - £600m<sup>53</sup>. As we have proposed in the WLA Network Expansion Consultation that the costs of BT's network expansion will be recovered in part via charge controlled prices for WLA services, paid for

<sup>50</sup> Service Level Guarantee ("SLG"). Service Level Guarantee is A contractual commitment by Openreach to telecoms providers specifying the amount of compensation payable by Openreach to a telecoms provider for a failure to adhere to a Service Level Agreement.

<sup>51</sup> Operational Support Systems ("OSS") and Business Support Systems ("BSS").

<sup>52</sup> Financial amounts that became repayable by BT to government authorities in relation to BDUK grants where the take-up of broadband exceeds pre-defined levels in the BDUK contracts.

<sup>53</sup> This is BT's assumed total capital expenditure cost, not what Ofcom proposed is recovered over this charge control period, see paragraph 2.2, page 5, WLA Network Expansion Consultation.

by other telecoms providers, it is appropriate that BT ensures that the cost of Network Expansion recorded within the RFS is consistent with the basis of the WLA charge control.

- 4.24 Incremental operating cost expenditure, such as on repair costs and SLGs, that reflect the incremental calculations within our network expansion cost model, are likely to be much harder to record accurately. In the WLA charge control, we estimate these costs to be [~~8~~] % of the total. It may not be proportionate (or even possible) to require BT to separately record its incremental operating cost expenditure related to network expansion. We are interested in stakeholders' views on this point.
- 4.25 Finally, whilst FWA and Satellite access could be deployed by BT to meet its proposed commitment in relation to network expansion, we have excluded the costs from our model because "BT is not currently subject to Wholesale Access obligations that would force it to provide access to telecom providers over these technologies."<sup>54</sup> "We expect BT would recover costs of FWA through its retail charges"<sup>55,56</sup>. To be consistent with the way we considered costs and with the regulatory status of this form of network access, we propose these costs are excluded from the WLA market.

## Reporting costs to be consistent with the charge control

### Public reporting

- 4.26 Following on from our proposed requirements for BT to accurately record incremental network expansion costs, the underlying information would now be available to allow for the monitoring of our proposed charge control remedy. Stakeholders, as we have stated above, require confidence that the costs of network expansion are attributed in a non-discriminatory way on a per line basis as set out in paragraph 4.8. To provide for this we propose the creation of a new network component. The new network component would capture all the efficiently incurred costs set out in Table 4.1. It would be included within the fully allocated cost ("FAC") breakdowns for the services in paragraph 4.8, and where they are price controlled they will be published in the RFS, enabling stakeholders to see for themselves the level of cost, how they are attributed against the regulated services that they buy and how they compare against the amount included in the charge control.

### Private reporting

- 4.27 As noted above, we have additional monitoring requirements. We propose BT provides more granular information that allows us to monitor the effectiveness of the WLA charge

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<sup>54</sup> Paragraph 5.21, page 24, WLA Network Expansion Consultation.

<sup>55</sup> Paragraph 5.22, page 24, WLA Network Expansion Consultation.

<sup>56</sup>As set out in "Openreach briefing: Delivering universal broadband coverage".

<https://www.openreach.co.uk/orpg/home/updates/downloads/Deliveringuniversalbroadbandcoverage.pdf>. For Satellite coverage BT will refer customers to satellite providers.



control proposals – i.e. to facilitate tracking of the cost categories we modelled against actual costs. This information would also satisfy the requirement for information to enable us to investigate potential breaches of SMP conditions and anti-competitive practices.

## **Proposed directions to implement regulatory accounting requirements in respect of network expansion costs**

4.28 We set out below the amendments we propose to the draft directions on which we consulted in the March 2017 WLA Consultation.

### **Proposed consistency with regulatory decisions direction – amendment to the basis of preparation**

4.29 This direction seeks to ensure that the information contained in the RFS continues to be consistent with our proposed regulatory decisions in the WLA market. As we have explained above, we propose that BT's Regulatory Financial Reporting remains consistent with our proposal to allow BT to recover its efficiently incurred network expansion costs. We therefore propose to amend the Consistency with Regulatory Decisions direction proposed in the March 2017 WLA Consultation (as amended in the August 2017 DPA Pricing Consultation).

4.30 We propose that BT should only include the incremental costs of network expansion. FWA and Satellite costs must be excluded. Costs should not include attributions of other costs, such as corporate overheads, or human resources or property costs. Should BT rely on LR-VDSL technology for the network expansions, LR-VDSL migration, excluding customer modem costs, should be reported in services set out below.

4.31 Consistent with the WLA charge control proposals, we propose that these costs will be attributed on a per line basis to the following services:

- WLR plus SMPF;
- MPF;
- WLR plus GEA;
- MPF plus GEA; and
- GEA Only.

### **Proposed network components direction – amendment**

4.32 We propose to amend this proposed direction by requiring that BT creates a new network component called "Network Expansion for Universal Broadband". The proposed network component will capture all the efficiently incurred incremental costs related to BT's network expansion consistent with the WLA charge control.

## Proposed form and content direction – amendment

- 4.33 In the March 2017 WLA Consultation we proposed a form and content direction for the wider WLA market, that document explains the background behind that direction (we amended this proposed direction in the August 2017 DPA Pricing Consultation). This information and information provided to us in private seeks to allow the monitoring of network expansion costs and their recovery and will provide us with a reliable source of data on these costs. The published information will provide stakeholders comfort that BT's spend on network expansion relates to the costs that were included for that activity within the WLA charge control.
- 4.34 In the following sub-section, we set out our proposals on the additional financial information ("AFI") that BT should be required to provide on certain network expansion costs, both in the RFS and confidentially to Ofcom, to allow us to monitor its compliance with the proposals described in the WLA Network Expansion Consultation for the reasons set out above.

### Public information

- 4.35 The published RFS reports financial information for specific markets at broadly three levels: market level information; service level information; and network component level information for regulated services. We set out below additional information that we propose should be published in the RFS relating to service level information and network components for reported services. There is no impact on market level information.

#### Service level information

- 4.36 In line with the proposal in the WLA Network Expansion Consultation for both GEA 40/10 without MPF SML1 and GEA 40/10 with MPF SML1 to be subject to a service level charge control, we propose an information requirement for these services based on the level at which they are regulated. For reasons we set out in the March 2017 WLA Consultation, we therefore also propose that BT should publish revenue, volume, average price, FAC and FAC network component breakdowns for GEA 40/10 (FTTC) rentals without MPF SML1, GEA 40/10 (FTTC) rentals with MPF SML1, GEA 40/10 (Other) rentals without MPF SML1 and GEA 40/10 (Other) rentals with MPF SML1.

### Private information

- 4.37 We set out below additional information that we propose is included in the confidential section of the RFS to provide us with the information that will enable us to track actual network expansion costs against our forecasts of these costs. The information will also allow us to monitor the effectiveness of the proposed remedy. We propose this additional information is provided by way of an AFI.

### Network expansion AFI

- 4.38 We propose the introduction of two new schedules. The first is a volume schedule which sets out the number of qualifying premises covered by the network expansion and the volume of rentals (split between speeds up to 40/10 and speeds above 40/10). This proposed schedule will allow us to assess the effectiveness of the remedy, in terms of the additional end users taking up SFBB resulting from the allowance for network expansion included within the WLA charge control.
- 4.39 The second schedule would require BT to provide additional information on network expansion costs. It would have two parts.
- Part one is the annual incremental cash costs of the network expansion split on a basis consistent with BT's network component structure. As noted in paragraphs 4.23 and 4.24 we expect capital expenditure to represent most cash costs.
  - Part two of the schedule sets out the total operating costs and capital costs (Mean Capital Employed ("MCE"<sup>57</sup>) and Return on Capital Employed ("ROCE")), also on a basis that would be consistent with BT's network component structure. The total of these costs must reconcile to the total Network Expansion for Universal Broadband network component FAC in the RFS.
- 4.40 Annex 10 sets out a proforma of the network expansion AFI for guidance with the proposed direction in Annex 6.

## **Legal tests**

- 4.41 We consider that our proposed directions (as amended in this consultation) would fulfil our general duties under section 3 of the Act and meet the Community requirements set out in section 4 of the Act for the reasons given above.
- 4.42 We have also considered our proposals to amend the Consistency with Regulatory Decisions direction against the tests set out in section 49(2) of the Act and for all the reasons set out above, we consider that they are:
- objectively justifiable because it is necessary for us to give a direction which includes specifying the accounting treatment of the relevant network expansion costs so that the RFS is consistent with our proposed regulatory decision to take account of BT's efficiently incurred costs of such network expansion in setting the WLA charge controls. The proposed amendment to the direction also provides BT with clarity as to how our proposals made in the WLA Network Expansion Consultation would need to be reflected in the RFS;

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<sup>57</sup> Mean capital employed, means total assets less current liabilities, excluding corporate taxes and dividends payable, and provisions other than those for deferred taxation. The mean is computed from the start and end values for the period, except in the case of short-term investments and borrowings, where daily averages are used in their place

- not unduly discriminatory because it reflects BT's market position in the UK excluding the Hull Area;
- proportionate because our proposed amendment is no more than would be required to ensure consistency with our decisions. Further, BT retains a key role in determining the basis of preparation of the RFS; and
- transparent because it is clear that the intention of our proposal is to ensure that BT's RFS are consistent with our proposed decision in relation to BT's network expansion costs.

4.43 We also consider that the proposed amendments to the direction specifying BT's list of network components for each market meet the tests set out in section 49(2) of the Act in that they are:

- objectively justifiable because it is necessary to make the reporting of services in the WLA market consistent our regulatory requirements;
- not unduly discriminatory because it reflects BT's market position in the UK excluding the Hull Area;
- proportionate because our proposed amendment goes no further than is necessary to specify network components for network expansion; and
- transparent because it is clear that our proposal seeks to specify additional network components and to ensure that these network components remain fit for purpose.

4.44 We have also considered that the proposed amendments to the direction setting the requirements in relation to preparation, delivery, publication, form and content of the RFS meets the tests set out in section 49(2) of the Act in that it is:

- objectively justifiable because the amendments to the proposed direction will reflect the proposals in the WLA Network Expansion Consultation. Our proposals concerning the additional information to be provided, both in public and in private, seek to ensure that stakeholders have sufficient information about the products and services they purchase to provide them with reasonable confidence about BT's compliance with its SMP conditions and that we have sufficient information necessary to carry out our functions;
- not unduly discriminatory because it reflects BT's market position in the UK excluding the Hull Area. We have explained in this consultation the reasons for requiring relevant additional information from BT both publicly and privately;
- proportionate because the amendments to the proposed direction will be no more than is required to ensure the effectiveness of the proposals in the WLA Network Expansion Consultation and will ensure that Ofcom and stakeholders are provided with a sufficient level of information, and does not extend beyond these; and
- transparent because it is clear that the intention of the proposed direction (as amended) will be to make sure that the RFS remain fit for purpose and that Ofcom and stakeholders are provided with a sufficient level of information.

- 4.45 In proposing this change, we have taken due account of all applicable recommendations issued by the European Commission under Article 19(1) of the Framework Directive, in particular the 2005 EC Recommendation.

## Next steps

- 4.46 Based on responses to the WLA Network Expansion Consultation, responses to the wider regulatory financial reporting proposals in the March 2017 WLA Consultation, the September 2017 WLA Consultation and this consultation, and subject to a clear public agreement between BT and the Government in respect of BT's commitment to carry out the network expansion, we would expect to make a final decision on our approach to treatment of costs incurred in that rollout in early 2018 with the new reporting requirements in place for April 2018. These changes would be reflected in the 2018/19 RFS to be published in July 2019.

## Consultation question

Question 4.1. Do you agree with our proposals for BT's Regulatory Financial Reporting in relation to the reporting of network expansion costs?

Please provide reasons and evidence in support of your views.

## 5. Regulatory financial reporting for WLA ancillary services

- 5.1 This section sets out our proposed amendments to the draft directions in the March 2017 WLA Consultation (as amended in the August 2017 DPA Pricing Consultation) to reflect the charge control proposals made in the September 2017 WLA Consultation where regulatory financial information for WLA ancillary services was either lacking or in need of improvement.

### Introduction

- 5.2 In the March 2017 WLA Consultation, we proposed to impose regulatory financial reporting requirements on BT in relation to the WLA market in the UK excluding the Hull area, including regulatory financial reporting SMP conditions and directions, including:
- a) the Consistency with regulatory decisions and RAV direction;
  - b) the Network Components direction; and
  - c) the Form and Content of the RFS direction.
- 5.3 In September 2017 we published a further consultation on changes to aspects of our proposed charge controls for the WLA market, including WLA ancillary services. For certain WLA ancillary services, our charge control proposals had a regulatory financial reporting impact. Whilst we set out our thinking on regulatory financial reporting proposals for certain ancillary services, we said that “[w]e intend to consult more fully on these reporting proposals and provide draft directions in a separate consultation on regulatory reporting issues to be published in Autumn 2017. When we consult on these issues any requirements will supplement the requirements proposed in the March 2017 WLA Consultation”<sup>58</sup>.

### Summary

- 5.4 In summary we propose:
- BT should no longer capitalise (mainly, but not exclusively labour) costs that have been charged within one-off or connection charges for certain WLA ancillary services. We propose to implement this by way of an amendment to our proposed Consistency with regulatory decisions and RAV direction.
  - BT be required to establish five new network components that provide the transparency to monitor that BT no longer includes costs within certain WLA ancillary

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<sup>58</sup> Paragraph 4.100, page 77, September 2017 WLA Consultation.

services that have already been charged within one-off or connection charges. We propose to implement this by way of an amendment to our proposed network components direction.

- We also propose that BT publishes information for all ancillary services at the level at which they are regulated. We propose to implement this by way of an amendment to our proposed Form and content of the RFS direction.

5.5 The amendments to the directions are included in Annex 6 (see Schedules 1, 2 and 3 to the Notification respectively). These proposals should be read in conjunction with the proposed directions set out at Annex 23 of the March 2017 WLA Consultation and Annex 6 of the August 2017 DPA Pricing Consultation.

## Market review proposals

5.6 In the September 2017 WLA Consultation, after considering stakeholder responses to the March 2017 WLA Consultation and our own further analysis we decided to consult further on specific issues relating to the proposed WLA charge controls. These included changing the proposed charge controls on certain ancillary services. We set out details of those changes in the September 2017 WLA Consultation.

5.7 The main proposals with regulatory financial reporting implications were:

- GEA Cablelink<sup>59</sup>: to reduce the starting charges we proposed in March 2017 to reflect Openreach's decision to reduce its charges and use a flat real cap rather than flat nominal price cap;
- Tie cables<sup>60</sup>: to correct some forecasting assumptions and make similar base year adjustments to remove historical costs that have already been recovered;
- Co-mingling<sup>61</sup>: to adjust the base year data to remove historical costs that have already been recovered;
- Other MPF Ancillary services basket: this was no longer proposed, instead we proposed to align the individual charges for MPF Cancellations<sup>62</sup> and MPF Amends<sup>63</sup> with GEA Bandwidth Change to 40/10 which we expect to have similar costs, and to impose an

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<sup>59</sup> Related to 1 Gbit/s GEA Cablelink (provides access to the Fibre-enabled customer base) and 10 Gbit/s GEA Cablelink (provides access to the Fibre-enabled customer base). See the Cablelink service definitions in proposed Conditions 7B.10(a)-(d), Annex 5, September 2017 WLA Consultation.

<sup>60</sup> The 48 services as set out in Part 1, Annex to Condition 7A, Annex 5, September 2017 WLA Consultation.

<sup>61</sup> The 33 services as set out in Part 4, Annex to Condition 7A, Annex 5, September 2017 WLA Consultation.

<sup>62</sup> Defined at Condition 7C.10(g), page 54, Annex 5, September 2017 WLA Consultation.

<sup>63</sup> Defined at Condition 7C.10(f), page 54, Annex 5, September 2017 WLA Consultation.

individual charge control on MPF Standard Line Test.<sup>64</sup> We proposed to include the remaining services previously in this basket within the MPF New Provides basket;

- GEA 40/10 Bandwidth Change<sup>65</sup> ("GEA Bandwidth Change"): to change the proposed charge control due to a correction to our forecasting calculation;
- GEA 40/10 Cancel/Amend/Modify – CRD<sup>66</sup> ("GEA CRD"): to align the charges for these services to the GEA bandwidth Change which we expect to have similar costs;
- GEA 40/10 Cancel/Amend/Modify – Regrading<sup>67</sup> GEA cancellation, modification and amendment services ("GEA regrading") CRD: to align the charges for these services to the GEA bandwidth Change which we expect to have similar costs; and
- VLAN moves applied to GEA Cablelink Modify transactions<sup>68</sup> ("VLAN moves"): to align the charges for these services to the GEA bandwidth Change which we expect to have similar costs.

5.8 We also discussed additional financial reporting for GEA Cablelink, Co-mingling, Tie cables, and Abortive Visit Charges ("AVCs") to ensure greater transparency on the costs and revenues associated with these services in the market review period.

## Review of the requirements for WLA ancillary services regulatory financial reporting

5.9 Below, we consider how well BT's current regulatory financial reporting provides us with the information we need to make informed regulatory decisions and what information we need to monitor compliance with the non-discrimination and what needs to be provided to stakeholders. We then consider whether the information that is provided has the attributes of effective financial reporting, as described in Section 2.

### Information to make informed regulatory decisions

5.10 We need financial information to make informed regulatory decisions, including investigating potential breaches of SMP conditions and anti-competitive practices relating to WLA ancillary services and as a source of information for cost modelling.

5.11 In the September 2017 WLA Consultation, we noted that in the case of some WLA ancillary services (GEA Cablelink 1 Gbit/s and 10Gbit/s, MPF Cancellations, MPF Amend, MPF Standard Line test, GEA CRD, GEA regrading and VLAN Moves) the relevant cost data was not reported to the required level of granularity to use in modelling a charge control.<sup>69</sup>

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<sup>64</sup> Defined at Condition 7A.12(s), page 14, Annex 5, September 2017 WLA Consultation.

<sup>65</sup> Defined at Condition 7B.10(v), page 38, Annex 5, September 2017 WLA Consultation.

<sup>66</sup> Defined at Condition 7B.10(w), page 38 - 39, Annex 5, September 2017 WLA Consultation.

<sup>67</sup> Defined at Condition 7B.10(x), page 39, Annex 5, September 2017 WLA Consultation

<sup>68</sup> Defined at Condition 7B.10(u), page 38, Annex 5, September 2017 WLA Consultation.

<sup>69</sup> Paragraphs 4.49 – 4.83 of the September 2017 WLA Consultation.



- 5.12 In respect of other WLA ancillary services (Tie cables and Co-mingling) whilst RFS cost data was available it was not appropriate to use unadjusted data in modelling the charge controls as there were issues over its reliability.

### **Monitoring compliance with non-discrimination and EOI remedies**

- 5.13 We need financial information to monitor BT's compliance with the non-discrimination and EOI<sup>70</sup> conditions proposed in the March 2017 WLA Consultation.

### **Providing Stakeholders with reasonable confidence**

- 5.14 We need to provide stakeholders with reasonable confidence that BT has complied with the requirement to attribute the costs to certain WLA ancillary services in a non-discriminatory way and consistent with our charge control, which seeks to prevent over recovery of costs.

### **The attributes of the information we currently receive**

- 5.15 In respect of MPF Cancellations, MPF Amend, Standard Line test, GEA CRD, GEA regrading and VLAN Moves, in the September 2017 WLA Consultation we noted that the RFS does not have relevant cost information.<sup>71</sup>
- 5.16 In respect of GEA Cablelink, BT does not currently record any directly incurred engineering costs against the services. The costs for GEA Cablelink are currently capitalised (despite the service being paid "up front") and aggregated within the 'GEA Other' service<sup>72</sup>.
- 5.17 In respect of Tie cables rental charges, the information is not reliable as BT currently capitalises labour costs it incurs when installing Tie cables which paid for "up front" through connection charges. This cost treatment leads to an inconsistency in the timing of costs and revenues.
- 5.18 We also considered it likely that this could lead to over-recovery of costs as these capitalised labour costs will have already been recovered in historical connection charges as well as Tie cable rentals.
- 5.19 In respect of Co-mingling rentals, we identified two costs treatments that looked unreliable.

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<sup>70</sup> Tie cables and co-mingling are EOI inputs into the WBA market.

<sup>71</sup> Paragraphs 4.49 – 4.83 of the September 2017 WLA Consultation.

<sup>72</sup> Paragraphs 4.4 – 4.16 of the September 2017 WLA Consultation.

- Firstly, for set up costs<sup>73</sup> we found that BT has historically capitalised the survey costs it undertakes on the Co-mingling areas within its local exchanges. As with Tie cables, these costs were recovered when the surveys were undertaken and paid for, so this could lead to an over-recovery of costs.
- Secondly for the ACPA<sup>74</sup> CoW, as explained in the 2017 September WLA Consultation,<sup>75</sup> BT attributes too high a proportion of costs for ACPA to Co-mingling services compared to GEA services.

5.20 As noted above, in respect of GEA Cablelink, engineering costs are currently capitalised (despite the service being paid “up front”) and aggregated within the ‘GEA Other’ service. As with Tie cables and Co-mingling, these costs were recovered when GEA Cablelink was installed and paid for, so this could lead to an over-recovery of costs relating to ‘GEA Other’ service.

## The changes we proposed in the September 2017 WLA Consultation

### Recording costs to be consistent with our charge control

5.21 As noted above, in the September 2017 WLA Consultation we explained that we had found that in relation to Tie Cables, Co-mingling and GEA Cablelink, BT was capitalising labour costs, inconsistently with how they were currently being recovered. We also found this to be the case with AVCs<sup>76</sup> which we did not propose to charge control. We explained that in our charge control model, we removed them from the asset base of our estimate of capitalised costs that had been recovered through “up-front” charges. We considered these costs to be operating expenses in the year in which they were incurred.

5.22 We set out the regulatory financial reporting suggested treatments consistent with our charge control proposals in Table 5.1.

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<sup>73</sup> Network component CL131. See paragraphs 4.49-4.55 of the September 2017 WLA Consultation.

<sup>74</sup> The ACPA class of work includes spend on assets relating to construction provision, installation and recovery necessary for the operation of network equipment e.g. ventilation and cooling plant. - BT's response of 18 August 2017 to question 2f (ii) of the 27th WLA 2017 s.135 request. See also page 343 of BT's 2016 AMD.

<sup>75</sup> See paragraphs 4.59 – 4.74 of the September 2017 WLA Consultation.

<sup>76</sup> AVCs are where an appointment is agreed for work at a customer's site and the engineer arrives within the appointment slot but is unable to carry out the work at, or gain access to, the customer's site.

**Table 5.1 Regulatory financial suggested treatment in the September 2017 WLA Consultation**

	<b>Suggested treatment in the RFS in the September 2017 WLA Consultation</b>
GEA Cablelink	GEA Cablelink (Connection) - 1 Gbit/s and GEA Cablelink (Connection) – 10 Gbit/s – We suggested that BT must not capitalise any labour installation or equipment costs required to provide GEA Cablelink services and must remove the costs of historical assets already recovered via GEA Cablelink one-off charges from Net Replacement Costs (“NRCs”) and GRCs.
Tie cables	We suggested that BT removes all the historical labour installation assets from GRCs and NRCs and, going forward, treats any labour costs that would previously have been capitalized as operating costs.
Co-mingling Set up costs (CL131)	We suggested that BT removes all the historical assets already recovered via one-off or connection fees from GRCs and NRCs and treats any labour costs that would previously have been capitalised as operating costs.
Co-mingling Rentals (CL132)	<p>In the March 2017 WLA Consultation we suggested that BT establish separate Plant Groups for GEA ACPA costs and LLU ACPA costs and that the ACPA CoW was attributed on a basis that took account of the age of the assets within the Plant group.</p> <p>In the September 2017 WLA Consultation we suggested amending the March 2017 WLA Consultation proposal by requiring that ACPA assets that are required for co-mingling services are separately identified within the ACPA CoW (rather than assumed they are the balancing item) in addition to GEA and fibre related ACPA being separately identified.</p> <p>The separately identified Co-mingling (excluding those already recovered) and GEA assets within the ACPA CoW would then be attributed to the respective separate Plant groups.</p>
AVCs	We suggested that BT removes all the historical labour installation assets from GRCs and NRCs and, going forward, treats any labour costs that would previously have been capitalised as operating costs.

- 5.23 We did not make any suggestions in relation to regulatory financial reporting of MPF Cancellations, MPF Amend, Standard Line test, GEA CRD, GEA Regrading and VLAN Moves concerning consistency with our proposed charge controls on these services.

### BT's response to our regulatory financial reporting proposals<sup>77</sup>

- 5.24 BT disagreed with our suggestion to require them to change how they accounted for the costs of Tie Cables, Co-mingling, GEA Cablelink and AVCs. They said our suggestion "is not consistent with the relevant accounting standards and cannot therefore be adopted in our statutory accounts. We believe that adopting different accounting treatments for these costs in the statutory and regulatory accounts will reduce their comparability and lead to a reduction in the transparency of the regulatory accounts".<sup>78</sup>
- 5.25 In response to our suggestion on Co-mingling Rentals (CL1312) – ACPA BT proposed to:
- i) Move the cost of assets which provide power to the GEA DSLAMs to the Class of Work LFME, which is attributed to the Plant Group PG953C GEA DSLAM and Cabinets, which is in turn allocated to the Component CL953 GEA DSLAM and Cabinets and then attributed to GEA FTTC Rentals Internal and External;
  - ii) Leave the remaining costs in Class of Work ACPA and amend the attribution, removing PG953C GEA DSLAM and Cabinets, so that costs are shared between PG132B LLU Co-mingling Recurring Costs and PG136A LLU Co-mingling Surveys; and
  - iii) make no other changes on the basis that its own investigation has identified no other material assets which are included in the ACPA class of work<sup>79</sup>.

### Our response

- 5.26 In response to BT's point that our suggestion conflicts with the accounting policy they have in the statutory accounts in relation Tie Cables, Co-mingling, GEA Cablelink services, and AVCs, our view is that if there are good reasons, the statutory accounting policies do not have to align to those in the RFS.
- 5.27 The Regulatory Accounting Principles are listed in order of priority; Principle 4, "Consistency with regulatory decisions" which is the relevant principle for our proposed reporting for these services ranks above Principle 6, "Compliance with statutory accounting standards." We set out in the 2014 Regulatory Financial Reporting Statement (Section 3) our rationale behind the priority.

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<sup>77</sup> Openreach non-confidential response to September 2017 WLA Consultation, available here [https://www.ofcom.org.uk/data/assets/pdf\\_file/0025/108088/Openreach.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0025/108088/Openreach.pdf).

<sup>78</sup> Openreach non-confidential response to September 2017 WLA Consultation, paragraph 169.

<sup>79</sup> Openreach non-confidential response to September 2017 WLA Consultation, paragraph 172.

- 5.28 In response to BT's point that there would be a reduction in comparability and transparency between the statutory accounts and the RFS, we note that BT publishes a reconciliation between the two sets of accounts<sup>80</sup> which set out the reconciling differences over £1m. We propose BT includes this adjustment within the reconciliation statement to address their concern<sup>81</sup>.
- 5.29 In response to BT's point on ACPA, based on the results of BT's investigation we considered that BT's proposal of splitting GEA ACPA costs from Co-mingling ACPA costs was similar to the proposed treatment set out in Table 5.1 for Co-mingling Rentals (CL132) above. However, BT's proposes<sup>82</sup> some of the remaining ACPA Co-mingling costs are re-attributed to PG136A LLU Co-mingling Surveys, which conflicts with our proposal set out in Table 5.1 for Co-mingling Set up cost, which is that capitalised costs in respect of Co-mingling surveys that have already been paid for should not be recovered again.

### Reporting costs to be consistent with our regulatory proposals

- 5.30 In the September 2017 WLA Consultation in respect of monitoring that BT no longer capitalises costs that are paid up front in respect of Tie Cables, Co-mingling, GEA Cablelink and AVCs, we said "we will be discussing with BT whether the implementation of our proposals requires the introduction of new network components that will help demonstrate that BT no longer capitalises in-year spend on assets that we have identified above or continues to attribute costs of the removed historical assets to these services".<sup>83</sup>
- 5.31 In the September 2017 WLA Consultation, for private reporting in relation to our suggestion that BT no longer capitalises costs that are paid up front in respect of Tie Cables, Co-mingling, GEA Cablelink and AVCs, we said "Given our proposals on certain Wholesale Ancillary services we consider that BT should provide one new AFI to us that demonstrates how it has removed the historical cost of assets (GRCs, NRCs and Depreciation) from these services".<sup>84</sup>

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<sup>80</sup> Currently on page 100 of the 2017 RFS.

<sup>81</sup> Openreach non-confidential response to September 2017 WLA Consultation, paragraph 169.

<sup>82</sup> Openreach non-confidential response to September 2017 WLA Consultation, paragraph 172b, repeated in paragraph 5.26 ii) above.

<sup>83</sup> Paragraph 4.111, page 79, September 2017 WLA Consultation.

<sup>84</sup> Paragraph 4.113, page 79, September 2017 WLA Consultation.

### BT's response to our regulatory financial reporting proposals

5.32 BT disagreed with our suggestion to require them to create new network components and produce an additional AFI. They said "In the event that Ofcom nevertheless requires BT to immediately recognise the costs for Tie Cables, Co-mingling, GEA Cablelink services and AVCs, we disagree with Ofcom's proposal to require BT to both i) provide an AFI demonstrating our compliance and ii) create additional network components to demonstrate compliance. We believe it is disproportionate to require us to do both and instead propose to discuss with Ofcom which alternative would be more effective and efficient."<sup>85</sup>

### Our response

5.33 We have considered BT's response and agree that in terms of providing information to monitor compliance with any future regulatory decisions on the capitalisation of costs within certain WLA ancillary services, there is an element of duplication in our suggestion. We therefore propose to proceed only with a network component proposal as this has the added advantage of additionally providing comfort to stakeholders on BT's compliance, which private reporting does not.

## The changes we propose

5.34 To obtain information to make informed regulatory decisions we need relevant, reliable and transparent costs to be reported (to us and where relevant, to stakeholders) consistent with how we considered them in our pricing proposals.

### Recording costs to be consistent with our regulatory proposals

5.35 In the introduction (see paragraphs 2.10 – 2.15), we set the questions we consider when deciding whether and how costs we include in the charge control should be accounted for and reported in the RFS. We have considered these questions in relation to the cost of WLA ancillary services, they are:

- a) Do the costs we considered replace BT's incurred costs with an alternative estimate of cost?
- b) Do the costs we considered have the effect of replacing BT's incurred costs with a value that is not based on BT's network (whether actual, estimated or for forecasting purposes)?

5.36 We would not expect to see a cost adjustment to be reflected in BT's RFS or the Adjusted Financial Performance Schedules if the adjustment has the effect of replacing BT's incurred

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<sup>85</sup> Paragraph 4.113, page 79, September 2017 WLA Consultation.

costs with a value that is not based on BT's network and it is only made for forecasting purposes. To determine whether the adjustments listed in Table 5.2 should be reflected in BT's RFS or Adjusted Financial Performance Schedules we have applied the approach set out above and set out our analysis in Table 5.2.

**Table 5.2 Analysis of the reporting of WLA ancillary services costs**

	Do the costs we considered replace BT's incurred costs with an alternative estimate of cost?	Do the costs we considered have the effect of replacing BT's incurred costs with a value that is not based on BT's network (whether actual, estimated or for forecasting purposes)?
a) GEA Cablelink	No	No
b) Tie cables	No	No
ci) Co-mingling – set up costs	No	No
cii) Co-mingling rentals	No	No
d) MPF Cancellations	No	No
e) MPF Amend	No	No
f) MPF Standard line test	No	No
g) GEA CRD	No	No
h) GEA regrading	No	No
i) VLAN Moves	No	No

5.37 In line with the approach set out above, we consider that there are no reasons not to reflect adjustments a) - i) in Table 5.2 in BT's RFS. We therefore propose that the RFS should include these adjustments.

5.38 We propose that BT should reflect adjustments a) -i) in the order presented above because some of the adjustments logically should follow others, whilst others have a cumulative effect on the RFS.

5.39 As noted above, in the September 2017 WLA Consultation, we set out how we have calculated the adjustments we have made to BT's 2016/17 RFS base year data to correct

GEA Cablelink, Tie cables and Co-mingling. We also set out regulatory financial reporting proposals which BT have commented on and which we have considered. We set the proposed directions out in the next section.

- 5.40 In respect of MPF Cancellations, MPF Amend, Standard Line test, GEA CRD, GEA Regrading and VLAN Moves, as noted above, BT does not currently separately report these services within the RFS. As these services will now be subject to charge controls we propose that BT should separately identify these services within the published RFS.

## Other changes to the basis of preparation

- 5.41 Whilst we have not proposed to set a charge control for AVCs, under our proposals they are subject to a fair and reasonable charges obligation.<sup>86</sup> As with Co-mingling and Tie cable services, we understand that BT is currently capitalising the costs of AVCs whilst charging for these services as they are incurred. This again leads to an inconsistency between the revenues reported within the RFS and the costs, with some AVC costs reflecting historical activity stretching back over several years and again giving rise to potential double recovery of these costs in the future. We therefore propose that BT no longer capitalises the costs of AVCs and removes those that have been already paid for from the balance sheet.

## Reporting costs to be consistent with our regulatory proposals

### Public reporting

- 5.42 Following on from our proposed requirements for BT to ensure that WLA ancillary services are recorded in a manner that is consistent with how we modelled the costs for the charge controls<sup>87</sup>, we need to consider what information should be provided by BT to allow for the monitoring of our charge control remedy. Stakeholders, as we have stated above, require confidence that WLA ancillary costs that have been paid for upfront are not potentially being recovered again in rental charges. To provide this confidence we propose the creation of new network components. The new network components will capture all costs (especially labour) relating to WLA ancillary services where the revenue for the connection/ installation / one-off cost has been received up-front but the connection / installation / one off cost had been previously capitalised as an asset. The proposed network components would be disclosed within the within the FAC breakdowns where of the price controlled services.

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<sup>86</sup> Paragraph 4.79, page 76, September 2017 WLA Consultation.

<sup>87</sup> In the case of AVC's that the treatment is consistent with the Regulatory Accounting Principles.



- 5.43 In addition, as we have proposed that several services are subject to service level charge controls, there will be an increase in the service level reporting consistent with the charge controls on these services.
- 5.44 We do not propose any changes in the level of private reporting.

## Proposed directions to implement regulatory accounting requirements in respect of WLA ancillary services

- 5.45 We set out below the amendments we are proposing to make to the draft directions set out in the March 2017 WLA Consultation (as amended in the August 2017 DPA Pricing Consultation).

### Proposed consistency with regulatory decisions direction – amendment to the basis of preparation

- 5.46 In the September 2017 WLA Consultation, we set out how we calculated the adjustments we have made to BT's 2015/16 RFS base year data to correct Tie cables, Co-mingling and GEA Cablelink costs.
- 5.47 In the September 2017 WLA Consultation, we outlined our thinking on what we would propose in respect of Consistency with regulatory decisions, to which BT responded. No other stakeholder made specific responses. We have taken account of the responses in our proposals below.

**Table 5.3 Proposed adjustments and proposed treatment in the RFS**

Proposed adjustment	Proposed treatment in the RFS
a) GEA Cablelink	GEA Cablelink (Connection) - 1 Gbit/s and GEA Cablelink (Connection) – 10 Gbit/s - BT must not capitalise any labour installation or equipment costs required to provide GEA Cablelink services and must remove the costs of historical assets already recovered via GEA Cablelink one-off charges from NRCs and GRCs.
b) Tie cables	We propose that BT removes all the historical labour installation assets from GRCs and NRCs and, going forward, treats any labour costs that would previously have been capitalised as operating costs.
c) Co-mingling i) Set up costs (CL131)	We propose that BT removes all the historical assets already recovered via one-off or connection fees from GRCs and NRCs and treats any labour costs that would previously have been capitalised as operating costs.

Proposed adjustment	Proposed treatment in the RFS
ii) Co-mingling Rentals (CL132)	<p>We propose that BT moves the NRCs and GRCs of the ACPA assets which provide power to the GEA DSLAMs to the Class of Work LFME. We propose that BT removes all the historical assets already recovered via one-off or connection fees from GRCs and NRCs and treats any labour costs that would previously have been capitalised as operating costs.</p> <p>In respect of the remaining ACPA assets used to provide power to co-mingling equipment, we propose that BT removes all the historical assets already recovered via one-off or connection fees from GRCs and NRCs and treats any labour costs that would previously have been capitalised as operating costs. The costs are then attributed to PG132B LLU Co-mingling Recurring Costs.</p>

5.48 In respect of AVCs, we set out our view in the September 2017 WLA Consultation that the costs in the RFS are unreliable. We are therefore proposing modifications to the consistency with regulatory decisions direction which will require BT to:

- remove/write-off the potentially double recovered historical assets from GRCs and NRCs and the associated historical depreciation from operating costs;
- treat the corresponding expenditure that had been previously treated as in year capex as operating costs; and
- ensure that these services do not receive attributions of historical assets from the identified classes of work or asset types.

5.49 We have included the proposed amendments in respect of the proposed direction in the March 2017 WLA Consultation which implements our requirement for consistency with regulatory decisions in Annex 6.

### Proposed network components direction - amendment

5.50 We propose to amend this proposed direction by requiring that BT creates five new network cost components. They are:

- GEA Cablelink Expenditure;
- Co-mingling Rentals Expenditure;
- Co-mingling Connections Expenditure;
- AVC Expenditure; and
- Other WLA Ancillary Expenditure.

5.51 The proposed network components are operating cost components and should capture all costs (especially labour) relating to WLA ancillary services of the same name where the

revenue for the connection / installation / one-off cost has been received up-front but the connection / installation / one off cost had been previously capitalised as an asset. BT should report all future connection/ installation / one-off cost that it receives up-front for these services in these network components.

- 5.52 The introduction of these new components will improve the relevance and reliability of the financial information we receive to investigate competition concerns, and for cost modelling purposes. It will also provide stakeholders with greater confidence that these costs will not potentially be double recovered.
- 5.53 We have included the proposed amendments in respect of the proposed direction in the March 2017 WLA Consultation which specifies the list of network components in Annex 6.

### **Proposed form and content direction - amendment**

- 5.54 We set out our proposals for the additional financial information that BT should be required to provide on certain WLA ancillary services.

### **Public information**

- 5.55 The published RFS reports financial information for specific markets at broadly three levels: market level information; service level information; and network component cost level information for regulated services. We set out below additional information that we propose should be published in the RFS relating to service level information and network components for reported services. There is no impact on market level information.

#### Service level information

- 5.56 We propose that BT should publish revenue, volume, average price and FAC information for the following services where revenues are greater than £5m for the following services<sup>88</sup>;
- GEA 40/10 Bandwidth Change;
  - VLAN moves applied to GEA Cablelink Modify transactions;
  - AVCs;

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<sup>88</sup> With the exception of the following services, this list is supplemental to that proposed in the March 2017 WLA Consultation (Volume 1, paragraph 10.79): Other MPF Ancillary Services basket (which we proposed to remove in the September 2017 WLA Consultation), GEA 40/10 FTTC rentals (now split by GEA 40/10 FTTC rentals provided with or without MPF SML1 further to our WLA Network Expansion Consultation), GEA 40/10 Other (now split by GEA 40/10 Other rentals provided with or without MPF SML1 further to our WLA Network Expansion Consultation) and Cablelink 1 Gbit/s and 10Gbit/s (each now split by rentals and connections further to our September 2017 WLA Consultation).

- MPF Cancellations;<sup>89</sup>
- MPF Amend;<sup>90</sup>
- MPF Standard line test;<sup>91</sup>
- GEA CRD;<sup>92</sup> and
- GEA Regrading.<sup>93</sup>

5.57 This public reporting is in line with the basis on which the charge controls are proposed or, in the case of AVCs, the Regulatory Accounting Principles.

5.58 We have included the proposed amendments in respect of the proposed direction in the March 2017 WLA Consultation setting the requirements in relation to preparation, delivery, publication, form and content of the RFS in Annex 6.

### Private information

5.59 In the September 2017 WLA Consultation we proposed a new AFI be provided to us that would demonstrate how BT removed the historical cost of assets (GRCs, NRCs and Depreciation) from Tie Cables, Co-mingling, GEA Cablelink services and AVCs. We now consider that the requirements behind our proposal (monitoring BT's compliance) are better delivered by our proposed change to the network components direction.

## Legal tests

5.60 We consider that the proposed directions (as amended in this consultation and where relevant, the August 2017 DPA Pricing Consultation) would fulfil our general duties under section 3 of the Act and meet the Community requirements set out in section 4 of the Act for the reasons given above.

5.61 We consider that our proposals meet the tests set out in section 49(2) of the Act and for all the reasons set out below.

5.62 Our proposed amendment to the draft Consistency with regulatory decisions direction is:

- objectively justifiable because it is necessary for us to give a direction which includes specifying the accounting treatment of the relevant WLA ancillary services costs so that the RFS is consistent with our proposed regulatory decision to set charge controls (or in

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<sup>89</sup> Per paragraph 4.83b, page 71, of the September 2017 WLA Consultation. These services would be subject to FAC service level charge controls.

<sup>90</sup> Per paragraph 4.83b, page 71, of the September 2017 WLA Consultation. These services would be subject to FAC service level charge controls.

<sup>91</sup> Per paragraph 4.83b, page 71, of the September 2017 WLA Consultation. These services would be subject to FAC service level charge controls.

<sup>92</sup> Per paragraphs 4.88 – 4.91, pages 74 – 75 of the September 2017 WLA Consultation. These services would be subject to FAC service level charge controls.

<sup>93</sup> Per paragraphs 4.88 – 4.91, pages 74 – 75 of the September 2017 WLA Consultation. These services are subject to FAC service level charge controls.

the case of AVCs, other pricing obligations) in relation to WLA ancillary services. The proposed amendment to the direction also provides BT with clarity as to how our proposals made in the September 2017 WLA Consultation would need to be reflected in the RFS;

- not unduly discriminatory because it reflects BT's market position in the UK excluding the Hull Area;
- proportionate because our proposal is no more than would be required to ensure consistency with our decisions. Further, BT retains a key role in determining the basis of preparation of the RFS; and
- transparent because it is clear that the intention of our proposal is to ensure that BT's RFS are consistent with our proposed decision in relation to the WLA charge control (or in the case of AVCs, wider pricing obligations).

5.63 Our proposed amendment to the draft Network Components direction is:

- objectively justifiable because it is necessary to make the reporting of services in the WLA market consistent with our regulatory requirements;
- not unduly discriminatory because it reflects BT's market position in the UK excluding the Hull Area;
- proportionate because our proposal is no more than is required to specify network components relevant to the charge controls that we are proposing for ancillary services; and
- transparent because it is clear that our proposal seeks to specify relevant network components in the light of our proposed charge controls and to ensure that these network components remain fit for purpose.

5.64 Our proposed amendments to the Form and Content of the RFS direction are:

- objectively justifiable because the amendments to the proposed direction are required to reflect the regulatory proposals made in the September 2017 Consultation. Our proposals concerning the additional information to be provided, both in public and in private, seek to ensure that stakeholders have sufficient information about the products and services they purchase to provide them with reasonable confidence about BT's compliance with its SMP conditions and that we have sufficient information necessary to carry out our functions;
- not unduly discriminatory because it reflects BT's market position in the UK excluding the Hull Area. We have explained in this consultation the reasons for requiring relevant additional information from BT both publicly and privately;
- proportionate because the amendments to the proposed direction will be no more than is required to ensure the effectiveness of the proposals in the September 2017 WLA Consultation and will ensure that Ofcom and stakeholders are provided with a sufficient level of information, and does not extend beyond these; and

- Transparent because the intention of the proposed direction (as amended) will be to make sure that the RFS remain fit for purpose and that Ofcom and stakeholders are provided with a sufficient level of information.

5.65 In proposing this change, we have taken due account of all applicable recommendations issued by the European Commission under Article 19(1) of the Framework Directive, in particular the 2005 EC Recommendation.

## Next steps

5.66 Based on responses to the September 2017 WLA Consultation, responses to the wider regulatory financial reporting proposals in the March 2017 WLA Consultation, further discussions with BT and responses to this consultation, we would expect to make a final decision on our approach to reporting these WLA ancillary services in early 2018 with the new reporting requirements in place for April 2018. These changes would be reflected in the 2018/19 RFS to be published in July 2019.

## Consultation question

Question 5.1. Do you agree with our proposals for BT's Regulatory Financial Reporting in relation to the reporting of WLA ancillary services?

Please provide reasons and evidence in support of your views.

## 6. Other regulatory financial reporting proposals in relation to the WLA market

### Introduction

- 6.1 In the March 2017 WLA Consultation, we proposed to impose regulatory financial reporting requirements on BT in relation to the WLA market in the UK excluding the Hull area, including regulatory financial reporting SMP conditions and directions as to:
- a) the Consistency with regulatory decisions and RAV direction (including cumulo rates),
  - b) the preparation, delivery, publication, form and content of the RFS,
  - c) the reconciliation report, and
  - d) network components.
- 6.2 In this section we set out a number of further proposals to amend financial reporting requirements on BT for the WLA market relating to those directions.

### Summary

- 6.3 In summary, we are proposing to:
- clarify within the draft legal instrument our March 2017 proposal for the attribution of non-Next Generation Access ("NGA") related cumulo costs to remain unchanged and introduce minor changes to the wording relating to NGA related cumulo costs to ensure the requirements are clear. In the March 2017 WLA Consultation, we proposed that BT makes a small change to the cumulo attribution methodology in relation to GEA related cumulo costs and that the rest of the provisions dealing with cumulo attributions in the current consistency direction would remain unchanged.<sup>94</sup> While we reflected the first aspect of our proposals in the draft legal instruments at Annex 23 of the March 2017 WLA Consultation (changes to GEA related cumulo cost attributions), we did not reflect the second aspect, namely that there was no change in relation to non-GEA related cumulo cost attributions. This is now clarified by way of amendments to the proposed consistency direction, along with minor changes to the wording relating to NGA related cumulo costs to ensure the requirements are clear.
  - require BT to publish information in the RFS that allows us to monitor compliance with the EOI obligation imposed in the WLA market. As these particular WLA inputs are consumed by services in the WBA market, we are proposing that the relevant

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<sup>94</sup> See Table 10.3, page 164 of Volume 1 of the March 2017 WLA Consultation.

information be published within the WBA market disclosures. We propose to implement this by way of an amendment to our March 2017 proposal for a direction setting the requirements in relation to preparation, delivery, publication, form and content of the RFS, as amended by the August 2017 DPA Pricing Consultation.

- amend the requirements relating to the production and publication of the reconciliation report. We propose that BT no longer produces two annexes to the current report. The first annex reproduces in full the RFS to show the impact of reversing all methodology changes, the second annex reproduces in full the RFS to show the impact of all errors. We propose the remainder of the current report is consolidated within the RFS to reduce duplication. We propose to implement this by way of an amendment to our March 2017 proposal for a direction setting the requirements for the reconciliation report.
- amend the requirements in relation to network components, to ensure the list reflects the network components that are reported in the RFS. We propose to implement this by way of an amendment to our March 2017 proposal for a direction specifying network components, as amended by other proposals made in this consultation.

6.4 The proposed amendments to the draft directions for the 2017 WLA Market Review are set out in Annex 6 (see Schedules 1 to 4 to the Notification respectively). These proposed amendments are to the draft directions set out at Annex 23 of the March 2017 WLA Consultation (as amended by Annex 6 of the August 2017 DPA Pricing Consultation).

## Market review proposals

6.5 Cumulo rates. In the March 2017 WLA Consultation we proposed<sup>95</sup> that BT should make a minor change to the way in which it attributes its cumulo rates, so that the amounts to be attributed to GEA-FTTC rental services should be calculated with reference to a rateable value per connected line of £18 per annum and Other GEA rental services should be calculated with reference to a rateable value per connected line of £20 per annum. With regard to non-GEA related services, we proposed for the attribution methodology to remain unchanged.

6.6 EOI reporting. In the March 2017 WLA Consultation<sup>96</sup> we proposed that BT continues to be subject to a specific requirement to provide network access to LLU, VULA and other key wholesale services on an EOI basis. In the March 2017 WLA Consultation we did not

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<sup>95</sup> Paragraph 10.34 and Table 10.3, page 164, Volume 1 of the March 2017 WLA Consultation.

<sup>96</sup> Paragraphs 5.59-5.92, pages 75-81, Volume 1 of the March 2017 WLA Consultation.



however propose any regulatory financial reporting requirements for monitoring BT's compliance with that EOI obligation.

- 6.7 The reconciliation report. In the March 2017 WLA Consultation, we set out our regulatory financial reporting proposals in Section 10. We proposed to re-impose the requirement for BT to publish the reconciliation report.<sup>97</sup>
- 6.8 Network components. In the March 2017 WLA Consultation, we also proposed a network component direction based on the list of network components that existed at that time<sup>98</sup>.

## Review of the requirements for WLA regulatory financial reporting

- 6.9 Below, we consider how well BT's current regulatory financial reporting provides us with the information we need to make informed regulatory decisions, and what information we need to monitor compliance and what needs to be provided to stakeholders. We then consider whether the information that is provided has the attributes of effective financial reporting, as described in Section 2.

### Information to make informed regulatory decisions

- 6.10 We need financial information to make informed regulatory decisions, including investigating potential breaches of SMP conditions and anti-competitive practices and as a source of information for cost modelling.
- 6.11 We explained in the March 2017 WLA Consultation what cumulo rates are (see also Section 7 of this consultation) and why our proposals relating to the cumulo rates attribution methodology were necessary and met the relevant legal tests.<sup>99</sup>

### Monitoring compliance with non-discrimination and EOI remedies

- 6.12 We need financial information to monitor BT's compliance with the non-discrimination and EOI<sup>100</sup> conditions proposed in the March 2017 WLA Consultation.
- 6.13 The information we currently receive from BT on compliance with its WLA EOI obligations is published within the WBA market section of the RFS. The regulatory financial reporting requirement which was imposed in connection with the WBA charge control remedy required BT to publish a network component breakdown for the key WBA services. This network component information included FAC information in respect of the non-EOI input costs and EOI input prices in respect of Openreach provided EOI inputs. Whilst the purpose of the network component information was to show stakeholders how the FAC of the

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<sup>97</sup> Paragraphs 10.62 - 10.65, pages 174-175, Volume 1 of the March 2017 WLA Consultation.

<sup>98</sup> Paragraphs 10.56 - 10.61, pages 173-174, Volume 1 of the March 2017 WLA Consultation.

<sup>99</sup> See Section 10 of Volume 1 and Annex 17 of the March 2017 WLA Consultation.

<sup>100</sup> For example, Tie cables and Co-mingling are EOI inputs into the WBA market.

services they purchased matched the regulated price that they were charged, as a by-product, this information also allowed stakeholders to see which EOI inputs were provided from the WLA market, included within the published WBA service costs and their relative importance in the overall total cost of the WBA services.

- 6.14 This information currently has all the good attributes of basic financial reporting.

## Providing stakeholders with reasonable confidence

- 6.15 We need to provide stakeholders with reasonable confidence that BT has complied with the requirement to provide certain WLA inputs on an EOI basis, including those which are inputs into services that fall within the WBA market.
- 6.16 The reconciliation report attempts to ensure that regulatory financial reporting gives confidence to stakeholders and allows them to contribute to the regulatory regime. The aim of the reconciliation report is to provide stakeholders with the impact of all material changes and material errors discovered in the RFS to provide stakeholders with transparency of changes that BT made to the RFS.

## EOI reporting

- 6.17 In respect of providing stakeholders with confidence that BT has complied with its non-discrimination and EOI obligations, stakeholders get the same information we do which is in the published RFS. This information provides stakeholders with the required level of confidence that BT complies with its EOI obligations.

## The reconciliation report

- 6.18 The aim of the reconciliation report is to provide stakeholders with the impact of all material changes and material errors discovered in the RFS in order to provide stakeholders with transparency of changes that BT made to the RFS. We said in the 2014 Regulatory Financial Reporting Statement, "the reconciliation report, together with the published notifications about proposed changes, makes the implemented changes and their impacts on markets transparent<sup>101</sup>". This information would also help explain to stakeholders year-on-year changes to the RFS and their causes.
- 6.19 In Section 4 of the 2014 Regulatory Financial Reporting Statement we set out the form of the report to be published for stakeholders<sup>102</sup>.

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<sup>101</sup> Paragraph 3.184, page 60, 2014 Regulatory Financial Reporting Statement.

<sup>102</sup> The report should show, the impact of all changes to the RFS on an aggregated basis, the impact of each material changes at an aggregated level, the impact of each material changes at the level of markets and technical areas on an individual and aggregate basis, changes below the materiality threshold would be aggregated, the impacts were in absolute amounts and as percentage changes and the report would be audited.

6.20 These requirements were set out in the Annex 5 of the 2015 Directions Statement.

## The attributes of the information we receive

### Reconciliation report

6.21 As part of our ongoing engagement with BT on regulatory financial reporting, we have had discussions over the information contained in the reconciliation report. To meet its current obligation, BT publishes a report including two annexes.<sup>103,104</sup>

6.22 BT has asked<sup>105</sup> for Ofcom to change the form of the information provided within the reconciliation report, they asked to no longer produce the two annexes on the basis that their production involves a disproportionate level of resource relative to the benefit they bring to Ofcom and other stakeholders.

6.23 BT has explained the resources required for the preparation, evaluation, peer review, approvals and casting of information for the annexes:

- For preparation, BT's accounting system (REFINE) must be run for each annex. This takes [X] each with a further [X] each to input the information into the publishable schedules. BT typically must run each scenario several times, multiplying the production time for each annex.
- Evaluation of the resulting information depends on the level of changes but on average takes two weeks for both annexes. This is done simultaneously as preparing the reconciliation report itself that sets out the impact of each change at a market level.
- Casting, review and approvals then add at least a week. In the event of re-running REFINE to amend any changes following evaluation, these processes need to be undertaken again.

6.24 BT has submitted that all these processes add significant risk to achieving the RFS and reconciliation report publication deadline of 17 July. It means the RFS must be finished

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<sup>103</sup> BT, Reconciliation Report 2017

<http://www.btplc.com/Thegroup/RegulatoryandPublicaffairs/Financialstatements/2017/ReconciliationReport2016-17.pdf>

<sup>104</sup> The two annexes BT publishes are;

Annex 1 "Methodology reversal impact" which reproduces the full RFS to show the impact of reversing all the methodology changes as well as calculating the impact of all the reversals and each and every RFS number on an absolute and a percentage basis for the current year.

Annex 2 "Error correction impact" shows the same information in respect of errors in the prior year.

The annexes satisfy the requirement for the reconciliation report to be audited.

<sup>105</sup> BT, Letter from [X] to [X], Ofcom, 26 May 2017.

earlier, with less evaluation to accommodate production of the reconciliation report annexes.

- 6.25 We have reviewed the information provided in the annexes in the light of the level of resource indicated by BT and the benefit that they provide to Ofcom and stakeholders more generally.
- 6.26 In terms of the substance of the information covered, our view is that the information contained in the main reconciliation report is likely to be sufficient.
- 6.27 In a second proposal<sup>106</sup>, BT asked us to consider including the remaining sections of the current reconciliation report together with a proposed new summary schedule within the published RFS itself rather than as a separate published document. The objective of the request being to reduce duplication of published material.<sup>107</sup>
- 6.28 On balance we are minded to agree with BT's proposals to remove the requirement to publish separate annexes. Instead, BT will include the remainder of the current reconciliation together with a summary schedules of all the methodology changes and all the error corrections in the RFS. The purpose of the summary schedules is to allow BT's Regulatory Auditors to continue to provide an audit opinion.

### Network components

- 6.29 As part of our ongoing engagement with BT on regulatory financial reporting, it was brought to our attention that there were differences between the list of network components we proposed in the March 2017 WLA Consultation and those that were published in the 2016/2017 RFS.
- 6.30 We discussed these differences with BT. Below we set out what the differences are and why those differences detract from the relevance of the RFS.
- a) "Openreach time related charges" was included on our proposed direction in the March 2017 WLA Consultation whilst BT publishes "Regulated time related charges" in the RFS. From discussions with BT, we discovered there are two network components in relation to time related charges. These are "Regulated Time Charges" which are disclosed within the RFS and "Non-regulated time related charges" which is a non-SMP component consumed only by non-regulated services in the residual market. Costs are attributed to the components in a different manner – the costs for each component originate from separate CoWs and are attributed through different Plant Groups. We therefore propose to amend the name of the published network component to ensure that it is clear that this component is consumed by only regulated services.

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<sup>106</sup> BT, Email from [X] to [X], [X] and [X], Ofcom, 10 August 2017 16:55.

<sup>107</sup> For example, information on pages 12 – 18 of the 2017 RFS are part duplicated in pages 12, 20-30, 34, 36, 38 and 40-47 of the 2017 BT Reconciliation Report.

- b) TISBO Components. There are 11 components in our proposed list of network components that are consumed only by unregulated TISBO services. Therefore, these components are no longer relevant for our regulatory financial reporting purposes.
- c) Ofcom Administration Fee. In the 2016 BCMR, we directed BT to attribute the Ofcom Administration Fee based on relevant revenue<sup>108</sup>. We did not specify the reporting in relation to this. In accordance with our direction, BT created two new components (Ofcom Administration Fee- Openreach and Ofcom Administration Fee- Wholesale). We therefore propose to update the network component list to include these cost components which will ensure greater transparency about how these costs are attributed.
- d) Pair Gain. In the 2015 Directions Statement we removed this component as we no longer expected there to be any costs associated with Pair gain equipment<sup>109</sup>. We now expect there to be a small level of costs going during the next market review period. We therefore propose to re-introduce the Pair Gain network component.

## **Proposed directions to implement regulatory reporting requirements in the March 2017 WLA Consultation**

### **Proposed amendment to the consistency with regulatory decisions direction**

- 6.31 In relation to cumulo costs, we propose to reflect in the draft legal instruments the adjustment we proposed in the March 2017 WLA Consultation<sup>110</sup> in its entirety. We have clarified that the rest of the current direction on cumulo attributions would remain unchanged by reproducing the current Direction in so far as it relates to non-GEA related cumulo cost attributions. We also introduce minor changes to the wording relating to NGA related cumulo costs to ensure the requirements are clear.
- 6.32 We set out in Annex 6 the amendments to the proposed consistency with regulatory decisions direction relating to cumulo cost attributions.

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<sup>108</sup> Paragraph 2.218 [https://www.ofcom.org.uk/data/assets/pdf\\_file/0020/46622/final-annex-28.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0020/46622/final-annex-28.pdf)

<sup>109</sup> Paragraph 7.67.4 page 92, 2015 Directions Statement.

## Proposed amendment to the form and content direction

- 6.33 We propose a WLA regulatory financial reporting direction that requires BT to report the name of the EOI inputs (i.e. the WLA service or part service inputs which are subject to an EOI obligation under regulation in the WLA market), their usage factors and their unit prices for key WBA services.<sup>111</sup>
- 6.34 We propose that the total FAC (but not the individual non EOI network component costs) for these regulated services is also published. This information is required to show stakeholders which EOI inputs are provided from the WLA market and their relative importance within the WBA services they purchase, as well as to provide stakeholders with a sufficient level of confidence that BT complies with its obligation to provide certain WLA inputs on an EOI basis.
- 6.35 We set out in Annex 6 the proposed direction.

## Proposed amendment to the reconciliation report direction

- 6.36 We propose to remove the requirement to provide Annex 1, except for section 5.1 Reversal (Performance summary by Market), 10.1.1 Reversal (Attribution of Wholesale Current Costs), Schedule 10.1.2 Reversal (Attribution of Wholesale Current Cost Mean Capital Employed) as BT's regulatory auditor can provide an opinion on these sections of the Annex, as they show in summary form, the aggregate impact of reversing the methodology changes on the current year in the RFS.
- 6.37 We propose to remove the requirement to provide Annex 2, except for section 5.1 Restated (Performance summary by Market) Schedule 6.1.1 Restated (Attribution of Wholesale Current Costs), Schedule 6.1.2 Restated (Attribution of Wholesale Current Cost Mean Capital Employed) as BT's regulatory auditors can provide an opinion on these sections of the Annex, as they show, in summary form, the aggregate impact of correcting the errors on the prior year RFS.
- 6.38 We propose that BT continues to keep the data that is currently used to generate annexes 1 and 2 to reproduce any page of the annexes 1 and 2 if that page is requested by us in the future.
- 6.39 We propose that BT include what is currently the main body of the reconciliation report together with the retained sections of the annexes which the regulatory auditors can opine on (set out in the above paragraphs) within the published RFS with no loss of detail. As well as reducing the amount of published information, the inclusion of the information within the RFS will aid readability to stakeholders.

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<sup>111</sup> For information, we set out the main WBA services we proposed to require service level information about at paragraph 7.53, page 86 of the 2017 WBA Consultation.

- 6.40 We set out the proposed amendment to the WLA reconciliation report direction in Annex 6.

### **Proposed network components direction - amendment**

- 6.41 The proposed direction specifying network components in the March 2017 WLA Consultation sets out all the network components used by BT to prepare the RFS. As noted above, the proposed list requires amendment to ensure it remains relevant.
- 6.42 We propose to amend this proposed direction by changing the name of the following component:
- Amend 'Openreach time related charges' to 'Regulated time related charges'.
- 6.43 We propose to amend this proposed direction by removing the following components:
- High TISBO 3rd Party Equipment Depn
  - Medium TISBO 3rd Party Equipment Depn
  - PC rental 140Mbit/s link
  - PC rental 140Mbit/s link local end
  - PC rental 140Mbit/s link national trunk
  - PC rental 140Mbit/s link per km distribution
  - PC rentals 140Mbit/s regional trunk
  - PC rental 34Mbit/s link
  - PC rental 34Mbit/s link local end
  - PC rental 34Mbit/s link per km distribution
  - PC rentals 34Mbit/s regional trunk.
- 6.44 We propose to amend this proposed direction by adding the following components:
- Ofcom Administration Fee - Openreach
  - Ofcom Administration Fee – Wholesale.
- 6.45 We have included the proposed amendments in respect of the proposed direction in the March 2017 WLA Consultation which specifies the list of network components in Annex 6.

### **Legal tests**

- 6.46 We consider that giving the proposed directions (as amended in the August 2017 DPA Pricing Consultation and this consultation) for consistency with regulatory decisions in the WLA market, setting the requirements in relation to preparation, delivery, publication, form and content of the RFS in respect of the WLA market, and specifying the requirements in relation to the reconciliation report, would fulfil our general duties under section 3 of the Act and meet the Community requirements set out in section 4 of the Act for the reasons given above.

6.47 We consider that our proposals meet the tests set out in section 49(2) of the Act.

6.48 Our proposed amendment to the direction setting the requirements in relation to preparation, delivery, publication, form and content of the RFS is:

- objectively justifiable because the amendments to the proposed direction ensure that we have relevant information to monitor compliance with our proposed regulatory decisions in relation to the attribution of cumulo rates and in relation to the proposed EOI obligation in the WLA market. Our proposals concerning the additional information to be provided, both in public and in private, seek to ensure that stakeholders have sufficient information about the products and services they purchase to provide them with reasonable confidence about BT's compliance with its SMP conditions and that we have sufficient information necessary to carry out our functions;
- not unduly discriminatory because it reflects BT's market position in the UK excluding the Hull Area. We have explained in this consultation the reasons for requiring relevant additional information from BT both publicly and privately;
- proportionate because the amendments to the proposed direction will be no more than is required to monitor compliance with the EOI obligation; and
- transparent because it is clear that the intention of the proposed direction (as amended) will be to make sure that the RFS remain fit for purpose and that Ofcom and stakeholders are provided with a sufficient level of information.

6.49 We also consider that our proposed amendment to the reconciliation report direction meets the tests set out in section 49(2) of the Act in that it is:

- objectively justifiable because it is necessary for there to be visibility in relation to changes and errors made in the Regulatory Financial Statements both for us and for other stakeholders and it is therefore necessary for us to specify the requirements in relation to the content of the reconciliation report and the accompanying audit opinion;
- not unduly discriminatory because it reflects BT's market position in the UK excluding the Hull Area;
- proportionate because our proposals are no more than is required to provide visibility in relation to changes and errors both for us and for other stakeholders. Our proposal to remove the requirement for the two annexes ensures that the burden on BT is no more than is necessary to meet our objectives; and
- transparent because it is clear that our proposals seek to provide visibility in relation to changes and errors both for us and for other stakeholders and to provide BT with clarity about the requirements specifying the content of the reconciliation report and the accompanying audit opinion.



6.50 We also consider that the proposed amendments to the direction specifying BT's list of network components for the WLA market meet the tests set out in section 49(2) of the Act in that they are:

- objectively justifiable because it is necessary for us to give a direction specifying network components. Our proposal about the modification of the list of network components is objectively justifiable because it is necessary to make the reporting of services in the WLA market consistent with our regulatory requirements;
- not unduly discriminatory because it reflects BT's market position in the UK excluding the Hull Area;
- proportionate because our proposal is no more than is required to specify network components; and
- transparent because our proposal seeks to specify network components and to ensure that these network components remain fit for purpose.

6.51 In making these proposals, we have taken due account of all applicable recommendations issued by the European Commission under Article 19(1) of the Framework Directive, in particular the 2005 EC Recommendation.

## Next steps

6.52 Based on responses to the March 2017 WLA Consultation and this consultation, we would expect to make a final decision on the WLA market in early 2018 with the new reporting requirements in place for April 2018. These changes would be reflected in the 2018/19 RFS to be published in July 2019.

## Consultation questions

Question 6.1: Do you agree with our proposals for BT's Regulatory Financial Reporting, modifying requirements relating to the form and content of the RFS in respect of EOI reporting?

If not, what alternative would you propose and why?

Question 6.2: Do you agree with our proposals for BT's Regulatory Financial Reporting, including the proposed direction modifying requirements relating to the provision of information contained in the reconciliation report annexes and the Consolidation of the information within the published RFS?

In respect of information currently contained within the reconciliation report annexes, if you believe important information is being lost, please could you explain why it is important and what you feel you will lose from its removal?

Question 6.3: Do you agree with our proposals for BT's Regulatory Financial Reporting, including modifying requirement specifying the list of network components?

If not, what alternative would you propose and why?

## 7. Amending the consistency with regulatory decisions direction from the 2014 Fixed Access Market Review in relation to cumulo rates

### Introduction

- 7.1 In this section we set out our proposal to amend BT's financial reporting requirements for cumulo rates imposed in the 2015 Directions Statement<sup>112</sup> which gave effect to the regulatory financial reporting aspects of the 2014 FAMR. This proposal will affect reporting for the 2017/2018 RFS.

### Summary

- 7.2 In summary, we are proposing to amend the Consistency with regulatory decisions direction that was set in the 2015 Directions Statement that set out how BT should attribute its cumulo rates bill relating to its network assets. We propose the amended direction for the 2017/18 RFS should be the same as that proposed in the March 2017 WLA Consultation in relation to the next charge control period (including the clarifications made in this consultation – see Section 6). We propose to implement this by way of an amendment to the Consistency with regulatory decisions direction imposed in the 2015 Directions Statement<sup>113</sup>.
- 7.3 The draft legal instrument proposing the necessary amendment to the direction is set out in Annex 8.

### Market review proposals

- 7.4 In the March 2017 WLA Consultation we proposed a direction specifying requirements for consistency with regulatory decisions, which included a requirement in relation to how BT attributed its cumulo rates. We proposed<sup>114</sup> BT make a minor change, compared to the direction imposed in the 2014 FAMR to the cumulo attribution methodology so that the amounts to be attributed to GEA-FTTC rental services should be calculated with reference to a rateable value per connected line of £18 per annum and Other GEA rental services

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<sup>112</sup> Paragraph 4.63 to 4.67, pages 40-41, 2015 Directions Statement.

<sup>113</sup> Paragraph 4.63 to 4.67, pages 40-41, 2015 Directions Statement.

<sup>114</sup> Paragraph 10.34 and Table 10.3, page 164, Volume 1 of the March 2017 WLA Consultation.

should be calculated with reference to a rateable value per connected line of £20 per annum.

- 7.5 The rest of the current direction on cumulo attributions would remain unchanged for the next charge control period. This reflected that the UK valuation authorities had published a new cumulo assessment that was due to come into effect on 1 April 2017.
- 7.6 Whilst this new assessment would affect the 2017/18 RFS we did not propose at the time to amend the equivalent direction set in the 2014 FAMR.

## Review of the requirements for WLA regulatory financial reporting

- 7.7 Below, we consider how well BT's current regulatory financial reporting provides us with the information we need to make informed regulatory decisions. We then consider whether the information that is provided has the attributes of effective financial reporting, as described in Section 2.

### Information to make informed regulatory decisions

- 7.8 We need financial information to make informed regulatory decisions, including investigating potential breaches of SMP conditions and anti-competitive practices relating to WLA services and a source of information for future cost modelling.
- 7.9 BT's cumulo rates are the non-domestic rates (a property tax) that BT pays on its rateable assets in the UK. The rateable assets consist primarily of passive assets such as duct, fibre, copper, cabinets, manholes and junction boxes as well as exchange buildings. Active assets such as electronic equipment (e.g. DSLAMs, MSANs, multiplexors, modems and switching equipment) are in general non-rateable. It is called a cumulo assessment because all the rateable assets are valued together.
- 7.10 Payments on non-domestic rates are usually calculated by multiplying a rateable value ("RV") for the property by a "rate in the pound". RVs are assessed by the relevant authority in each nation – for example the Valuation Office Agency ("VOA") in England and Wales.
- 7.11 Rateable values are reassessed periodically – usually every 5 years in each nation. The latest revaluation in England, Wales and Scotland took effect from 1 April 2017.
- 7.12 In previous charge controls we have allowed BT to recover its cumulo rates costs within its wholesale prices. To do so cumulo rates must be attributed across products.
- 7.13 There has been considerable discussion about the attribution of BT's cumulo rates cost historically. BT's current attribution of its cumulo rates costs is subject to a direction, imposed initially in 2015 that required it to allocate these costs consistently with how we modelled these in the 2014 FAMR charge control. The attribution has three stages, the first of which requires BT to identify the rates it paid on its NGA (VULA) services.

## The attributes of the information we currently receive

- 7.14 In our March WLA 2017 Consultation, we noted that BT would no longer be able to comply with our 2015 Directions on the attribution of its cumulo rates costs. This was because BT confirmed to us that “under the new rating valuation the GEA liability is included within the main valuation and so will no longer be separately identifiable”<sup>115</sup>. In the March 2017 WLA Consultation, we therefore proposed changes to the directions on the way BT attributes cumulo rates costs from 2018/19, the first year of the new proposed charge control on WLA services.
- 7.15 This however still leaves BT no longer being able to comply with our 2015 Directions on the attribution of its cumulo rates costs when compiling its 2017/18 RFS. We do not wish to put BT in a position whereby it could be technically in breach of these directions. We therefore are now consulting on proposals for the attribution of BT's cumulo rates that would apply to BT's preparation of its 2017/18 RFS.

## Proposed direction to implement regulatory reporting requirements

### Proposed amendment to the consistency with regulatory decisions direction

- 7.16 We discussed the future attribution of cumulo rates costs in paragraphs A17.64 to A17.83 of Annex 17 of the March 2017 WLA Consultation. We proposed to attribute BT's cumulo costs from 2017/18 onwards by continuing to use the existing three stage approach. We proposed to overcome the issue with BT's valuation no longer being able to identify the rates that it pays on VULA services on the basis that each GEA rental connection contributed £18 to BT's total RV<sup>116</sup>. This assumption was consistent with the VOA's 2010 guidance<sup>117</sup>.
- 7.17 In the September 2017 WLA Consultation we noted that we had received limited responses from stakeholders on our proposed approach to attributing BT's cumulo costs<sup>118</sup>. Given this and that no stakeholder proposed any alternative attribution methodology we therefore proposed to continue using the same three stage approach explained in our March 2017 WLA Consultation when producing revised estimates of cumulo unit costs for use within the charge control.

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<sup>115</sup> Paragraphs A17.65 and A17.67, page 322, Annex 17 of the March 2017 WLA Consultation.

<sup>116</sup> Strictly speaking the £18 RV per annum applied to GEA FTTC rental services. For other GEA rental services the RV to be applied was £20 per annum.

<sup>117</sup> See paragraphs A17.81 to A17.83, page 325 – 326, Annex 17 of the March 2017 WLA Consultation and paragraph 3.13 of the September 2017 WLA Consultation.

<sup>118</sup> We discussed the responses we had received in paragraphs 3.19 -3.20, pages 11-12 and 3.56, page 19 of the September 2017 WLA Consultation.

7.18 We now propose an amendment to the 2015 Consistency with regulatory decisions direction for cumulo rates that will apply for the 2017/18 RFS.

7.19 We set out in Annex 8 the proposed amendments to the current direction.

## Legal tests

7.20 We consider that making the proposed amendment to the 2015 Consistency with regulatory decisions direction would fulfil our general duties under section 3 of the Act and meet the Community requirements set out in section 4 of the Act for the reasons given above.

7.21 In addition, we consider that the proposed amendments meet the tests set out in section 49(2) of the Act and for all the reasons set out above, we consider in that the proposed amended Direction is:

- objectively justifiable because it is necessary to change the basis upon which BT allocates its cumulo rates in its RFS to account for its revised cumulo assessment that came into effect from 1 April 2017;
- not unduly discriminatory because it reflects BT's market position in the UK excluding the Hull Area;
- proportionate because the proposed amendment goes no further than is necessary to reflect this change; and
- transparent because it is clear that the intention of our proposed amendment is to ensure that BT is able to report its cumulo rates appropriately in the 2017/18 RFS.

7.22 In proposing this change, we have taken due account of all applicable recommendations issued by the European Commission under Article 19(1) of the Framework Directive, in particular the 2005 EC Recommendation.

## Next steps

7.23 Based on responses to this consultation we would expect to make a final decision in early 2018 with the new reporting requirements for the reporting period from April 2017. The outputs of those proposals, the 2017/18 RFS would be published at the end of July 2018.

## Consultation questions

Question 7.1: Do you agree with our proposals for BT's Regulatory Financial Reporting, modifying requirements relating to the attribution of BT's cumulo rates costs in 2017/18? If not, what alternative would you propose and why?

## 8. Regulatory financial reporting proposals in relation to the 2017 WBA Consultation

### Introduction

- 8.1 In the 2017 WBA Consultation, we proposed to determine that BT had SMP in relation to WBA Market A in the UK excluding the Hull area and to impose certain SMP conditions on BT, including cost accounting and accounting separation obligations, in relation to Market A.
- 8.2 In Section 7 of the 2017 WBA Consultation, we set out our proposals to impose a number of regulatory financial reporting requirements on BT in relation to WBA Market A, by way of directions, which were consistent with our policy decisions in the 2014 Regulation Financial Reporting Statement.
- 8.3 In the 2017 WBA Consultation, we did not however set out our proposals for requirements in relation to network components or the publication of a reconciliation report, as we explained that we intended to consult on these proposals as part of this consultation.
- 8.4 In this section we set out our proposals to impose financial reporting requirements on BT for the WBA market relating to network components and the publication of a reconciliation report.

### Summary

- 8.5 In summary, we propose to give directions relating to requirements:
- To specify the network components used by BT to prepare the RFS in WBA Market A. We propose to implement this by way of a direction specifying network components.
  - To require BT to produce and publish the reconciliation report setting out the impact of all material changes and errors in the WBA market with an accompanying assurance report from their regulatory auditors. We propose to implement this by way of direction setting the requirements for the reconciliation report.
- 8.6 The proposed directions we are set out in Annex 7 (see Schedules 1 and 2 to the Notification respectively). These proposed directions are in addition to the proposed directions set out at Annex 5 of the 2017 WBA Consultation.
- 8.7 We set out below our rationale for proposing to impose regulatory financial requirements on BT in relation to network components and the reconciliation report, followed by a description of our proposed directions referred to at paragraph 8.5 above.

## Market review proposals

- 8.8 In Section 7 of the 2017 WBA Consultation we set out our regulatory financial reporting proposals. We proposed to re-impose some of the requirements in the same form as currently imposed on BT in the WBA market in the 2015 Directions Statement<sup>119</sup>. We considered that certain directions continued to be appropriate in the context of WBA Market A. The directions we proposed to re-impose were:
- the Regulatory Accounting Principles;
  - preparing the RFS on a RAV basis;
  - transparency; and
  - audit of the RFS.
- 8.9 We proposed to re-impose the requirement relating to the form and content of the RFS direction with amendments that reflected our provisional view as to the appropriate requirements on BT in Market A.
- 8.10 We did not propose to give directions specifying requirements:
- for consistency with regulatory decisions; or
  - for reporting on BT's adjusted financial performance.
- 8.11 We considered that those directions were no longer relevant in the context of Market A. We explained that in the 2014 Regulatory Financial Reporting Statement, these requirements are relevant where we consider regulatory decisions should be reflected in the RFS to ensure consistency, as per Regulatory Accounting Principle number four, and we imposed such requirements on BT in connection with the WBA market in the 2015 Directions Statement to reflect certain adjustments we had made in connection with the charge control we imposed on BT in the 2014 WBA Market Review. In the 2017 WBA Consultation however, we did not propose to impose a cost-based charge control on WBA services in Market A. Thus, there was no need for us to direct BT to reflect any proposed changes to BT's costs because of our regulatory decisions within its RFS or in an Adjusted Financial Performance Schedule.

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<sup>119</sup> Ofcom, *Directions for Regulatory Financial Reporting: Final Statement*, 30 March 2015, The 2015 Directions Statement also imposed these directions on the WLA, WFAEL, ISDN30 and ISDN2, WCO, WCT and interconnect circuits. Further, these directions were imposed on the business connectivity markets in annex 35 of the 2016 BCMR Statement.



- 8.12 In the 2017 WBA Consultation, we did not set out any proposals to require BT to specify network components or publish the reconciliation report. This was because at the time we published the 2017 WBA Consultation:
- We were also considering updating the list of network components as part of our work relating to DPA (as explained further in Section 3).<sup>120</sup>
  - We were considering whether we should make changes to the requirements relating to the reconciliation report, and whether it could be simplified, following a request by BT (as explained further in Section 6).<sup>121</sup>
- 8.13 We therefore explained that we intended to consult on our proposals in relation to the reconciliation report and network components in a subsequent consultation. We accordingly set out our proposals in relation to these below.

## Review of the requirements for WBA regulatory financial reporting

### The need to specify network components

- 8.14 Network components provide us information necessary for us to make informed regulatory decisions, for example we use network component inputs in our top down cost modelling in relation to charge controls. Network components also meet our requirement to monitor compliance with proposed remedies, for example on non-discrimination, as checking the attribution rules on network components allows us to see how costs are attributed to internal as well as external services.
- 8.15 We need a direction to specify all the network components used by BT to prepare the RFS in order to preserve the integrity and consistency of BT's Regulatory Financial Reporting, as it is important that there is a single list of network components used to attribute costs to services in regulated markets. In the 2015 Directions Statement, we gave a direction to BT in respect of, among others, the WBA market, specifying the network components.
- 8.16 As explained above, in the 2017 WBA Consultation we did not propose a network components direction as we said that we intended to consult on them as part of a later consultation setting out a number of proposals relating to regulatory financial reporting.
- 8.17 As explained in Sections 3 to 6 of this consultation, we have now developed our proposals on amendments to network components. We consider that it is appropriate to implement these requirements for WBA Market A and we are therefore proposing to give a direction specifying network components in respect of WBA Market A which reflects the proposals set out in Sections 3 to 6 of the consultation.

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<sup>120</sup> Paragraph 7.12, page 79, 2017 WBA Consultation.

<sup>121</sup> Paragraph 7.12, page 79, 2017 WBA Consultation.

## The need for the reconciliation report

- 8.18 In the 2014 Regulatory Financial Reporting Statement, we decided as a matter of policy that BT must publish the impact of all material changes and errors in an annual reconciliation report with an accompanying assurance report from their regulatory auditors. We explained that “the reconciliation report, together with the published notifications about proposed changes, makes the implemented changes and their impacts on markets transparent”.<sup>122</sup> This information would also help explain to other telecom providers year-on-year changes to the RFS and their causes.
- 8.19 The reconciliation report meets our requirement that regulatory financial reporting should give confidence to stakeholders and allow them to contribute to the regulatory regime. The aim of the reconciliation report is to provide stakeholders with information about the impact of material changes and material errors discovered in the RFS in order to provide stakeholders with transparency of changes that BT made to the RFS.
- 8.20 Changes to attribution methods or the correction of errors can affect all markets published in the RFS. As a result, to preserve the integrity and consistency of the RFS, we consider that all markets should be subject to the same direction to produce a reconciliation report. In the 2015 Directions Statement, we gave a direction to BT in respect of, among others, the WBA market, setting out requirements relating to the preparation and publication of the reconciliation report.
- 8.21 As explained above, in the 2017 WBA Consultation we did not propose the reconciliation report direction as we said that we intended to consult on them as part of a later consultation setting out a number of proposals relating to regulatory financial reporting.
- 8.22 We have explained in Section 6, we are proposing certain amendments to the requirements relating to the preparation and publication of the reconciliation report, in particular to remove the requirement to provide most of the information contained within annexes to the report and include the remainder of the information in the reconciliation report within the published RFS with no loss of detail. We consider that it is appropriate to implement these requirements for WBA Market A and we are therefore proposing to give a direction setting out the requirements in relation to the reconciliation report which reflect our proposals set out in Section 6.

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<sup>122</sup> Para 3.184, page 60, 2014 Regulatory Financial Reporting Statement

## Proposed directions to implement regulatory accounting requirements in the 2017 WBA Consultation

### Proposed network components direction

- 8.23 In order to preserve the integrity and consistency of the RFS there should be a single list of network components used to attribute costs to services in regulated markets. As explained in Sections 3 to 6 of this consultation, we are proposing to amend the network components we specify to take reflect our DPA, Network Expansion, WLA ancillary and other WLA proposals. In relation to WBA Market A, we propose giving a direction which would reflect the proposed changes to network components set out in Sections 3 to 6 of this consultation, and would be in the same form as that we are now proposing to give in relation to the WLA market. The proposed direction is set out in Annex 7, Schedule 1.

### Proposed reconciliation report direction

- 8.24 As explained in Section 6 of this consultation, we are proposing to amend the form of the reconciliation report direction which we imposed on BT in the 2015 Directions Statement, in particular to remove the requirement to provide most of the information contained within annexes to the report and include the remainder of the information in the reconciliation report within the published RFS with no loss of detail.
- 8.25 We propose to give a direction setting out the requirements for the reconciliation report and accompanying audit opinion which would reflect the proposed changes set out in Section 6 to this consultation, and would be in the same form as that we are now proposing to give in relation to the WLA market. The proposed direction is set out in Annex 7, Schedule 2.

## Legal tests

- 8.26 We consider that giving the proposed directions in relation to WBA Market A specifying the list of network components and setting out the requirements in relation to the reconciliation report and the accompanying audit opinion would fulfil our general duties under section 3 of the Act and meet the Community requirements set out in section 4 of the Act for the following reasons:
- the network components direction would provide information necessary to monitor compliance with regulatory obligations, for example, non-discrimination, and adopting the same list of network components as for other regulated markets would preserve the integrity and consistency of BT's Regulatory Financial Reporting; and
  - the reconciliation report direction would provide information about the impact of accounting changes which adds credibility to the regulatory financial reporting regime.

8.27 We also consider that the proposed network component direction meets the tests set out in section 49(2) of the Act in that it is:

- objectively justifiable because it is necessary for us to give a direction specifying network components for the reasons set out above. Our proposal about the modification of the list of network components is objectively justifiable because it is necessary to make the reporting of services in the WBA market consistent with the reporting of services in other regulated markets;
- not unduly discriminatory because it reflects BT's market position in the UK excluding the Hull Area;
- proportionate because our proposal is no more than is required to specify network components. Our proposal about the modification of network components is no more than is required to make the reporting of services in the WBA market consistent with the reporting of services in other regulated markets; and
- transparent because our proposal seeks to specify network components and to make the reporting of services in the WBA market consistent with the reporting of services in other regulated markets, and to ensure that these components remain fit for purpose.

8.28 We also consider that the reconciliation report direction meets the tests set out in section 49(2) of the Act in that it is:

- objectively justifiable because it is necessary for there to be visibility in relation to changes and errors made in the RFS both for Ofcom and for other stakeholders and it is therefore necessary for us to specify the requirements in relation to the content of the reconciliation report and the accompanying audit opinion;
- not unduly discriminatory because it reflects BT's market position in the UK excluding the Hull Area;
- proportionate because our proposals are no more than are required to provide visibility in relation to changes and errors both for Ofcom and for other stakeholders; and
- transparent because it is clear that the intention of our proposals is to provide visibility in relation to changes and errors both for Ofcom and for other stakeholders and to provide BT with clarity about the requirements specifying the content of the reconciliation report and the accompanying audit opinion.

8.29 In proposing this change, we have taken due account of all applicable recommendations issued by the European Commission under Article 19(1) of the Framework Directive, in particular the 2005 EC Recommendation.

## Next steps

8.30 Based on responses to the 2017 WBA Consultation and this consultation, we would expect to make a final decision on the WBA market in early 2018 with the new reporting

requirements in place for April 2018. With the exception of the proposed DPA network components, these changes would be reflected in the 2018/19 RFS to be published in July 2019. The proposed DPA network components will take effect from April 2020 and would be reflected in the 2020/21 RFS to be published in July 2021.

## Consultation question

Question 8.1: Do you agree with our proposals for BT's Regulatory Financial Reporting, modifying requirements relating to the WBA market?

If not, what alternative would you propose and why?

# A1. Responding to this consultation

## How to respond

- A1.1 Ofcom would like to receive views and comments on the issues raised in this document, by 5pm on 15th January 2018.
- A1.2 You can download a response form from <https://www.ofcom.org.uk/consultations-and-statements/category-2/regulatory-financial-reporting2>. You can return this by email or post to the address provided in the response form.
- A1.3 If your response is a large file, or has supporting charts, tables or other data, please email it to [gary.carey@ofcom.org.uk](mailto:gary.carey@ofcom.org.uk), as an attachment in Microsoft Word format, together with the cover sheet (<https://www.ofcom.org.uk/consultations-and-statements/consultation-response-coversheet>). This email address is for this consultation only, and will not be valid after 15 January 2018.
- A1.4 Responses may alternatively be posted to the address below, marked with the title of the consultation:
- Gary Carey  
Ofcom  
Riverside House  
2A Southwark Bridge Road  
London SE1 9HA
- A1.5 We welcome responses in formats other than print, for example an audio recording or a British Sign Language video. To respond in BSL:
- Send us a recording of you signing your response. This should be no longer than 5 minutes. Suitable file formats are DVDs, wmv or QuickTime files. Or
  - Upload a video of you signing your response directly to YouTube (or another hosting site) and send us the link.
- A1.6 We will publish a transcript of any audio or video responses we receive (unless your response is confidential)
- A1.7 We do not need a paper copy of your response as well as an electronic version. We will acknowledge receipt if your response is submitted via the online web form, but not otherwise.
- A1.8 You do not have to answer all the questions in the consultation if you do not have a view; a short response on just one point is fine. We also welcome joint responses.

- A1.9 It would be helpful if your response could include direct answers to the questions asked in the consultation document. The questions are listed at Annex 4. It would also help if you could explain why you hold your views, and what you think the effect of Ofcom's proposals would be.
- A1.10 If you want to discuss the issues and questions raised in this consultation, please contact Gary Carey on 020 7783 4393, or by email to [gary.carey@ofcom.org.uk](mailto:gary.carey@ofcom.org.uk).

## Confidentiality

- A1.11 Consultations are more effective if we publish the responses before the consultation period closes. In particular, this can help people and organisations with limited resources or familiarity with the issues to respond in a more informed way. So, in the interests of transparency and good regulatory practice, and because we believe it is important that everyone who is interested in an issue can see other respondents' views, we usually publish all responses on our website, [www.ofcom.org.uk](http://www.ofcom.org.uk), as soon as we receive them.
- A1.12 If you think your response should be kept confidential, please specify which part(s) this applies to, and explain why. Please send any confidential sections as a separate annex. If you want your name, address, other contact details or job title to remain confidential, please provide them only in the cover sheet, so that we don't have to edit your response.
- A1.13 If someone asks us to keep part or all of a response confidential, we will treat this request seriously and try to respect it. But sometimes we will need to publish all responses, including those that are marked as confidential, in order to meet legal obligations.
- A1.14 Please also note that copyright and all other intellectual property in responses will be assumed to be licensed to Ofcom to use. Ofcom's intellectual property rights are explained further at <https://www.ofcom.org.uk/about-ofcom/website/terms-of-use>.

## Next steps

- A1.15 Following this consultation period, Ofcom plans to publish a statement in early 2018.
- A1.16 If you wish, you can register to receive mail updates alerting you to new Ofcom publications; for more details please see <https://www.ofcom.org.uk/about-ofcom/latest/email-updates>

## Ofcom's consultation processes

- A1.17 Ofcom aims to make responding to a consultation as easy as possible. For more information, please see our consultation principles in Annex x.
- A1.18 If you have any comments or suggestions on how we manage our consultations, please email us at [consult@ofcom.org.uk](mailto:consult@ofcom.org.uk). We particularly welcome ideas on how Ofcom could

more effectively seek the views of groups or individuals, such as small businesses and residential consumers, who are less likely to give their opinions through a formal consultation.

- A1.19 If you would like to discuss these issues, or Ofcom's consultation processes more generally, please contact Steve Gettings, Ofcom's consultation champion:

Steve Gettings  
Ofcom  
Riverside House  
2a Southwark Bridge Road  
London SE1 9HA  
Email: [corporationsecretary@ofcom.org.uk](mailto:corporationsecretary@ofcom.org.uk)



## A2. Ofcom's consultation principles

### Ofcom has seven principles that it follows for every public written consultation:

#### Before the consultation

- A2.1 Wherever possible, we will hold informal talks with people and organisations before announcing a big consultation, to find out whether we are thinking along the right lines. 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

- A2.2 We will be clear about whom we are consulting, why, on what questions and for how long.
- A2.3 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 for people to give us a written response. If the consultation is complicated, we may provide a short Plain English / Cymraeg Clir guide, to help smaller organisations or individuals who would not otherwise be able to spare the time to share their views.
- A2.4 We will consult for up to ten weeks, depending on the potential impact of our proposals.
- A2.5 A person within Ofcom will be in charge of making sure we follow our own guidelines and aim to reach the largest possible number of people and organisations who may be interested in the outcome of our decisions. Ofcom's Consultation Champion is the main person to contact if you have views on the way we run our consultations.
- A2.6 If we are not able to follow any of these seven principles, we will explain why.

#### After the consultation

- A2.7 We think it is important that everyone who is interested in an issue can see other people's views, so we usually publish all the responses on our website as soon as we receive them. After the consultation we will make our decisions and publish a statement explaining what we are going to do, and why, showing how respondents' views helped to shape these decisions.

## A3. Consultation coversheet

### 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 ☐

Name/contact details/job title ☐

Whole response ☐

Organisation ☐

Part of the response ☐

If there is no separate annex, which parts? \_\_\_\_\_

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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)

## A4. Consultation questions

Question 3.1. Do you agree with our proposals for BT's Regulatory Financial Reporting in relation to the reporting of duct and pole costs?

Please provide reasons and evidence in support of your views.

Question 4.1. Do you agree with our proposals for BT's Regulatory Financial Reporting in relation to the reporting of network expansion costs?

Please provide reasons and evidence in support of your views?

Question 5.1. Do you agree with our proposals for BT's Regulatory Financial reporting in relation to the reporting WLA ancillary services?

Please provide reasons and evidence in support of your views?

Question 6.1: Do you agree with our proposals for BT's Regulatory Financial Reporting, modifying requirements relating to the form and content of the RFS in respect of EOI reporting?

If not, what alternative would you propose and why?

Question 6.2: Do you agree with our proposals for BT's Regulatory Financial Reporting, including the proposed direction modifying requirements relating to the provision of information contained in the reconciliation report annexes and the Consolidation of the information within the published RFS?

In respect of information currently contained within the reconciliation report annexes, if you believe important information is being lost, please could you explain why it is important and what you feel you will lose from its removal?

Question 6.3: Do you agree with our proposals for BT's Regulatory Financial Reporting, including modifying requirement specifying the list of network components?

If not, what alternative would you propose and why?

Question 7.1: Do you agree with our proposals for BT's Regulatory Financial Reporting, modifying requirements relating to the attribution of BT's cumulo rates costs in 2017/18?

If not, what alternative would you propose and why?

Question 8.1: Do you agree with our proposals for BT's Regulatory Financial Reporting, modifying requirements relating to the WBA market?

If not, what alternative would you propose and why?

## A5. Accounting and reporting duct and pole costs

- A5.1 In respect duct and pole costs, to the extent that these are currently included in downstream regulated services, the Cartesian Report<sup>123</sup> "BT Cost Attribution Review" Cartesian explained how duct<sup>124</sup> and pole<sup>125</sup> costs are treated within BT's Regulatory Financial Reporting system.

### Duct costs

- A5.2 Cartesian found that duct costs (the capital cost of building the underground tunnels that carry BT's network, including manholes and joint boxes, plus the costs of repairing and maintaining them and plus the associated overheads) were apportioned to regulated services based on a sampled physical survey of the duct network carried out in 1997 (with adjustments to reflect additional capital expenditure spent since then) rather than using more up to date records. The costs for used and unused duct costs is shared by all regulated and non-regulated wholesale services.
- A5.3 Duct asset costs are recorded in BT's general ledger and are attributed between Access, Core and Backhaul 'Activity Groups'<sup>126</sup> duct based on BT's 1997 duct survey – adjusted for network investment since then – rather than from an up-to-date GIS system<sup>127</sup>. This occurs in stage one of Figure A5.1 below.
- A5.4 The biggest share (c74.9% - 78.7%)<sup>128</sup> in 2014/15 was attributed to the Access Duct activity group (AG135) which is the main duct activity group<sup>129</sup> for DPA and other network access

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<sup>123</sup> We engaged Cartesian, based on BT's 2013/14 Budget year to investigate a defined set of cost categories (including Duct, Copper and Fibre) that provided approximately 90% coverage of costs across all regulated Markets. We asked Cartesian to develop a detailed understanding of BT costing system and methods used for cost attribution, document the description of cost attribution methodologies to facilitate our and stakeholder's understanding BT's complex cost attribution system, review the data and information provided by BT (including published information) to assess BT's cost attribution rules against the Regulatory Accounting Principles (RAP), provide potential alternatives to attribution bases where sensible and estimate (where possible) the impact of BT adopting the proposed alternative attribution base.

[https://www.ofcom.org.uk/data/assets/pdf\\_file/0025/83482/ofcom\\_bt\\_cost\\_attribution\\_review\\_final\\_report.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0025/83482/ofcom_bt_cost_attribution_review_final_report.pdf)

<sup>124</sup> Pages 69-89, Cartesian Report.

<sup>125</sup> Pages 147 – 192, Cartesian Report. Poles are termed 'distribution points' and are included within the copper asset base.

<sup>126</sup> Page 109, BT Accounting Methodology Document 2017.

<sup>127</sup> Pages 304-305, Cartesian Report.

<sup>128</sup> Table 41, Page 70, Cartesian Report.

<sup>129</sup> Activity Groups ("AG") Activity Groups are the five main categories of costs BT use in the production of the RFS. Activity Groups are used to attribute onwards the costs and asset values of support functions (e.g. Duct, Motor

services. At this stage of the attribution process AG135 contains only the direct capital costs and the maintenance costs of the duct asset.

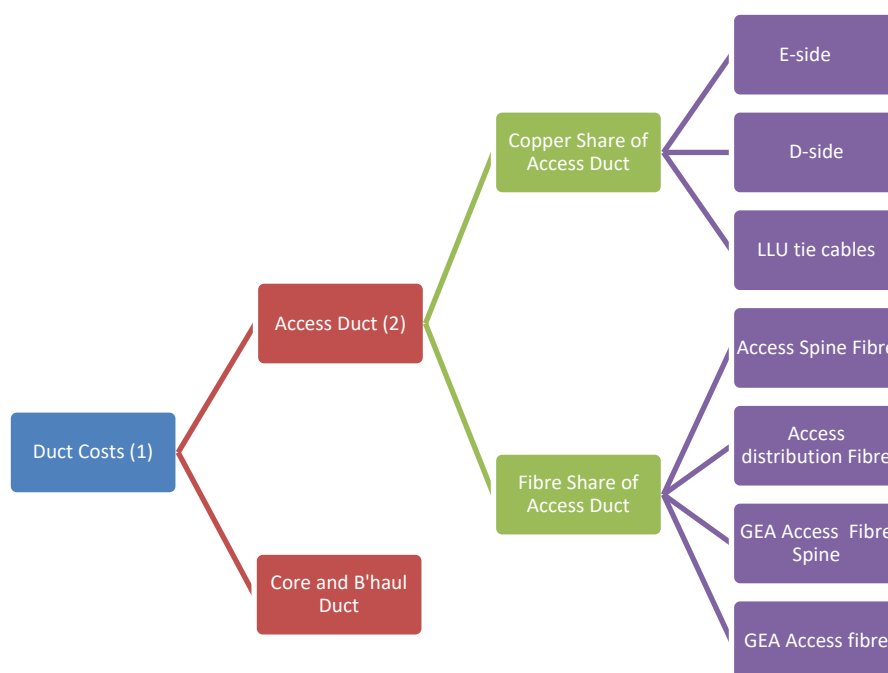
- A5.5 Other costs such as cumulo rates and Openreach overheads are attributed to this Activity group through early levels of attributions. Other BT overhead costs are then attributed to AG135 in later levels of attributions. They include Corporate overheads, BT property, BT TSO, Group business services and BT faculties managements.
- A5.6 The total cost within the AG135 Activity Group is then apportioned to Plant Groups<sup>130</sup>. AG135 is apportioned to seven plant groups, relating to Copper and Fibre in stage two of Figure A5.1. This is done in two steps. Firstly, costs are apportioned to the two different cable types present in the access duct, i.e., copper and fibre. This apportionment uses the 1997 duct survey. Note that all duct expenditure on GEA together with LLU Tie cables has occurred since 1997. This expenditure is essentially separately recorded in the general ledger. Next, fibre and copper-related costs are attributed to technology-specific cable segments, i.e., E-side and D-side cables for copper; and, Spine and Distribution cables for fibre. The apportionment to the Copper technology specific cable plant groups is based on the ratio of the year to date depreciation for that type of technology specific cable against total Copper cable depreciation.

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Vehicles, Group Property and Facilities Management). Activity Groups are then attributed into Plant Groups and Residual products. See page 123, BT Accounting Methodology Document 2017.

<sup>130</sup> Plant Groups are one of the five main categories of costs that BT use in the production of the RFS. Plant Groups are used to attribute onwards the costs and asset values of activities, equipment and infrastructure for the purposes of running and selling network services (e.g. Provision and maintenance activities, MSAN equipment, Copper infrastructure). See BT Accounting Methodology Document 2017, Section 11.

Figure A5.1



- A5.7 Backhaul Duct (AG148) comprised 11.8% – 17.7%<sup>131</sup> of the total duct FAC in 2014/15, 40-95% of the cost was attributed to BCMR services 10% - 57.9% to Narrowband markets with the remainder to other markets. The attribution to WLA / WAFEAL markets was less than 5%<sup>132</sup>.
- A5.8 Core Duct (AG149) comprised 1.2% - 5.9%<sup>133</sup> of the total duct FAC in 2014/15, 0%-80% of the cost was attributed to Narrowband markets, 0%-60% to BCMR markets with the remainder to other markets. The attribution to WLA markets was less than 10%<sup>134</sup>.

## Pole costs

- A5.9 For historical reasons, poles are treated as copper assets.
- A5.10 Copper costs comprise the cost of copper cables and poles that are used in the access network consisting of three segments; Exchange side (“E-side”), Distribution side (“D-side”)

<sup>131</sup> Table 41, Page 70, Cartesian Report.

<sup>132</sup> Table 98, Page 125, Cartesian Report.

<sup>133</sup> Table 41, Page 70, Cartesian Report.

<sup>134</sup> Table 98, Page 125, Cartesian Report.

and Dropwire that connect end-users to BT's local exchanges, plus the costs of repairing and maintaining them.

- A5.11 Copper asset and maintenance costs are recorded in BT's general ledger and are attributed straight to Plant Groups (not via an Activity groups such as duct) based on technology specific cables. The Plant groups are E-side (which includes intra exchange and FTTC tie cables), D-side and Drop wire. The capital costs (depreciation and WACC) are allocated to five Plant Groups (see Figure A5.1) based on the depreciation costs recorded in the relevant Class of Work<sup>135</sup> ("CoW")<sup>136</sup>. The maintenance costs are allocated to three maintenance plant groups related to the asset using direct and non-direct pay drivers. The list of the Copper Plant Groups and the total cost attributed to them at the end of attribution Level 1 (before the attribution of duct and other costs) into the Plant Groups in 2014/15 is set out below in Table A5.1 below.

**Table A5.1 Cost Components in the Copper group, values at Level 1**

		Plant Group	FAC £'m
E Side	Copper Cable	PG117C	[100 to 150]
	Maintenance	PG117M	[50 to 100]
	Tie cables	PG130A	[10 to 50]
	FTTC Copper Tie Cables	PG192A	[10 to 50]
	<b>E side Subtotal</b>		<b>[200 to 250]</b>
D side	Copper cable	PG118C	[500 to 600]
	Maintenance	PG118M	[150 to 200]
	<b>D Side Sub Total</b>		<b>[700 to 800]</b>
Drop wire	Drop wires	PG149A	[350 to 400]
	Maintenance	PG122M	[50 to 100]
	<b>Drop wire Total</b>		<b>[400 to 450]</b>
<b>Total</b>			<b>1,416</b>

<sup>135</sup> CoW are activities (e.g. Maintenance & Construction) which identify the plant type, or the product group/service being worked on. Usually identified as part of job/project set up. BT Accounting Methodology Document 2017, Glossary.

<sup>136</sup> Table 125, Page 149, Cartesian Report.



- A5.12 The biggest Plant groups in 2014/15 were D Side Copper capital (PG118C) (35.3% - 42.4% of the Plant group total) and Dropwire (PG149A) (24.7% to 28.4% of the Plant group total). In the early allocation stages, Openreach and cumulo costs are allocated to the Plant groups.
- A5.13 In the later attribution stages costs from Activity groups are then attributed. The biggest activity group is AG135 (see paragraphs A5.4 to A5.6) and makes up a high proportion of the final cost in the Plant group. For example, in 2014/15 PG118C (Duct) amounted for 35.7%-50% of the final Plant Group total. Other Activity group costs are attributed at the same time as AG135 including Corporate overheads, BT property, BT TSO, Group business services and BT faculties managements.
- A5.14 The Plant groups costs, which now all relate to Copper / Duct or Fibre / Duct are then allocated to network components. Apart from LLU tie cables<sup>137</sup> they are attributed 100% to related network components. Annex 9 sets out the list of current network components that include Duct and Copper (pole) costs.
- A5.15 The final stage of the process is to attribute the network component to the services. This is usually done on a usage basis. For example, the total D-side Copper and Duct is allocated to copper lines that use that network component, so in this case the cost is attributed equally across c25m copper lines.

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<sup>137</sup> Which attribute to internal and external components.

## A6. Draft Legal Instruments - WLA

### Proposals for directions relating to regulatory financial reporting requirements

Notification of proposals under sections 49 and 49A of the Communications Act 2003 and proposed SMP Services Condition 12.4 specifying the requirements in relation to (1) consistency with regulatory decisions, (2) network components, (3) preparation, delivery, publication, form and content of the regulatory financial statements and (4) reconciliation report and accompanying audit opinion

#### Background

1. On 31 March 2017, Ofcom published a consultation entitled “Wholesale Local Access Market Review Consultation” (“**March 2017 WLA Consultation**”), on proposals identifying markets, making market power determinations and setting SMP conditions. In the March 2017 WLA Consultation, Ofcom proposed to identify the market 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, determine that BT has significant market power in relation to such market and to impose, among other things, SMP conditions with respect to regulatory financial reporting on BT (proposed Condition 12).
2. Under proposed Condition 12 set out at Annex 23 to the March 2017 WLA Consultation, and in particular Condition 12.8(i), BT will be required to prepare, deliver to Ofcom and publish the Regulatory Financial Statements as directed from time to time.
3. Under proposed Condition 12.8(iv), set out at Annex 23 to the March 2017 WLA Consultation, BT is required to prepare and publish the reconciliation report as directed by Ofcom from time to time. The reconciliation report must set out changes to the Regulatory Accounting Methodology and the impact of such changes on the Regulatory Financial Statements, and Material Errors corrected in the Regulatory Financial Statements and the impact of such Material Errors on the Regulatory Financial Statements.

4. Under proposed Condition 12.10 set out in Annex 23 to the March 2017 WLA Consultation, BT shall prepare all Regulatory Financial Statements, explanations or other information required by virtue of proposed Condition 12 on a regulatory asset value adjusted current costs basis.
5. Under proposed Condition 12 set out at Annex 23 of the March 2017 WLA Consultation, network components are defined as the network components specified in a direction given by Ofcom from time to time for the purpose of that Condition.
6. Under proposed Condition 12.4 Ofcom may from time to time make such directions as they consider appropriate in relation to BT's obligations under proposed Condition 12.
7. On 31 March 2017 Ofcom issued Notifications proposing directions under proposed Condition 12, including Notifications titled:
  - i. Notification of proposal under sections 49 and 49A of the Communications Act 2003 (the "**Act**") and proposed SMP Services Condition 12.4 setting the requirements in relation to consistency with regulatory decisions and the preparation of the Regulatory Financial Statements on a regulatory asset value adjusted current costs basis;
  - ii. Notification of proposal under section 49 and 49A of the Act and proposed SMP Services Condition 12.4 setting the requirements in relation to reconciliation report and accompanying audit opinion;
  - iii. Notification of proposal under sections 49 and 49A of the Act and proposed SMP Services Condition 12.4 to specify network components; and
  - iv. Notification of proposal under section 49 and 49A of the Act and proposed SMP Services Condition 12.4 setting the requirements in relation to preparation, delivery, publication, form and content of the Regulatory Financial Statements.
8. On 1 August 2017 Ofcom published a consultation entitled "WLA Market Review, Consultation on pricing proposals for Duct and Pole Access Remedies" ("**August 2017 DPA Pricing**

**Consultation**") setting out proposals in relation to Physical Infrastructure Access pricing and regulatory financial reporting.

9. On 1 August 2017 Ofcom issued a Notification setting out proposals to amend the proposed directions set out in paragraphs 7.i. and 7.iv. above by specifying further requirements in relation to:

- i. ensuring consistency with Ofcom's regulatory decisions and the preparation of the Regulatory Financial Statements on a regulatory asset value adjusted current cost basis; and
- iii. preparation, delivery, publication, form and content of the Regulatory Financial Statements;

in respect of Physical Infrastructure Access in the market set out in paragraph 1.

10. On 9 August 2017 Ofcom published a consultation entitled "WLA Market Review, Consultation on recovering the costs of investment in network expansion" ("**WLA Network Expansion Consultation**") setting out proposals to amend the WLA charge controls in the light of the additional relevant network expansion costs BT would incur should it enter a clear and public agreement with Government to make an investment in universal broadband.

11. On 14 September 2017 Ofcom published a consultation entitled "Wholesale Local Access Market Review, Further Consultation on proposed charge control for wholesale standard and superfast broadband" ("**September 2017 WLA Consultation**") setting out further proposals on specific issues that have the effect of changing the levels of the charge controls proposed in the March 2017 WLA Consultation.

12. On 24 November 2017 Ofcom published a consultation entitled "*Regulatory Financial Reporting – Consultation on proposed directions to BT arising from the Wholesale Local Access and Wholesale Broadband Access market reviews*" ("**November 2017 Regulatory Financial Reporting Consultation**") setting out proposals in relation to regulatory financial reporting.

13. This Notification sets out proposals to amend the proposed directions set out in paragraph 7 above by specifying further requirements in relation to:

- i. ensuring consistency with regulatory decisions and the preparation of the Regulatory Financial Statements on a regulatory asset value adjusted current cost basis;
- ii. setting the requirements in relation to reconciliation report and accompanying audit opinion;
- iii. specifying network components; and
- iv. preparation, delivery, publication, form and content of the Regulatory Financial Statements;

in respect of the market set out in paragraph 1.

#### **Proposal to give directions**

14. Ofcom is proposing, in accordance with section 49 of the Act, to give directions pursuant to proposed Condition 12.4 specifying the requirements in relation to consistency with regulatory decisions and the preparation of the Regulatory Financial Statements on a regulatory asset value adjusted current costs basis, and setting the requirements in relation to preparation, delivery, publication, form and content of the Regulatory Financial Statements in relation to the market set out in paragraph 1.
15. The proposed directions are set out at Annex 23 to the March 2017 WLA Consultation, as amended in accordance with Annex 6 of the August 2017 DPA Pricing Consultation and in accordance with Schedules 1,2,3 and 4 to this Notification.
16. The effect of and reasons for giving the proposed directions are set out in the March 2017 WLA Consultation, the August 2017 DPA Pricing Consultation, and where amended by Schedules 1,2,3 and 4 to this Notification, in the WLA Network Expansion Consultation, the September 2017 WLA Consultation and the November 2017 Regulatory Financial Reporting Consultation document accompanying this Notification.

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

17. For the reasons set out in the March 2017 WLA Consultation, the August 2017 DPA Pricing Consultation and the November 2017 Regulatory Financial Reporting Consultation, Ofcom considers that the proposed directions referred to in paragraph 14 comply with the requirements of section 49(2) of the Act.
18. In making the proposals referred to in paragraph 14, Ofcom has considered and acted in accordance with its general duties set out in section 3 of the Act, the six community requirements set out 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**

19. Representations may be made to Ofcom about the proposals set out in this Notification by no later than 15 January 2018.
20. In accordance with section 49C(1)(a) of the Act, a copy of this Notification will be sent to the Secretary of State.

### **Interpretation**

21. Except as otherwise defined, words or expressions used shall have the same meaning as they have been ascribed in the proposed SMP conditions set out at Annex 23 of the March 2017 WLA Consultation, Annex 6 of the August 2017 DPA Pricing Consultation, Annex 5 of the WLA Network Expansion Consultation and Annex 5 of the September 2017 WLA Consultation. Otherwise any word or expression shall have the same meaning as it has in the Act.

**Signed**

A handwritten signature in black ink, appearing to read 'David Brown', with a stylized, cursive script.

**David Brown**

Director of Financial Economics, Ofcom

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

24 November 2017

## Schedule 1

**The proposed Direction under section 49 of the Communications Act 2003 and proposed Condition 12.4 specifying the requirements in relation to consistency with regulatory decisions and regulatory asset value at annex 23 of the March 2017 WLA Consultation (as amended pursuant to annex 6 of the August 2017 DPA Pricing Consultation) is amended as follows:**

1. In the Schedule to the proposed Direction, under Part 1: Definitions and Interpretation, insert the following additional definitions:

a) after paragraph (k):

“(ka) **“Fixed asset register”** means a list of assets held by BT, including their location, description, gross book values (GBV) and accumulated depreciation;

(kb) **“Fixed Wireless Access”** means an access service where the connection between the network and the equipment located at the customer premises is provided over the radio access medium;

(kc) **“Gain Share”** means financial amounts that became repayable by BT to government authorities in relation to Broadband Delivery UK (BDUK) grants where the take-up of broadband exceeds the levels that were pre-defined in the BDUK contracts;”

b) after paragraph (n):

“(na) **“Mean Capital Employed (MCE)”** means total assets less current liabilities, excluding corporate taxes and dividends payable, and provisions other than those for deferred taxation. The mean is computed from the start and end values for the period, except in the case of short-term investments and borrowings, where daily averages are used in their place;”

c) after paragraph (o):

“(oa) **“Network Expansion”** means the network build which BT would carry out should it enter into a clear and public agreement with the Government make an investment in universal broadband;

d) after paragraph (t):



“(ta) **“PIPeR”** (Physical Inventory Planning E-Records) means the database held within Openreach that holds all Openreach external inventories of duct, copper and fibre assets;”

e) after paragraph (u):

“(ua) **“Satellite”** means an access service where the connection between the network and the equipment located at the customer premises is provided over the satellite access medium;”

2. In the Schedule to the proposed Direction, under Part 1: Definitions and Interpretation, replace the “Class of Work (CoW)” definition at paragraph (c) with:

**“Class of Work (CoW)”** means activities (e.g. Maintenance & Construction) which BT uses to identify the plant type or the product group/service being worked on by BT’s engineers that BT’s fixed asset register categorises its assets into. These CoWs describe the type of asset in detail and are an appropriate level of granularity for BT to make its valuation decisions.”

3. In the Schedule to the proposed Direction, under Part 2: Requirements to ensure the Regulatory Financial Statements are consistent with specified regulatory decisions made by Ofcom in the WLA Statement, in the introductory paragraph replace references to “paragraphs 1 – 5” with “paragraphs 1 – 15”.

4. In the Schedule to the proposed Direction, under Part 2: Requirements to ensure the Regulatory Financial Statements are consistent with specified regulatory decisions made by Ofcom in the WLA Statement, replace paragraph 2 with the following:

“2. In the case of Cumulo costs, BT shall follow the requirements set out in paragraphs 2.1 – 2.2 in the order in which these requirements are set out below:

2.1 In the case of NGA related Cumulo costs, BT shall:

- attribute the share of NGA related Cumulo costs to GEA FTTC Rentals with reference to a rateable value of £18 per connected line per annum; and
- attribute the share of NGA related Cumulo costs to Other GEA Rental Services with reference to a rateable value of £20 per connected line per annum.

2.2 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:

$$Cumall_{i=NNGACC} \times \left( \frac{\sum_{j=1}^m nrc_{ij} land\%_j wacc_i}{\sum_{i=1}^n \sum_{j=1}^m nrc_{ij} land\%_j wacc_i} \right)$$

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."

5. In the Schedule to the proposed Direction, under Part 2: Requirements to ensure the Regulatory Financial Statements are consistent with specified regulatory decisions made by Ofcom in the WLA Statement, replace paragraph 5 with:

"5. In the case of assets within the ACPA Class of Work, BT shall separately identify those assets which are used in providing co-mingling services and those assets used in providing GEA services. BT shall move the NRCs and GRCs of the ACPA assets which provide power to the GEA DSLAMs to the Class of Work LFME. In respect of ACPA assets included in the Class of Work LFME BT shall remove all the historical assets already recovered via one-off or connection fees from GRCs and NRCs and treats any labour costs that would previously have been capitalised as operating costs.

In respect of the remaining ACPA assets used to provide power to co-mingling equipment, BT shall remove the historical assets already recovered via one-off or connection fees from GRCs and NRCs and treats any labour costs that would previously have been capitalised as operating costs. The shall then attribute the costs to Plant Group PG132B LLU Co-mingling Recurring Costs."

6. In the Schedule to the proposed Direction, under Part 2: Requirements to ensure the Regulatory Financial Statements are consistent with specified regulatory decisions made by Ofcom in the WLA Statement, after paragraph 10 insert:

"11. BT Shall ensure that aggregated cost data within its General Ledger data are reconciled on an annual basis to its physical asset record held within its PiPER system.

12. BT shall:

- a. ensure that it accurately records, in accordance with the Regulatory Accounting Principles, all the incremental network expansion costs;
- b. not include in such incremental network expansion costs:
  - i) any costs relating to Fixed Wireless Access,
  - ii) Satellite,
  - iii) Gain Share or
  - iv) customer modem costs should LR-VDSL technology be used for the network expansion.
- c. ensure that all the incremental Network Expansion costs are attributed equally on a per line basis to:
  - SMPF
  - MPF
  - WLR plus GEA
  - MPF plus GEA; and
  - GEA Only.

13. BT shall remove all capitalised installation and planning costs from the Mean Capital Employed within the network components used by any WLA Tie cable, WLA Co-mingling Rental service or WLA Co-mingling Connections service where BT reports the revenue in full on delivery of the service. The installation and planning costs instead shall be reported in full within the Other WLA Ancillary Expenditure network cost component in the case of WLA Tie Cables, in the Co-mingling Rentals Expenditure network component in the case or WLA Co-mingling rentals or in the Co-mingling Connections Expenditure in the case of WLA Co-mingling connections as an operating expense when BT delivers that service.

14. BT shall ensure all installation, planning and Short form pluggable ("SFP") compact, modular laser transceiver device costs relating to GEA Cablelink services are treated as an operating expense within GEA Cablelink Expenditure network component.

15. BT shall remove all capitalised installation and planning costs from the Mean Capital Employed for all network components that are attributed to the Abortive

Visit Charge service where BT reports the revenue in full on delivery of the Abortive Visit Charge service. The labour installation and planning costs instead shall be included in full within the AVC Expenditure network component as an operating expense when BT delivers the Abortive Visit Charge service.”

## Schedule 2

**The proposed Direction under section 49 of the Communications Act 2003 and proposed Condition 12.4 specifying network components at annex 23 of the March 2017 WLA Consultation is amended as follows:**

1. Replace the Annex titled "Annex: The Network Components" with:

### **"Annex A**

The network components until 31 March 2020 shall be as shown below:

1. AISBO Excess Construction
2. PC rentals 2Mbit/s regional trunk
3. Co-mingling set up
4. Co-mingling rentals
5. WLA Tie cables
6. Local Loop Unbundling systems development
7. Wholesale Access specific
8. Routeing & records
9. MDF Hardware jumpering
10. E side copper capital
11. E side copper current
12. D side copper capital
13. D side copper current
14. Local exchanges general frames equipment
15. Local exchanges general frames maintenance
16. Analogue line test equipment
17. Dropwire capital & analogue NTE
18. Analogue line drop maintenance
19. Analogue line cards

20. OR Service Centre - Provision AISBO
21. OR Service Centre - Provision Analogue/ISDN2
22. OR Service Centre - Provision WLA
23. Service Level Guarantees
24. OR Service Centre - Assurance Ethernet
25. OR Service Centre - Assurance Analogue/ISDN2
26. OR Service Centre - Assurance WLA
27. Combi Card and MSAN Access - Voice
28. Combi Card - Broadband
29. EES and MSAN Access - Broadband
30. Core Directors - Broadband
31. Edge Ethernet ports broadband
32. Ethernet Backhaul Direct - active
33. Ethernet Backhaul Direct - passive
34. Ethernet Backhaul Direct extended reach
35. Ethernet Backhaul Direct resilience - active
36. Ethernet Backhaul Direct – resilience - passive
37. Ethernet Switch BB
38. Core/Metro (broadband)
39. Metro-core broadband transmission
40. ADSL connections
41. EVOTAM testing systems
42. EVOTAM testing systems
43. MPF line testing systems
44. Broadband line testing systems
45. DSLAM support
46. DSLAM equipment
47. PC rental 2Mbit/s link per km distribution
48. Point of Handover electronics

- 49. PC rental 64kbit/s link
- 50. PC rental 2Mbit/s link
- 51. PC rental 64kbit/s link per km transmission
- 52. 2Mbit/s and above PC link connection cct provision
- 53. 64kbit/s PC link connection cct provision
- 54. PC rental 64kbit/s link local end
- 55. PC rental 2Mbit/s local end copper
- 56. PC rental 2Mbit/s local end fibre
- 57. Backhaul Extension Services Fibre
- 58. Wholesale Extension Services Fibre
- 59. OR systems & development - Ethernet
- 60. Ethernet Access Direct Fibre
- 61. Other Ethernet rentals - CCTV
- 62. Interconnect local end rental 2Mbit/s
- 63. Interconnect 2Mbit/s connection
- 64. Interconnect extension circuits (IEC) 2Mbit/s link
- 65. Customer Sited Interconnect cct (CSI) 2Mbit/s link
- 66. Nominated In Span I/Connect cct (ISI) transmission
- 67. Interconnect Extension Circuits (IEC) 2Mbit/s per km
- 68. Customer Sited Interconnect (CSI) 2Mbit/s per km
- 69. In Span Interconnect circuits (ISI) transmission
- 70. Intra Building Circuit (IBC) connection
- 71. Intra Building Circuit (IBC) rental
- 72. Ethernet main links
- 73. Ethernet Electronics
- 74. Other Ethernet new provides - CCTV
- 75. Customer support - partial private circuits
- 76. Customer support - interconnect
- 77. Customer support - broadband

- 78. Broadband backhaul circuits (excl Virtual Paths)
- 79. Openreach sales product management
- 80. Co-mingling power & vent
- 81. Revenue Receivables
- 82. Co-mingling electricity
- 83. Caller display
- 84. Metro BRAS and MSE
- 85. Regulated time related charges
- 86. PC rental 2Mbit/s link national trunk
- 87. FTTC Development
- 88. Service centre – provision WLR NGA
- 89. iNode features
- 90. Network Features
- 91. Special Fault Investigation
- 92. EOI Notional Payables
- 93. FTTP Development
- 94. OR Service Centre – Provision NGA
- 95. OR Service Centre – Assurance NGA
- 96. GEA DSLAM & Cabinets
- 97. GEA FTTC Repairs
- 98. GEA FTTP Repairs
- 99. GEA FTTP Provisions
- 100. GEA FTTC Provisions
- 101. Fibre Rollout Funding
- 102. Funded Fibre Rollout Spend
- 103. Network Expansion for Universal Broadband
- 104. Fibre Voice Access rental
- 105. Fibre Voice Access connection
- 106. FTTP Access Fibre Spine



- 107.FTTP Access Distribution
- 108.FTTP Electronics
- 109.FTTP Customer Site Installation
- 110.FTTC Access Fibre Spine
- 111.FTTC Access Distribution
- 112.FTTC Electronics
- 113.FTTC Customer Site Installation
- 114. Project services
- 115. GEA Cablelink Expenditure
- 116. Co-mingling Rentals Expenditure
- 117. Co-mingling Connections Expenditure
- 118. AVC Expenditure
- 119. Other WLA Ancillary Expenditure
- 120. Ofcom Administration Fee - Openreach
- 121. Ofcom Administration Fee - Wholesale
- 122. Pair Gain.”.

2. After Annex A (inserted pursuant to paragraph 1 above), insert:

## **“Annex B**

The network components from 1 April 2020 shall be as shown below:

- 1. AISBO Excess Construction
- 2. PC rentals 2Mbit/s regional trunk
- 3. Co-mingling set up
- 4. Co-mingling rentals
- 5.WLA Tie cables
- 6. Local Loop Unbundling systems development
- 7.Wholesale Access specific
- 8. Routeing & records

9. MDF Hardware jumpering
10. E side copper capital
11. E side copper current
12. D side copper capital
13. D side copper current
14. Local exchanges general frames equipment
15. Local exchanges general frames maintenance
16. Analogue line test equipment
17. Dropwire capital & analogue NTE
18. Analogue line drop maintenance
19. Analogue line cards
20. OR Service Centre - Provision AISBO
21. OR Service Centre - Provision Analogue/ISDN2
22. OR Service Centre - Provision WLA
23. Service Level Guarantees
24. OR Service Centre - Assurance Ethernet
25. OR Service Centre - Assurance Analogue/ISDN2
26. OR Service Centre - Assurance WLA
27. Combi Card and MSAN Access - Voice
28. Combi Card - Broadband
29. EES and MSAN Access - Broadband
30. Core Directors - Broadband
31. Edge Ethernet ports broadband
32. Ethernet Backhaul Direct - active
33. Ethernet Backhaul Direct - passive
34. Ethernet Backhaul Direct extended reach
35. Ethernet Backhaul Direct resilience - active
36. Ethernet Backhaul Direct – resilience - passive
37. Ethernet Switch BB

- 38. Core/Metro (broadband)
- 39. Metro-core broadband transmission
- 40. ADSL connections
- 41. EVOTAM testing systems
- 42. EVOTAM testing systems
- 43. MPF line testing systems
- 44. Broadband line testing systems
- 45. DSLAM support
- 46. DSLAM equipment
- 47. PC rental 2Mbit/s link per km distribution
- 48. Point of Handover electronics
- 49. PC rental 64kbit/s link
- 50. PC rental 2Mbit/s link
- 51. PC rental 64kbit/s link per km transmission
- 52. 2Mbit/s and above PC link connection cct provision
- 53. 64kbit/s PC link connection cct provision
- 54. PC rental 64kbit/s link local end
- 55. PC rental 2Mbit/s local end copper
- 56. PC rental 2Mbit/s local end fibre
- 57. Backhaul Extension Services Fibre
- 58. Wholesale Extension Services Fibre
- 59. OR systems & development - Ethernet
- 60. Ethernet Access Direct Fibre
- 61. Other Ethernet rentals - CCTV
- 62. Interconnect local end rental 2Mbit/s
- 63. Interconnect 2Mbit/s connection
- 64. Interconnect extension circuits (IEC) 2Mbit/s link
- 65. Customer Sited Interconnect cct (CSI) 2Mbit/s link
- 66. Nominated In Span I/Connect cct (ISI) transmission

- 67. Interconnect Extension Circuits (IEC) 2Mbit/s per km
- 68. Customer Sited Interconnect (CSI) 2Mbit/s per km
- 69. In Span Interconnect circuits (ISI) transmission
- 70. Intra Building Circuit (IBC) connection
- 71. Intra Building Circuit (IBC) rental
- 72. Ethernet main links
- 73. Ethernet Electronics
- 74. Other Ethernet new provides - CCTV
- 75. Customer support - partial private circuits
- 76. Customer support - interconnect
- 77. Customer support - broadband
- 78. Broadband backhaul circuits (excl Virtual Paths)
- 79. Openreach sales product management
- 80. Co-mingling power & vent
- 81. Revenue Receivables
- 82. Co-mingling electricity
- 83. Caller display
- 84. Metro BRAS and MSE
- 85. Regulated time related charges
- 86. PC rental 2Mbit/s link national trunk
- 87. FTTC Development
- 88. Service centre – provision WLR NGA
- 89. iNode features
- 90. Network Features
- 91. Special Fault Investigation
- 92. EOI Notional Payables
- 93. FTTP Development
- 94. OR Service Centre – Provision NGA
- 95. OR Service Centre – Assurance NGA

- 96.GEA DSLAM & Cabinets
- 97.GEA FTTC Repairs
- 98.GEA FTTP Repairs
- 99.GEA FTTP Provisions
- 100.GEA FTTC Provisions
- 101.Fibre Rollout Funding
- 102.Funded Fibre Rollout Spend
- 103. Network Expansion for Universal Broadband
- 104.Fibre Voice Access rental
- 105.Fibre Voice Access connection
- 106.FTTP Access Fibre Spine
- 107.FTTP Access Distribution
- 108.FTTP Electronics
- 109.FTTP Customer Site Installation
- 110.FTTC Access Fibre Spine
- 111.FTTC Access Distribution
- 112.FTTC Electronics
- 113.FTTC Customer Site Installation
- 114. Project services
- 115. GEA Cablelink Expenditure
- 116. Co-mingling Rentals Expenditure
- 117. Co-mingling Connections Expenditure
- 118. AVC Expenditure
- 119. Other WLA Ancillary Expenditure
- 120. Ofcom Administration Fee - Openreach
- 121. Ofcom Administration Fee - Wholesale
- 122. Pair Gain
- 123. Duct Spine capital
- 124. Duct Spine maintenance

- 125. Junction Boxes Capital
- 125. Junction boxes maintenance
- 126. Manhole Capital costs
- 128. Manhole maintenance costs
- 129. Pole capital costs
- 130. Pole maintenance costs
- 131. Lead in duct capital costs
- 132. Lead in maintenance costs.”.

## Schedule 3

**The proposed Direction under section 49 of the Communications Act 2003 and proposed Condition 12.4 setting the requirements in relation to preparation, delivery, publication, form and content of the Regulatory Financial Statements at annex 23 of the March 2017 WLA Consultation (as amended pursuant to annex 6 of the August 2017 DPA Pricing Consultation) is amended as follows:**

### **In relation to Network Expansion and WLA ancillaries:**

1. After paragraph 17 (b) (ix) insert:

“x. Provision of Additional Financial Information in respect of network expansion Costs;”
2. In Annex A, under the heading “Notes to the Statement entitled “Market/Technical Area Summary”, insert:
  - a. at the end of paragraph 1c. (i). GEA 40/10 (FTTC) Rentals:

“taken with MPF Rental (SML 1)”
  - b. at the at the end of paragraph 1c. (ii). GEA 40/10 (Other) Rentals:

“taken with MPF Rental (SML 1)”
  - c. After paragraph 1c. (xxi):

“xxiii. GEA 40/10 (FTTC) Rentals taken without MPF Rental (SML 1)  
xxiv. GEA 40/10 (Other) Rentals taken without MPF Rental (SML 1)  
xxv. GEA Bandwidth modify 40/10  
xxvi. VLAN moves applied to GEA Cablelink modify transactions  
xxvii. Abortive Visit Charges  
xxviii. Cancellation of MPF orders for provide, Migration, Working Lone Takeover, Modification of Amend  
xxix. Amend orders. Allowable change to MPF Order  
xxxi. MPF Standard Line Test  
xxxi. GEA Cancel/Amend/ modify – CRD Amend, order notes amend, order cancellation, Care Level etc.

xxxii. GEA Cancel/Amend/ modify – Regarding of existing upstream or downstream speed, both at point of sale and in life etc.”.

3. In Annex B, after row 5b (ix), insert the following additional table row:

5b (x)	Network expansion for universal broadband	<p>Sch 1. Provide the number of qualifying premises covered by network expansion and the volume of rentals (split between speeds up to 40/10 and speeds above 40/10)</p> <p>Sch 2. Provide the annual incremental cash costs of the network expansion split on a basis consistent with BT's network component structure</p> <p>Provide the total operating costs and capital costs (MCE and ROCE) on a basis that would be consistent with BT's network component structure. The total of these costs must reconcile to the total network component FAC for Network Expansion for Universal Broadband in the RFS.</p>
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## In relation to EOI Input Prices:

4. After paragraph 13.a.xv., insert under a new paragraph:

“13.b. the following statement in respect of wholesale broadband access provided in Market A (as identified in a statement entitled [“Review of the Wholesale Broadband Access Markets: Statement on market definition, market power determinations and remedies”] published on [XX November] 2017”) in accordance with the obligation in paragraph 15 below:

i. Calculation of EOI Input Prices.”

5. At the end of paragraph 15, insert:

“For ease of reference, BT shall set out the statement specified in paragraph 13.b.i. (whose form and content are further described in Annex A to this Direction) in the Wholesale Broadband Access Markets section of the Regulatory Financial Statements.<sup>138</sup>”

<sup>138</sup> “For reference, see page 87 of BT's 2017 Regulatory Financial Statements:  
<http://btplc.com/Thegroup/RegulatoryandPublicaffairs/Financialstatements/2017/RRD2017Final.pdf>.”



6. In Annex A, after the table titled "Price controls in wholesale markets (Non-confidential statements) (continued), insert the following table:

Market/Technical Area EOI Input 20XX											
calculation of EOI Input prices within Market X											
For the year ended 31 March 20XX											
			Market/Technical Area 1 etc								
Input		Average EOI input price per unit (from annex XX)	Basket 1 - internal *	Basket 1 - external	Sub-basket 1 - internal *	Sub-basket 1 - external	Basket 2 etc - internal *	Basket 2 etc - external	Sub-basket 3 etc - internal *	Sub-basket 3 etc - external	Single Charge Category 1 - Internal*
			£	£	£	£	£	£	£	£	£
Unit											
EOI Input Price 1	x.xx	x.xx	x.x	x.x	x.x	x.x	x.x	x.x	x.x	x.x	x.x
EOI Input Price 2	x.xx	x.xx	x.x	x.x	x.x	x.x	x.x	x.x	x.x	x.x	x.x
Total non EOI network components			x.x	x.x	x.x	x.x	x.x	x.x	x.x	x.x	x.x
Total FAC unit cost			x.xx	x.xx	x.xx	x.xx	x.xx	x.xx	x.xx	x.xx	x.xx
Volumes (unit) (where applicable)			xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx	xxx
Total Cost (£'m)			x.x	x.x	x.x	x.x	x.x	x.x	x.x	x.x	x.x
Specific services required to be shown seperately by Ofcom (if applicable)											
* Only where Internal unit FAC is different from External unit FAC											

## Schedule 4

**The proposed Direction under section 49 of the Communications Act 2003 and proposed Condition 12.4 setting out the requirements in relation to reconciliation report and accompanying audit opinion at annex 23 of the March 2017 WLA Consultation is amended as follows:**

1. In the first line of paragraph 13 of the proposed Direction, after “BT must prepare a reconciliation report”, insert “within the published RFS”.
2. In the first line of paragraph 13.i.b) of the proposed Direction, delete “on all figures”.
3. In the first line of paragraph 13.ii.b) of the proposed Direction, delete “on all figures”.
4. In the second line of paragraph 14.iii. of the proposed Direction, delete “on all figures”.

## A7. Draft Legal Instrument – WBA

### Proposals for directions relating to regulatory financial reporting requirements

**Notification of proposals under sections 49 and 49A of the Communications Act 2003 and proposed SMP Services Condition 8 specifying the requirements in relation to network components and the reconciliation report.**

#### Background

1. On 22 June 2017, Ofcom published a consultation document entitled “Review of the wholesale broadband access markets – Consultation on market definition, market power determinations and remedies”<sup>139</sup> (“**2017 WBA Consultation**”), on proposals identifying markets, making market power determinations and setting SMP conditions. In the 2017 WBA Consultation, Ofcom consulted on proposals, in relation to a geographic market for the provision of wholesale broadband access referred to as “Market A”, impose (among other things) SMP conditions with respect to regulatory financial reporting on BT.
2. Under proposed Condition 8 set out at Annex 4 of the 2017 WBA Consultation, network components are defined as the Network Components specified in a direction given by Ofcom from time to time for the purpose of that Condition.
3. Under proposed Condition 8.8 and proposed Condition 8.23 set out at Annex 4 of the 2017 WBA Consultation, BT must prepare a reconciliation report as directed by Ofcom from time to time, which sets out changes to the Regulatory Accounting Methodology and the impact of such changes on the Regulatory Financial Statements, and Material Errors corrected in the Regulatory Financial Statements and the impact of such Material Errors on the Regulatory Financial Statements.

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<sup>139</sup> [https://www.ofcom.org.uk/data/assets/pdf\\_file/0013/103180/wba-consultation.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0013/103180/wba-consultation.pdf)

4. Under proposed Condition 8.4 set out at Annex 4 of the 2017 WBA Consultation, Ofcom may from time to time make such directions as they consider appropriate in relation to BT's obligations under proposed Condition 8.
5. This Notification sets out proposals to specify network components and for requirements relating to the preparation of the reconciliation report.

#### **Proposal to give directions**

6. Ofcom is proposing, in accordance with section 49 of the Communications Act 2003 (the "**Act**"), to give the directions set out at Schedules 1 and 2 to this Notification.
7. The effect of and reasons for giving the proposed directions are set out in the Consultation accompanying this Notification.

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

8. For the reasons set out in the consultation document accompanying this Notification, Ofcom considers that the proposed directions referred to in paragraph 6 comply with the requirements of section 49(2) of the Act.
9. In making the proposals 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 set out 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 by no later than 15 January 2018.
11. In accordance with section 49C(1)(a) of the Act, a copy of this Notification will be 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 proposed SMP conditions set out at Annex 4 of the 2017 WBA Consultation. Otherwise any word or expression shall have the same meaning as it has in the Act.

## **Signed**

A handwritten signature in black ink, appearing to read 'David Brown', with a stylized, cursive script.

**David Brown**

Director of Financial Economics, Ofcom

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

24 November 2017

## Schedule 1

### The proposed Direction under section 49 of the Communications Act 2003 and proposed Condition 8 specifying network components

1. On 22 June 2017, Ofcom published a consultation entitled "Review of the wholesale broadband access markets – Consultation on market definition, market power determinations and remedies"<sup>140</sup> (the "2017 WBA Consultation"), consulting on proposals to identify markets, make market power determinations and set SMP conditions. In the 2017 WBA Consultation, Ofcom is proposing, in relation to the market for wholesale broadband access referred to as "Market A", to impose SMP services conditions on BT, and to give directions, in relation to regulatory financial reporting. Ofcom invited responses to the 2017 WBA Consultation by 14 September 2017.
2. On 24 November 2017, Ofcom published a consultation entitled "*Regulatory financial reporting - Consultation on proposed directions to BT arising from the Wholesale Local Access and Wholesale Broadband Access market reviews*" (the "November 2017 Regulatory Financial Reporting Consultation") consulting on further proposed directions in relation to the market for wholesale broadband access referred to as "Market A", including proposals to issue a direction specifying Network Components. Ofcom invited responses to the November 2017 Regulatory Financial Reporting Consultation by 15 January 2018.
3. On [DATE], Ofcom concluded its review of the wholesale broadband access market in which it identified markets, made a market power determination and set appropriate SMP conditions as set out in the 2017 WBA Notification.
4. Ofcom determined in the review referred to in paragraph 3 above, that BT has SMP in the market set out a paragraph 1 above. Condition [8] (Regulatory Financial Reporting) set out in the 2017 WBA Notification was set in relation to this market and, as a result of this SMP determination. This Direction concerns matters to which Condition [8] relates.

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<sup>140</sup> [https://www.ofcom.org.uk/data/assets/pdf\\_file/0013/103180/wba-consultation.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0013/103180/wba-consultation.pdf)

5. Under Condition [8], network components are defined as the network components specified in a direction given by Ofcom from time to time for the purpose of that Condition.
6. Under Condition 8.4 set out in the 2017 WBA Notification, Ofcom may from time to time make such directions as they consider appropriate in relation to BT's obligations under Condition [8].
7. For the reasons set out in the explanatory statement accompanying this Direction, Ofcom is satisfied that, in accordance with section 49(2) of the Communications Act 2003 (the "Act"), this Direction is:
  - a. objectively justifiable in relation to the networks, services, facilities, apparatus or directories to which it relates;
  - b. not such as to discriminate unduly against particular persons or against a particular description of persons;
  - c. proportionate to what it is intended to achieve; and
  - d. in relation to what it is intended to achieve, transparent.
8. For the reasons set out in the explanatory statement accompanying this Direction, Ofcom is satisfied that it has 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.
9. Ofcom has considered every representation about the proposed Direction duly made to it and the Secretary of State has not notified Ofcom of any international obligation of the United Kingdom for the purposes of section 49A(6)(b) of the Act.
10. The proposals set out in the 2017 WBA Consultation and November 2017 Regulatory Financial Reporting Consultation contained proposals of EU significance for the purposes of the Act. Therefore, after making any modifications of the proposals that appeared to Ofcom to be appropriate following domestic consultation, Ofcom sent on [DATE] a copy of them, and of a draft of the statement accompanying this Direction setting out the reasons for

them, to the European Commission, BEREC and the regulatory authorities of every other member State for EU consultation, in accordance with section 49B(2) of the Act.

11. [Ofcom received comments from the European Commission on its proposals on [DATE], and has made such modifications to this Direction and the statement accompanying this Direction as it considers appropriate.]

**[DRAFT] Direction**

12. Ofcom hereby, pursuant to section 49 of the Act and Condition [8.4], directs BT that the Network Components specified for the purposes of Condition [8] in relation to each of the market set out in paragraph 1, are:

- a. from the date that this Direction comes into effect up to and including 31 March 2020, those shown in the Annex A to this Direction; and
- b. from 1 April 2020, those shown in Annex B to this Direction.

13. Annex A and Annex B to this Direction form part of the Direction.

**Interpretation**

14. For the purpose of interpreting this Direction:
- a. except as otherwise defined in paragraph 15 below or in so far as the context otherwise requires, words or expressions have the meaning assigned to them in SMP conditions set out in the 2017 WBA Notification, and otherwise any word or expression has the same meaning as it has in the Act;
  - b. headings and titles shall be disregarded;
  - c. expressions cognate with those referred to in this Direction shall be construed accordingly; and
  - d. the Interpretation Act 1978 (c. 30) shall apply as if this Direction were an Act of Parliament.



15. For the purposes of interpreting this Direction the following definitions shall apply:

- a. "2017 WBA Notification" means the notification at Annex [X] of the statement [wholesale broadband access markets] dated [DATE]; and

16. The Direction will take effect on [DATE].

**Signed**

**[NAME]**

**[Competition Policy Director]**

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

**[DATE]**

## Annex A

The Network Components up to and including 31 March 2020 shall be shown as below:

1. AISBO Excess Construction
2. PC rentals 2Mbit/s regional trunk
3. Co-mingling set up
4. Co-mingling rentals
5. WLA Tie cables
6. Local Loop Unbundling systems development
7. Wholesale Access specific
8. Routeing & records
9. MDF Hardware jumpering
10. E side copper capital
11. E side copper current
12. D side copper capital
13. D side copper current
14. Local exchanges general frames equipment
15. Local exchanges general frames maintenance
16. Analogue line test equipment
17. Dropwire capital & analogue NTE
18. Analogue line drop maintenance
19. Analogue line cards
20. OR Service Centre - Provision AISBO
21. OR Service Centre - Provision Analogue/ISDN2
22. OR Service Centre - Provision WLA
23. Service Level Guarantees
24. OR Service Centre - Assurance Ethernet
25. OR Service Centre - Assurance Analogue/ISDN2
26. OR Service Centre - Assurance WLA
27. Combi Card and MSAN Access - Voice

- 28. Combi Card - Broadband
- 29. EES and MSAN Access - Broadband
- 30. Core Directors - Broadband
- 31. Edge Ethernet ports broadband
- 32. Ethernet Backhaul Direct - active
- 33. Ethernet Backhaul Direct - passive
- 34. Ethernet Backhaul Direct extended reach
- 35. Ethernet Backhaul Direct resilience - active
- 36. Ethernet Backhaul Direct – resilience - passive
- 37. Ethernet Switch BB
- 38. Core/Metro (broadband)
- 39. Metro-core broadband transmission
- 40. ADSL connections
- 41. EVOTAM testing systems
- 42. EVOTAM testing systems
- 43. MPF line testing systems
- 44. Broadband line testing systems
- 45. DSLAM support
- 46. DSLAM equipment
- 47. PC rental 2Mbit/s link per km distribution
- 48. Point of Handover electronics
- 49. PC rental 64kbit/s link
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- 51. PC rental 64kbit/s link per km transmission
- 52. 2Mbit/s and above PC link connection cct provision
- 53. 64kbit/s PC link connection cct provision
- 54. PC rental 64kbit/s link local end
- 55. PC rental 2Mbit/s local end copper
- 56. PC rental 2Mbit/s local end fibre

- 57. Backhaul Extension Services Fibre
- 58. Wholesale Extension Services Fibre
- 59. OR systems & development - Ethernet
- 60. Ethernet Access Direct Fibre
- 61. Other Ethernet rentals - CCTV
- 62. Interconnect local end rental 2Mbit/s
- 63. Interconnect 2Mbit/s connection
- 64. Interconnect extension circuits (IEC) 2Mbit/s link
- 65. Customer Sited Interconnect cct (CSI) 2Mbit/s link
- 66. Nominated In Span I/Connect cct (ISI) transmission
- 67. Interconnect Extension Circuits (IEC) 2Mbit/s per km
- 68. Customer Sited Interconnect (CSI) 2Mbit/s per km
- 69. In Span Interconnect circuits (ISI) transmission
- 70. Intra Building Circuit (IBC) connection
- 71. Intra Building Circuit (IBC) rental
- 72. Ethernet main links
- 73. Ethernet Electronics
- 74. Other Ethernet new provides - CCTV
- 75. Customer support - partial private circuits
- 76. Customer support - interconnect
- 77. Customer support - broadband
- 78. Broadband backhaul circuits (excl Virtual Paths)
- 79. Openreach sales product management
- 80. Co-mingling power & vent
- 81. Revenue Receivables
- 82. Co-mingling electricity
- 83. Caller display
- 84. Metro BRAS and MSE
- 85. Regulated time related charges

- 86. PC rental 2Mbit/s link national trunk
- 87. FTTC Development
- 88. Service centre – provision WLR NGA
- 89. iNode features
- 90. Network Features
- 91. Special Fault Investigation
- 92. EOI Notional Payables
- 93. FTTP Development
- 94. OR Service Centre – Provision NGA
- 95. OR Service Centre – Assurance NGA
- 96. GEA DSLAM & Cabinets
- 97. GEA FTTC Repairs
- 98. GEA FTTP Repairs
- 99. GEA FTTP Provisions
- 100. GEA FTTC Provisions
- 101. Fibre Rollout Funding
- 102. Funded Fibre Rollout Spend
- 103. Network Expansion for Universal Broadband
- 104. Fibre Voice Access rental
- 105. Fibre Voice Access connection
- 106. FTTP Access Fibre Spine
- 107. FTTP Access Distribution
- 108. FTTP Electronics
- 109. FTTP Customer Site Installation
- 110. FTTC Access Fibre Spine
- 111. FTTC Access Distribution
- 112. FTTC Electronics
- 113. FTTC Customer Site Installation
- 114. Project services

- 115. GEA Cablelink Expenditure
- 116. Co-mingling Rentals Expenditure
- 117. Co-mingling Connections Expenditure
- 118. AVC Expenditure
- 119. Other WLA Ancillary Expenditure
- 120. Ofcom Administration Fee - Openreach
- 121. Ofcom Administration Fee - Wholesale
- 122. Pair Gain

## **Annex B**

The Network Components from 1 April 2020 shall be shown as below:

- 1. AISBO Excess Construction
- 2. PC rentals 2Mbit/s regional trunk
- 3. Co-mingling set up
- 4. Co-mingling rentals
- 5. WLA Tie cables
- 6. Local Loop Unbundling systems development
- 7. Wholesale Access specific
- 8. Routeing & records
- 9. MDF Hardware jumpering
- 10. E side copper capital
- 11. E side copper current
- 12. D side copper capital
- 13. D side copper current
- 14. Local exchanges general frames equipment
- 15. Local exchanges general frames maintenance
- 16. Analogue line test equipment
- 17. Dropwire capital & analogue NTE

18. Analogue line drop maintenance
19. Analogue line cards
20. OR Service Centre - Provision AISBO
21. OR Service Centre - Provision Analogue/ISDN2
22. OR Service Centre - Provision WLA
23. Service Level Guarantees
24. OR Service Centre - Assurance Ethernet
25. OR Service Centre - Assurance Analogue/ISDN2
26. OR Service Centre - Assurance WLA
27. Combi Card and MSAN Access - Voice
28. Combi Card - Broadband
29. EES and MSAN Access - Broadband
30. Core Directors - Broadband
31. Edge Ethernet ports broadband
32. Ethernet Backhaul Direct - active
33. Ethernet Backhaul Direct - passive
34. Ethernet Backhaul Direct extended reach
35. Ethernet Backhaul Direct resilience - active
36. Ethernet Backhaul Direct – resilience - passive
37. Ethernet Switch BB
38. Core/Metro (broadband)
39. Metro-core broadband transmission
40. ADSL connections
41. EVOTAM testing systems
42. EVOTAM testing systems
43. MPF line testing systems
44. Broadband line testing systems
45. DSLAM support
46. DSLAM equipment

47. PC rental 2Mbit/s link per km distribution
48. Point of Handover electronics
49. PC rental 64kbit/s link
50. PC rental 2Mbit/s link
51. PC rental 64kbit/s link per km transmission
52. 2Mbit/s and above PC link connection cct provision
53. 64kbit/s PC link connection cct provision
54. PC rental 64kbit/s link local end
55. PC rental 2Mbit/s local end copper
56. PC rental 2Mbit/s local end fibre
57. Backhaul Extension Services Fibre
58. Wholesale Extension Services Fibre
59. OR systems & development - Ethernet
60. Ethernet Access Direct Fibre
61. Other Ethernet rentals - CCTV
62. Interconnect local end rental 2Mbit/s
63. Interconnect 2Mbit/s connection
64. Interconnect extension circuits (IEC) 2Mbit/s link
65. Customer Sited Interconnect cct (CSI) 2Mbit/s link
66. Nominated In Span I/Connect cct (ISI) transmission
67. Interconnect Extension Circuits (IEC) 2Mbit/s per km
68. Customer Sited Interconnect (CSI) 2Mbit/s per km
69. In Span Interconnect circuits (ISI) transmission
70. Intra Building Circuit (IBC) connection
71. Intra Building Circuit (IBC) rental
72. Ethernet main links
73. Ethernet Electronics
74. Other Ethernet new provides - CCTV
75. Customer support - partial private circuits



- 76. Customer support - interconnect
- 77. Customer support - broadband
- 78. Broadband backhaul circuits (excl Virtual Paths)
- 79. Openreach sales product management
- 80. Co-mingling power & vent
- 81. Revenue Receivables
- 82. Co-mingling electricity
- 83. Caller display
- 84. Metro BRAS and MSE
- 85. Regulated time related charges
- 86. PC rental 2Mbit/s link national trunk
- 87. FTTC Development
- 88. Service centre – provision WLR NGA
- 89. iNode features
- 90. Network Features
- 91. Special Fault Investigation
- 92. EOI Notional Payables
- 93. FTTP Development
- 94. OR Service Centre – Provision NGA
- 95. OR Service Centre – Assurance NGA
- 96. GEA DSLAM & Cabinets
- 97. GEA FTTC Repairs
- 98. GEA FTTP Repairs
- 99. GEA FTTP Provisions
- 100. GEA FTTC Provisions
- 101. Fibre Rollout Funding
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- 104. Fibre Voice Access rental

- 105. Fibre Voice Access connection
- 106. FTTP Access Fibre Spine
- 107. FTTP Access Distribution
- 108. FTTP Electronics
- 109. FTTP Customer Site Installation
- 110. FTTC Access Fibre Spine
- 111. FTTC Access Distribution
- 112. FTTC Electronics
- 113. FTTC Customer Site Installation
- 114. Project services
- 115. GEA Cablelink Expenditure
- 116. Co-mingling Rentals Expenditure
- 117. Co-mingling Connections Expenditure
- 118. AVC Expenditure
- 119. Other WLA Ancillary Expenditure
- 120. Ofcom Administration Fee - Openreach
- 121. Ofcom Administration Fee - Wholesale
- 122. Pair Gain
- 123. Duct Spine capital
- 124. Duct Spine maintenance
- 125. Junction Boxes Capital
- 125. Junction boxes maintenance
- 126. Manhole Capital costs
- 128. Manhole maintenance costs
- 129. Pole capital costs
- 130. Pole maintenance costs
- 131. Lead in duct capital costs
- 132. Lead in maintenance costs"

## Schedule 2

### **The proposed Direction under section 49 of the Communications Act 2003 and proposed Condition 8.8 and proposed Condition 8.23 setting out the requirements in relation to the reconciliation report and accompanying audit opinion**

#### **Background**

1. On 22 June 2017, Ofcom published a consultation document entitled "Review of the wholesale broadband access markets – Consultation on market definition, market power determinations and remedies"<sup>141</sup> ("2017 WBA Consultation"), on proposals identifying markets, making market power determinations and setting SMP conditions. In the 2017 WBA Consultation, Ofcom consulted on proposals, in relation to a geographic market for the provision of wholesale broadband access referred to as "Market A", to impose (among other things) SMP conditions on BT, and to give directions, with respect to regulatory financial reporting. Ofcom invited responses to the 2017 WBA Consultation by 14 September 2017.
2. On 24th November 2017, Ofcom published a consultation entitled "*Regulatory financial reporting - Consultation on proposed directions to BT arising from the Wholesale Local Access and Wholesale Broadband Access market reviews*" (the "November 2017 Regulatory Financial Reporting Consultation") consulting on further proposed directions in relation to the market for wholesale broadband access referred to as "Market A", including proposals to issue a direction setting out the requirements in relation to the reconciliation report and accompanying audit opinion. Ofcom invited responses to the November 2017 Regulatory Financial Reporting Consultation by 15th January 2018.
3. On [DATE], Ofcom concluded its review of the wholesale broadband access market in which it identified markets, made a market power determination and set appropriate SMP conditions as set out in the 2017 WBA Notification.

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<sup>141</sup> [https://www.ofcom.org.uk/\\_data/assets/pdf\\_file/0013/103180/wba-consultation.pdf](https://www.ofcom.org.uk/_data/assets/pdf_file/0013/103180/wba-consultation.pdf)

4. Ofcom determined in the review referred to in paragraph 3 above, that BT has SMP in the market set out a paragraph 1 above. Condition [8] (Regulatory Financial Reporting) set out in the 2017 WBA Notification was set in relation to this market and, as a result of this SMP determination. This Direction concerns matters to which Condition [8] relates.
5. Under Condition [8.8] and Condition [8.23] set out in the 2017 WBA Notification, BT is required to prepare and publish the reconciliation report as directed by Ofcom from time to time. The reconciliation report must set out changes to the Regulatory Accounting Methodology and the impact of such changes on the Regulatory Financial Statements, and Material Errors corrected in the Regulatory Financial Statements and the impact of such Material Errors on the Regulatory Financial Statements.
6. Under proposed Condition [8.4] Ofcom may from time to time make such directions as they consider appropriate in relation to BT's obligations under proposed Condition [8].
7. For the reasons set out in the explanatory statement accompanying this Direction, Ofcom is satisfied that, in accordance with section 49(2) of the Act, this Direction is:
  - a. objectively justifiable in relation to the networks, services, facilities, apparatus or directories to which it relates;
  - b. not such as to discriminate unduly against particular persons or against a particular description of persons;
  - c. proportionate to what it is intended to achieve; and
  - d. in relation to what it is intended to achieve, transparent.
8. For the reasons set out in the explanatory statement accompanying this Direction, Ofcom is satisfied that it has acted in accordance with its general duties set out in section 3 of the Act, the six community requirements set out in section 4 of the Act and the duty to take account of European Commission recommendations for harmonisation in section 4A of the Act.

9. Ofcom has considered every representation about the proposed Direction duly made to it and the Secretary of State has not notified Ofcom of any international obligation of the United Kingdom for the purposes of section 49A(6)(b) of the Act.
10. The proposals set out in the 2017 WBA Consultation and the November 2017 Regulatory Financial Reporting Consultation contained proposals of EU significance for the purposes of the Act. Therefore, after making any modifications of the proposals that appeared to Ofcom to be appropriate following domestic consultation, Ofcom sent on [DATE] a copy of them, and of a draft of the statement accompanying this Direction setting out the reasons for them, to the European Commission, BEREC and the regulatory authorities of every other member State for EU consultation, in accordance with section 49B(2) of the Act.
11. [Ofcom received comments from the European Commission on its proposals on [DATE], and has made such modifications to this Direction and the statement accompanying this Direction as it considers appropriate.]

**[DRAFT] Direction**

12. Ofcom hereby, pursuant to section 49 of the Act and Condition [8.4], directs BT to act as prescribed in paragraphs 13 and 14 below in relation to the market set out in paragraph 1.
13. BT must prepare a reconciliation report within the published RFS which sets out:
  - a) In relation to changes to the Regulatory Accounting Methodology:
    - i) each and every change;
    - ii) the impact of all changes presented in the Regulatory Financial Statements, by setting out, on an aggregated basis, the difference between the Current Year Figures and the Current Year Figures had such changes not been made, expressed as an absolute amount and as a percentage change;
    - iii) the impact of each Material Change at the Markets and Technical Areas Level, by setting out, for each Material Change separately, the difference between the Current Year

Figures and the Current Year Figures had such Material Change not been made, expressed as an absolute amount and as a percentage change;

- iv) the impact of changes which are not Material Changes at the Markets and Technical Areas Level, by setting out, on an aggregated basis, the difference between the Current Year Figures and the Current Year Figures had such changes not been made, expressed as an absolute amount and as a percentage change; and
- b) in relation to Material Errors identified since the publication of the previous Financial Year's Regulatory Financial Statements:
  - i) for each Material Error, a description of the Material Error, the circumstances of discovery of the Material Error, the reason for the Material Error, and whether such Material Error has been corrected in the restated Prior Year Comparatives;
  - ii) the impact of all Material Errors presented in the Regulatory Financial Statements for the previous Financial Year, by setting out, on an aggregated basis:
    - (1) the Current Year Figures set out in the Regulatory Financial Statements for the previous Financial Year had such Material Errors been corrected in the previous Financial Year ("the Corrected Previous Year Figures"); and
    - (2) the difference as an absolute amount and as a percentage change between the Current Year Figures set out in the Regulatory Financial Statements for the previous Financial Year and the Corrected Previous Year Figures.
  - iii) the impact of each Material Error at the Markets and Technical Areas Level, by setting out, for each Material Error, the difference as an absolute amount and as a percentage change between:
    - (1) the Current Year Figures set out in the Regulatory Financial Statements for the previous Financial Year; and

- (2) the Current Year Figures set out in the Regulatory Financial Statements for the previous Financial Year had such Material Error been corrected in the previous Financial Year.

14. BT must obtain an audit opinion on the reconciliation report which must set out:

- a) whether all Material Changes were included in the Change Control Notification. Where this is not the case, the audit opinion must report whether Material Changes other than those included in the Change Control Notification were made as a result of an audit requirement made following delivery of the Change Control Notification or otherwise;
- b) whether the description of each of the Material Changes provided by BT in the Change Control Notification is accurate;
- c) whether BT included each and every Material Change in the reconciliation report and correctly calculated the impact of all changes presented in the Regulatory Financial Statements in accordance with paragraph 13(i)(b) above;
- d) whether the description of each of the Material Errors provided by BT in the reconciliation report is accurate; and
- e) whether the Corrected Previous Year Figures set out in the reconciliation report in accordance with paragraph 13(ii)(b)(1) above are properly prepared in accordance with the Accounting Methodology Documents for the previous Financial Year had these Accounting Methodology Documents not included these Material Errors.

#### **Interpretation**

15. For the purpose of interpreting this Direction:

- a) except as otherwise defined in paragraph 16 below or in so far as the context otherwise requires, words or expressions have the meaning assigned to them in SMP conditions set out in the Notification, and otherwise any word or expression has the same meaning as it has in the Act;

- b) headings and titles shall be disregarded;
- c) expressions cognate with those referred to in this Direction shall be construed accordingly;  
and
- d) the Interpretation Act 1978 (c. 30) shall apply as if this Direction were an Act of Parliament.

16. For the purposes of interpreting this Direction the following definitions shall apply:

- a) "2017 WBA Notification" means the notification at Annex [X] of the statement [wholesale broadband access market review] dated [DATE].
- b) "Audit and Risk Committee" means the committee of the board of directors of BT whose principal duties include financial reporting, internal controls, risk management and audit and includes any committee or unit established from time to time by the board of directors of BT to perform such duties;
- c) "Change Control Notification" means a list of each and every change to the Regulatory Accounting Methodology which BT is required to publish and deliver to Ofcom by 31 March of the Financial Year in which the change to the Regulatory Accounting Methodology is to be made;
- d) "Markets and Technical Areas Level" means the level at which total costs, total revenue and total assets are reported for each separate Market and Technical Area to which this Direction applies;
- e) "Material Change" means a change in any element of the Regulatory Accounting Methodology which results in a change (be it positive or negative) in any figure in the Regulatory Financial Statements which exceeds the higher of 5% or £1 million. The percentage change in a figure shall be calculated by taking the value of the affected figure before the change in the Regulatory Accounting Methodology is applied, and subtracting from it, the value of the same figure after the change in the Regulatory Accounting Methodology is applied, and then dividing this result by the former value;
- f) "Material Error" means an error which:



- i) results in a correction (be it positive or negative) in any figure in the Regulatory Financial Statements which exceeds the higher of 5% or £1 million. The percentage correction in a figure shall be calculated by taking the value of the affected figure in the Regulatory Financial Reporting before the error is corrected, and subtracting from it, the value of the same figure after the error is corrected, and then dividing this result by the former value; and
- ii) fulfils at least one of the following conditions set out in paragraphs (ii)(a) and (ii)(b) below:
  - (1) the error has arisen within the Regulatory Attribution System;
  - (2) the error has been brought to the attention of the Audit and Risk Committee by the Regulatory Auditor;
- g) "Regulatory Attribution System" means the set of computerised and manual accounting methods, procedures, Processes and controls established to attribute the costs, revenues, assets and liabilities and summarise, interpret, and present the resultant financial data in an accurate and timely manner for the purposes of the whole of the Regulatory Financial Statements, the Accounting Methodology Documents, the accounting records and the Regulatory Accounting System.

17. The Direction will take effect on [DATE].

**Signed**

**[NAME]**

**[Competition Policy Director]**

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

**[DATE]**

## A8. Draft Legal Instrument – 2014 Fixed Access Market Review

### Proposal for modifications to a direction relating to regulatory financial reporting requirements

**Notification of proposals 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 and regulatory asset value**

#### 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 other things, to introduce:
  - i. new Regulatory Accounting Principles which principles will include a requirement for “Consistency with regulatory decisions” (“Principle 4”);
  - ii. a requirement to prepare all Regulatory Financial Statements, explanations and other required information on a regulatory asset value current cost basis (the “RAV basis”).
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:
  - i. 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;
  - ii. wholesale fixed analogue exchange line services in the United Kingdom excluding the Hull Area;
  - iii. wholesale ISDN30 exchange line services in the United Kingdom excluding the Hull Area;
  - iv. 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.10 set out at Annex 29 of the FAMR Statement and condition 8A.10 set out at Annex 2 of the WBA Statement, BT shall prepare all Regulatory Financial Statements, explanations or other information required by virtue of the conditions 13A and 8A respectively on the RAV basis.
6. 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.
7. On 30 March 2015, Ofcom published a statement entitled "Directions for Regulatory Financial Reporting" (the "2015 RFR Statement"), which set out a decision to issue a direction specifying the requirements in relation to Principle 4 of the Regulatory Accounting Principles (the "2015 Direction"). The 2015 Direction was provided in the Schedule to the notification at Annex 2 of the 2015 RFR Statement and was given 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. The 2015 Direction specifies the requirements in relation to Principle 4 of the Regulatory Accounting Principles and the preparation of the Regulatory Financial Statements, explanations or other required information on the RAV basis.
8. On 24 November 2017, Ofcom published a consultation entitled "*Regulatory Financial Reporting arising from the WLA and WBA market reviews*" (the "November 2017 Regulatory Financial Reporting Consultation"), on proposals which included modifying our reporting requirements in relation to how BT attributes its Cumulo rates (business rates charged by the UK rating authorities on BT's network assets) to reflect their new rating valuation effective from 1 April 2017.
9. This Notification sets out proposals to modify the 2015 Direction in so far as it specifies requirements in relation to Cumulo costs in relation to the market set out in paragraph 2 above.

## Proposal to modify the 2015 Direction

10. Ofcom is proposing, in accordance with section 49 of the Communications Act 2003 (the "Act"), to modify the 2015 Direction pursuant to Condition 13A.4 and Condition 8A.4

specifying revised requirements in relation to the preparation of the Regulatory Financial Statements on a regulatory asset value adjusted current costs basis in relation to the market set out in paragraph 2a) above, in so far as they relate to Cumulo costs (the "Proposed Modification").

11. The Proposed Modification is set out in the Schedule to this Notification.
12. The effect of and reasons for modifying the 2015 Direction are set out in the November 2017 Regulatory Financial Reporting Consultation document accompanying this Notification.

## Ofcom's duties and legal tests

13. For the reasons set out in the November 2017 Regulatory Financial Reporting Consultation, Ofcom considers that its proposal to modify the 2015 Directions referred to in paragraph 10 complies with the requirements of section 49(2) of the Act.
14. In making the proposals referred to in paragraph 10, Ofcom has considered and acted in accordance with its general duties set out in section 3 of the Act, the six community requirements set out 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 by no later than 15 January 2018.
16. In accordance with section 49C(1)(a) of the Act, a copy of this Notification, together with the proposed amendments to the 2015 Direction set out in the Schedule to this Notification, will be 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 29 of the FAMR Statement and Annex 2 of the WBA Statement each as appropriate and otherwise any word or expression shall have the same meaning as it has in the Act.

Signed



**David Brown**

Director of Financial Economics, Ofcom

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

24 November 2017

## Schedule

### **The proposed amendments to the Direction under section 49 of the Communications Act 2003 and SMP Services Conditions 13A.4 and 8A.4 specifying the requirements in relation to consistency with regulatory decisions and regulatory asset value**

1. In Part 1 of the Schedule to the Direction, insert after the definition for 'FAMR Statement', in a new paragraph: "'Fibre To The Cabinet (FTTC)' means an Electronic Communications Network consisting of optical fibre extending from the local access node to the street cabinet;".
2. In Part 2 of the Schedule to the Direction, replace paragraph 1.6.1 with the following paragraph:

"1.6.1. In the case of NGA related Cumulo costs, BT shall:

  - attribute the share of NGA related Cumulo costs to GEA FTTC Rentals with reference to a rateable value of £18 per connected line per annum; and
  - attribute the share of NGA related Cumulo costs to Other GEA Rental Services with reference to a rateable value of £20 per connected line per annum.

## A9. Current network capital components that include access duct and pole costs

WLA Only components (% of total FAC)

<b>Current Network Cost Components (Access Duct and Poles - WLA)</b>	
Current Components	
CL173 - D side copper capital	80 - 90%
CL171 - E side copper capital	10 - 20%
CL951 - GEA Distribution Fibre	< 10%
CL950 - GEA Access Fibre Spine	< 10%

All components (% of total FAC)

<b>Current Network Cost Components (Access Duct and Poles - ALL)</b>	
Current Components	
CL173 - D side copper capital	70 - 80%
CL171 - E side copper capital	10 - 20%
CW609 - Ethernet Access Direct Fibre	< 10%
CL951 - GEA Distribution Fibre	< 10%
CO450 - Wholesale & LAN extension services fibre etc	< 10%
CL189 - ISDN30 access	< 10%
CG101_S - PC rentals 2Mbit/s regional trunk	< 10%
CK985 - Openreach Managed Services for Retail Other	< 10%
CL950 - GEA Access Fibre Spine	< 10%
CO447 - Backhaul extension services fibre etc	< 10%
CO434_S - PC rental 34Mbit/s link local end	< 10%
CO436 - PC rental 140Mbit link local end	< 10%
CO452 - Interconnect local end rental 2Mbit	< 10%

## A10. Network expansion cost AFI

The schedules referred to in Annex 5, Schedule 3, para 3, 5b(x) above)

### Schedule 1 (volumes and revenues)

For the year ended 31/03/20xx	Volumes		
	Internal	External	Total
Period: 1/4/20xx-31/3/20yy			
Qualifying Premises Passed			x
Rentals			
40/10 Rentals	x	x	x
Over 40/10 Rentals	x	x	x
	<hr/>	<hr/>	<hr/>
	x	x	x



## Schedule 2 (incremental cash costs and incremental FAC)

		Incremental Cash costs			Network expansions costs for universal broadband for year ended 31/3/20XX								
		Opex	Capitalised	Total	Opex	Total CCA					Total FAC		
					Pay	Non-pay	HCA Dep	Supp D	HG/L	Other CCA	Opex	WACC	MCF
Technology													
GEA	Duct												
	Access Fibre Spine												
	Access Distribution Fibre												
	Other Fibre												
	Electronics												
	Other equipment												
	Other cables												
	Systems development												
	OSS/BSS/Systems Costs												
	Provision												
	Customer installation												
	Repairs												
	SLGs												
	Other costs												
Gfast	Duct												
	Access Fibre Spine												
	Access Distribution Fibre												
	Other Fibre												
	Electronics												
	Other equipment												
	Other cables												
	Systems development												
	OSS/BSS/Systems Costs												
	Provision												
	Customer installation												
	Repairs												
	SLGs												
	Other costs												
LRVDSL	Duct												
	Access Fibre Spine												
	Access Distribution Fibre												
	Other Fibre												
	Electronics												
	Other equipment												
	Other cables												
	Systems development												
	OSS/BSS/Systems Costs												
	Provision												
	Customer installation												
	Repairs												
	SLGs												
	Other costs												
Total Network Expansion for Universal Broadband component													
Excluded Costs													
FWA	Cost 1												
	Cost 2 etc												
Satellite	Cost 1												
	Cost 2 etc												
Other	Cost 1												
	Cost 2 etc												