CONFIDENTIAL

Ofcom

19 November 2013

Mark Shurmer
Group Director, Regulatory Affairs
BT
81 Newgate Street
EC1A 7AJ

Stuart McIntosh
Group Director, Competition

Direct line: 020 7981 3947
stuart.mcintosh@ofcom.org.uk

Dear Mark

Base year financial data for the proposed LLU/WLR and WBA charge controls

I am writing to you in the context of the work we are undertaking for the Fixed Access Market Reviews on proposed charge controls for Local Loop Unbundling / Wholesale Line Rental ("LLU/WLR") and Wholesale Broadband Access ("WBA"). In particular, I am writing further to my email to you and Sean Williams of 14 June 2013 and Ed Dolling's letter of 16 October 2013 to David Brown to set out our current view as regards the use of BT's 2013 Current Cost Financial Statements ("RFS") in those charge controls.

By way of summary:

- we do not consider that it would be appropriate to use the 2013 RFS, as presented, as the basis for the LLU/WLR and WBA charge controls;
- this is because of the effect of the material methodological changes undertaken by BT in the 2013 RFS;
- we propose to proceed by seeking to update the cost models used in the charge controls with the cost data available in the 2013 RFS (where this is appropriate) but to retain the allocation methodologies presented in the 2012 RFS.

The remainder of this letter explains our reasons for proposing to proceed with this approach. We will set out our intention to proceed in this way in our forthcoming consultation and you will have an opportunity to provide your views in response.

The use of the 2013 RFS for the LLU/WLR and WBA charge controls

In July of this year we consulted on proposals for new LLU/WLR and WBA charge controls. The cost models underpinning the proposed charge controls were based on information for the financial year 2011/12 taken from BT's 2012 RFS, as this was the most up to date data available at the time. In the LLU/WLR consultation we said the following:

> *"6.21 BT plans to publish its RFS for 2013 later this summer. We will therefore be able to take this information into account, alongside other information, in our cost estimates and it may be appropriate to use 2012/13 as the base year in our cost model. To the extent that changes in the 2012/13 RFS reflect changes in accounting methodologies (such as cost allocation rules) rather than changes in the underlying costs, we will need to consider if and how it is appropriate to reflect these changes in our base year costs and whether they justify a move away from the methodologies in this Consultation."*

Our normal starting position in charge control reviews, is to seek to use the best available information to forecast BT's relevant costs over the charge control period. In practice, over the course of several different market reviews, we have often used BT's most recent RFS, appropriately scrutinised and adjusted where necessary, as the basis for our assessment of BT's relevant costs. A key reason for starting with the most up to date RFS has been that the RFS has typically formed a sensible check point for the consistent allocation of costs across different markets and services subject to *ex ante* regulatory review as well as to unregulated services.

However, the RFS is only a starting point. In the specific context of each charge control review, Ofcom is required to exercise its judgement, based on its experience and expertise, to adopt an appropriate, proportionate and timely means to model BT's relevant costs in light of the specific circumstances applying at the time so as to address the competition concerns identified. Our duties require us to achieve an outcome which both furthers the interests of citizens in relation to communications matters and those of consumers in relevant markets, where appropriate by promoting competition. Any charge control remedy must be one that promotes efficiency, sustainable competition and be in the best interests of citizens and consumers as the end-users of those services.

Having regard to this and having reviewed the 2013 RFS alongside the report subsequently published by BT on 3 October 2013[1] and the Deloitte Report provided on 15 October 2013, we have given careful consideration to whether it would be appropriate to use the information contained in the 2013 RFS to update the cost models used for the LLU/WLR and WBA

[1] Report requested by Ofcom describing certain changes to the Accounting Documents for the year ended 31 March 2013 and illustrating the resulting differences to the Current Cost Financial Statements had those changes not applied

charge controls. In other words, we have considered whether the 2013 RFS is the best source of information on which to base our forecast of BT's relevant costs in these markets and for these services.

Having done so, and by way of exception to what has normally been our starting position, our judgement is that in this case it would not be appropriate to use the 2013 RFS as presented by BT for the purpose of the proposed LLU/WLR and WBA charge controls. This is because of the effect of the material changes in allocation methodology that have been applied in the 2013 RFS, when compared to the 2012 RFS and the basis upon which we consulted in July. Our analysis of the effect of the methodological changes, as presented in the October 2013 Report, indicates that using the 2013 RFS as presented would result in the significant over-recovery of costs for BT. This is because costs that have been included in other recently set charge controls (e.g. leased lines) are now being allocated to services within the scope of the proposed LLU/WLR and WBA charge controls.

In our view where there have been significant methodological changes, the recovery of the same costs in multiple concurrent charge controls (double-recovery) would be acceptable only if it was clear that the revised methodology was superior and that the process of its introduction was clearly even-handed (i.e. as likely to result in under- as over-recovery). To be clear about our position, I should say that we are not satisfied that this is the case.

This situation presents Ofcom with a very significant dilemma in the context of charge controls for LLU/WLR and WBA services that are set to expire on 31 March 2014. Given our position on the 2013 RFS as presented, we need to determine a suitable basis for forecasting BT's relevant costs for these charge controls. Two potential approaches are: to use the 2013 RFS data but adjusted to remove the new allocation methodoligies or to use the 2012 RFS data as we did in the July consultation.

BT has suggested that in the event of the 2013 RFS (as presented) not being used as the starting point for the charge controls, Ofcom should make amendments only to correct for individual errors or to disapply specific methodological changes not considered to be 'superior' to those previously in use. However, the 2013 RFS data incorporates material re-allocations of costs between the markets covered by the proposed charge controls (e.g. between LLU and WLR services) and between these markets and un-regulated markets (in addition to the material reallocation of common costs from other regulated markets where charge controls are already in place).

Given the potential interdependence of the effects of the various methodological changes and the broader question of whether the changes represent a balanced approach to the review of allocations, we would not be confident that proceeding as BT suggests would produce a sufficiently accurate or suitable assessment of BT's relevant costs even after undertaking significant further work.

Contrary to the suggestion in Ed Dolling's letter, and notwithstanding the production of the October Report and the Deloitte Report, Ofcom is not in a position to resolve these issues. Whilst I note the regular engagement that our respective teams have had on regulatory accounting issues it is not correct to suggest, as that letter seeks to do, that Ofcom has been in a position to scrutinise the market level effects of the methodological changes applied in the 2013 RFS prior to the publication of the October Report. Moreover, we have no information on the impact of each methodological change at a product level; an analysis of which would be fundamental to any assessment for the purposes of the charge controls.

Given this, we do not consider that our duties (including those set out above) are best achieved in the context of the current proposed LLU/WLR and WBA controls by undertaking a detailed evaluation of these allocations. To do so would in our view lead to a material delay in the implementation of the revised controls, without necessarily producing a better outcome in terms of cost allocation.

We therefore propose to proceed by seeking to update the charge control models with the most recent cost data available from the 2013 RFS but to retain the allocation methodologies presented in the 2012 RFS (which were the subject of consultation in July 2013). In our judgement, this approach would be most consistent with our statutory duties. Should this approach turn out to be unworkable for some as yet unanticipated reason, we would then need to consider reverting to using the 2012 RFS as the base year for the cost models. We will set out our intention to proceed in this way in our forthcoming consultation (which is due to be published shortly).

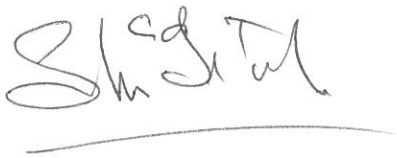
As you are aware, our forthcoming consultation will include our proposals on Quality of Service and faults, as well as a few other outstanding issues. In light of the timing of that consultation, we plan to use data from the 2012 RFS in that document. We plan to make any neceassay update to the base year cost data subsequently. Because our proposed regulatory remedies explicitly link Quality of Service and costs, it is essential that we have a consistent Quality of Service and associated cost data in the base year. If we conclude that it is not appropriate for us to use the 2012/13 Quality of Service data in the base year, which is a real possibility, then when we update the base year costs we will have to continue to use 2011/12 costs for those components associated with delivering Quality of Service.

In order to undertake this task and proceed to finalised charge controls in 2014, we will require the support of your regulatory team, particularly in gathering the necessary data to respond to statutory information requests on tight timeframes to support this modelling approach.

I should also add that, as a general matter, we accept that it may be appropriate to change the allocation bases underlying the RFS from time to time. The position we propose to take in respect of the 2013 RFS should not be taken to mean that the allocation methodologies should be 'frozen' and fixed over time. Where those changes are material, however, and have significant implications for several charge controls, and competition across both

regulated and unregulated services, they need to be considered carefully to ensure that they are objectively justified and balanced (e.g. not chosen selectively in a manner that benefits BT relative to other stakeholders). This is consistent with our proposals for Regulatory Financial Reporting on which we will be consulting shortly. We would be pleased to engage further on the regulatory accounts following the publication of that document.

Yours sincerely



Stuart McIntosh

cc. Ed Dolling, BT; David Clarkson, David Brown, Ofcom

Mr Stuart McIntosh
Group Director, Competition
Office of Communications
Riverside House
2a Southwark Bridge Road
London SE1 9HA

26 November 2013

Dear Stuart

Base year financial data for the proposed LLU/WLR and WBA charge controls

Thank you for your letter of 19 November 2013 which sets out Ofcom's current position on the use of 2012/13 RFS data in the LLU/WLR and WBA charge controls (the controls).

Your letter sets out Ofcom's intention to finalise the controls using base year data taken from the 2012/13 RFS, but with all methodology changes unadjusted from those applied in 2011/12. You also explain that, amongst other things, this position would be reflected in the further consultation on the controls expected in the next few weeks, although – somewhat confusingly in our view – modelling in those consultations will still use base year data reflecting the published 2011/12 RFS.

As set out in more detail below, we have significant concerns with Ofcom's proposed approach and do not consider it to have been sufficiently justified. Given these, BT would request an urgent meeting with Ofcom to discuss in more detail.

Summary of BT's position

1) We remain of the view that the most appropriate starting point for the LLU/WLR and WBA charge controls is the published 2012/13 RFS: this is the most up to date and relevant data and its use is consistent with Ofcom's standard practice.

2) Each of the 2012/13 methodology changes was introduced following rigorous internal review by BT. Ofcom has been provided with an independent report produced by BT setting out the merits of each change and the 2012/13 RFS received an unqualified audit approval by PWC. However, Ofcom's blanket dismissal of all 2012/13 methodology changes fails to give proper and appropriate consideration to the merits of each individual change and the detailed information supplied by BT. As such, Ofcom's approach is arbitrary, inconsistent with Ofcom's standard approach to the principles of cost recovery and contrary to Ofcom's duties.

3) Ofcom cites as an issue the potential double recovery of costs included within recently set charge controls, such as leased lines, but then fails to adequately consider how such concerns could be simply and readily addressed - e.g. by using data Ofcom already has about the impact of each change on specific regulated markets or by requesting further information from BT.

Mark Shurmer
Group Director Regulatory Affairs

BT Group
BT Centre
81 Newgate Street
London EC1A 7AJ

Tel: +44 (0)20 7356 8213
Mob: +44 (0) 7730 908553
Email: mark.2.shurmer@bt.com

British Telecommunications plc
Registered office:
81 Newgate Street
London EC1A 7AJ
Registered in England No 1800000
www.bt.com

4) BT submits that if, as Ofcom states, its intention is to use 2012/13 RFS data but based on 2011/12 methodologies, such data should be used as the basis for the forthcoming Quality of Service and further LLU/WLR (and possible WBA) charge control consultations. To not do so, risks further delay in the resetting of these controls as stakeholders will have had inadequate time to properly consider and respond to the impact of the use of this revised data.

Substantive comments on the points raised in Ofcom's letter

Ofcom is proposing to ignore all methodology changes in the 2012/13 RFS. It is extremely concerning that this decision has been reached without any detailed reference to the specific, individual methodology improvements introduced in the 2012/13 RFS. These changes have each been discussed with Ofcom's regulatory finance team in a series of meetings since the beginning of the year and were also explained and analysed in the detailed reports BT has provided over the last month[1]. Ofcom has not expressed a view on whether it considers the new methodologies to be superior to the previous methodologies; further, your letter sets out that you see no value in conducting such an evaluation ahead of setting the controls.

Such an approach, rejecting each of the methodology changes without setting out a full rationale for doing so, is arbitrary, opaque and inconsistent with Ofcom's duties – in short it is unsound.

It appears to be common ground between us that **the appropriate and normal starting position for setting charge controls should be to use the best and latest available information** as the basis to forecast BT's relevant costs over the charge control period. Indeed, your letter further states that this is normally the latest published RFS data. You note that such data would always be "*appropriately scrutinised and adjusted where necessary*". Again, that is common ground: BT accepts that any data used in regulatory decisions should be scrutinised and that Ofcom can decide to make adjustments to reported numbers – but this must only be where it has been found to be appropriate to do so, following due process . As Ed Dolling emphasised in his letter to David Brown of 16 October 2013, any decision to make adjustments to the published numbers must be "*specific, deliberate and considered*", i.e. based on a sound justification. To be clear, BT would expect Ofcom to only depart from the use of published data where scrutiny of the financial information raised clearly identified concerns with regulatory accounting principles, economic efficiency considerations and/or with other specific aspects relating to Ofcom's duties and responsibilities.

Instead and exceptionally, Ofcom appears to be proposing to dismiss all the accounting improvements introduced in the 2012/13 RFS by sole reference to the overall effect of the changes. Ofcom's view is that using the 2012/13 RFS data as presented would result in "*significant over-recovery of costs for BT*" because your analysis of the reports shows that some costs that were included within recently set

[1] (1) BT Report "Report requested by Ofcom describing certain changes to the Accounting Documents for the year ended 31 March 2013 and illustrating the resulting differences to the Current Cost Financial Statements had those changes not applied" published 3 October 2013 (the "**BT RFS Report**"); (2) Deloitte Report "BT RFS Attribution Methodology Changes", 15 October 2013 (the "**Deloitte's Report**")

charge controls, such as the leased lines control set in March 2013, would now be allocated to products within the scope of the LLU, WLR and/or WBA controls. We make a number of points in response to this:

- First, "over-recovery" and "under-recovery" of specific costs across different charge controls is an inevitable consequence of setting charge controls based on RFS-based models at different points in time. As noted, controls are generally set based on models that will use the latest actual and forecast cost and volume information available. That information will change from period to period for a variety of reasons. For instance, under a constant volume-driven cost allocation methodology, changes in relative volumes of any products will shift common cost allocations between products between periods in ways that will not be captured in controls. A charge control set for product X based on the relative volumes in year A may therefore be inconsistent with a charge control set for product Y based on the relative volumes in year A+1. New information may also become available on many key forecast parameters – future volumes, potential for efficiency improvements, changes in the cost of capital, etc. – in the periods between the setting of different controls. But that simply brings us back to the importance of following the key principle: Ofcom should set controls at any point in time based on the best and most timely information available to it. In this case that it is the audited 2012/13 RFS, appropriately scrutinised and adjusted, not the 2012/13 RFS adjusted to use methodologies that – with the passage of time, new evidence, or improvements in accounting practice – are now viewed as inferior.

- Second, you accept that the risk of "double recovery" across controls would be acceptable if: (i) the revised methodologies were superior; and (ii) the process of introducing the methodology changes was "*clearly even-handed*". You state that you are "*not satisfied*" that this is the case. But no assessment of either of these factors appears to have been conducted at this stage. Our position on these matters is clear: the RFS report requested by Ofcom set out our view that each of the changes implemented is superior, in certain cases correcting known errors, and the process followed in identifying the need for these changes was part of our usual review of methodologies in producing the audited RFS each year.

- Third, you do not appear to have considered that setting glide path charge controls will, at least to some extent, mitigate against any risk of "double recovery" concerns. Nor do you appear to have assessed ways in which glide paths for this and future controls could be specifically set to further mitigate, and potentially remove altogether, any such legitimately identified and quantified cost recovery concerns. Specifically, the effects of the methodology changes shown in the RFS Report show the single year impact of the change against the counterfactual of retaining the previous methodologies. However, while the methodology changes would generate a higher final year projected cost in the LLU, WLR and WBA controls compared to the counterfactual, today's prices will reflect previous charge controls – which may themselves have been set by reference to models which incorporated previous methodologies. The glide from where prices start to where costs are forecast to end the period will therefore reduce the impact of any "double recovery" in the initial years of the control. Indeed, as some prices may well start control periods beneath costs, it may be inappropriate to consider that any "double recovery" (which is in any event perhaps more accurately described in this context as "double allocation" between charge controls) inevitably results in "over-recovery" of costs over the charge control period, in anything other than a very narrow sense, when measured against a

specific counterfactual. Furthermore, Ofcom could change the trajectory of any glide path to address any "double recovery" concerns identified; noting in particular that Ofcom will likely re-set the leased lines charge control before the end of the WLR/LLU charge control period.

- Fourth, linked to the above and despite your reference to the need for the process of implementing changes to be "even-handed", the implication of Ofcom's rationale for dismissing the changes in setting these controls is that any changes – even if considered superior – would be more acceptable if they result in BT under-recovering costs. For example, if the same changes had been implemented in the 2011/12 RFS and moved costs away from leased lines markets, the implication is that you would have been more comfortable setting those controls on the lower base year costs even if the previous LLU/WLR controls had been set by reference to the previous methodology which implicitly assumed those costs were allocated to, and recoverable from, leased lines. Indeed, as no view is expressed on the reasonableness of each of the changes themselves, it is unclear whether you would in fact reflect the methodology changes made to the 2012/13 RFS in setting the next round of charge controls (i.e. beyond 2014) on the basis that leased lines would "go first" and BT would see (relatively) lower prices in this area before getting any (relatively) higher prices at the next LLU/WLR control.

- Fifth, in dismissing all the methodology changes, you do not appear to have assessed and considered the scale of the impact of any "double recovery" or of overall cost recovery from different products. Based on the in-year assessment of impacts on the 2012/13 RFS data, the changes result in £170m of additional costs being allocated to the fixed access markets and £10m of additional costs being allocated to the Wholesale Broadband Access markets. £79m of costs has moved away from leased lines markets and £20m from the call termination and call origination markets. Not all of these costs are relevant in setting charge controls – call termination and call origination charges have been set by reference to a hypothetical bottom-up LRIC model, not to the RFS; and not all products in the other markets are charge controlled. However, even this single-year, market-level analysis shows that approximately £100m of the £180m of additional costs allocated to the fixed access and WBA markets cannot be relevant to any consideration of "double-recovery" from the other recently set and relevant charge controls (i.e. leased lines). Your dismissal of all the methodology changes by reference to the "double recovery" resulting in over-recovery is therefore arbitrary and wrong.

The rationale for reaching the decision set out in your letter is therefore flawed. The general concern with "double recovery" is: (i) insufficient to justify the dismissal of all changes; (ii) made with no specific analysis of the scale and nature of the impacts and whether they are justified; and (iii) made with no consideration of how impacts could be mitigated. Ofcom's conclusion that its duties will not be achieved through "*undertaking a detailed evaluation of* [these] *allocations*" is clearly misguided or at the very least made prematurely. Contrary to Ofcom's position, it cannot set charge controls that are consistent with its duties on the basis of base year numbers that arbitrarily exclude audited methodology changes without first conducting a proper analytical exercise. Ofcom can only reach reasonable conclusions on "double recovery" once it has taken a view on whether each of the changes is itself justified by reference to whether it is superior to the previous methodology. To put it another way, if a previous charge control was set on the basis of information which has now been bettered, Ofcom would be wrong to further entrench that decision by failing to take account of that better information in new controls, especially when, as BT has explained above, there are alternatives available

that may well militate or mitigate the perceived risks to competition and consumers of multiple cost recovery.

We would also note that you do not appear to have considered (or at least not given weight to) those specific changes which are driving your "double recovery" concern or to identifying changes that are relatively simple to explain and consider (e.g. changes that address clear errors). The information to do this is all set out in the BT RFS Report and the Deloitte's Report. For instance, the changes to Openreach computing alone moves £32m of cost from leased line markets to fixed access markets. A focus of resource in understanding that change would help put the more general concerns raised in some context. Any exercise that narrowed down the areas of concern and ensured there was focus on the key changes would seem sensible given the concerns raised with resourcing and timing. An 'all in' or 'all out' approach is unnecessarily and inappropriately rigid.

Timing and provision of additional information

We note that your view on the need to conduct a detailed evaluation is also linked to concerns about potential timing impacts on the charge control. We have no desire to unduly delay implementation of these controls. In fact, given that we believe that key LLU and WLR rental prices need to increase, it would be perverse for us to seek an extended delay. However, the risk of delay is no justification for the approach you are proposing to take. It is also frustrating that concerns with timing appear to be influencing your proposed approach here when the individual methodologies in issue have been discussed at some length with your team. For instance, all of the changes impacting the WBA charge control were discussed with the Ofcom team in August as well as covered in the reports and we find it hard to believe that Ofcom has not reached a conclusion on those changes, at least.

We also believe you have overstated the additional work involved in conducting a detailed evaluation of changes and appear to have reached a view on such matters without actually requesting any additional data. Further cuts of data can be produced which may help assess the potential interdependencies of different methodology changes and consideration of whether Ofcom could adopt some, but not all, of the changes. To assist Ofcom's understanding, we will provide a further breakdown of the data in the BT RFS Report – which shows impacts by market – to show methodology impacts by product for the key products in the controls. We could also provide input templates (we understand this to be 7) to update Ofcom's charge control model, that could show the impact of removing any of the methodology changes in the 2012/13 regulatory accounts, within 3 weeks of being asked.

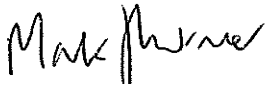
The further consultation and conclusion

We are also disappointed that, despite signalling the intention to use adjusted 2012/13 RFS as the base year, the next set of consultations, now expected to be published in mid-December, will actually still use 2011/12 RFS data. We see no reason why this should be the case given the information supplied to Ofcom. We submitted 2012/13 RFS data on the 2011/12 basis to Ofcom on 4th October 2013, which we believe gave Ofcom ample time to model this data. Continuing to use 2011/12 data is likely to mislead stakeholders and create erroneous expectations if Ofcom's true intention is to use 2012/13 data for the final charge control decision, particularly as it is unclear from your letter what process Ofcom will follow to "*make any necessary update to the base year cost data subsequently*", including whether this will be the subject of any stakeholder consultation.

I would reiterate BT's strongly-held view, set out and evidenced in our first set of consultation responses, that 2012/13 was not an atypical year regarding Quality of Service. This is supported by our fault data for 2013/14 which evidences a trend from the previous year. We are therefore concerned by the suggestion that Ofcom might somehow seek to adjust the 2012/13 cost data to reflect a lower level of faults; if Ofcom is considering such an adjustment we would expect full transparency of Ofcom's proposed methodology and data.

Finally, as suggested, I believe it would aid both BT and Ofcom if our respective teams were to meet urgently and discuss our respective positions and concerns in more detail. Given the shortness of time before publication of the further consultation, I'm sure you would agree that the sooner this important meeting can take place the better.

Yours sincerely



Mark Shurmer
Group Director Regulatory Affairs

cc. Ed Dolling, James Tickel, BT; David Clarkson, David Brown, Ofcom

CONFIDENTIAL

Ofcom

6 December 2013

Mark Shurmer
Group Director Regulatory Affairs
BT
BT Centre
81 Newgate Street
EC1A 7AJ

Stuart McIntosh
Group Director, Competition

Direct line: 020 7981 3647
stuart.mcintosh@ofcom.org.uk

Dear Mark

Base year financial data for the proposed LLU/WLR and WBA charge controls

I refer to your letter of 26 November 2013 regarding our proposals on the use of BT's 2013 RFS in the context of our review of the Local Loop Unbundling (LLU) / Wholesale Line Rental (WLR) and Wholesale Broadband Access (WBA) charge controls, which replied to my letter of 19 November 2013.

I am writing to confirm that the proposed approach on which we will consult later in December (in the case of the LLU/WLR charge controls) remains as set out in my letter. That is, we propose to proceed by seeking to update the costs models we are using to set the relevant charge controls with the cost data available in the 2013 RFS (where this is appropriate) but to retain the allocation methodologies presented in the 2012 RFS.

As I explained in my letter, when setting charge controls, Ofcom must do so in a way that fulfils our statutory duties. That is, our aim is to achieve an outcome that is appropriate for the purposes of promoting efficiency, sustainable competition and is in the interests of citizens and consumers. When pursing this objective we also seek to allow BT the opportunity to recover its efficiently incurred relevant costs for the services in question. To do this we need a dataset that allows us to model BT's relevant costs in a sufficiently robust manner. It is a matter for our regulatory judgement to determine the best source of that dataset at the time the charge control is set.

In practice Ofcom has, when appropriate, used BT's latest RFS as a starting point. As I explained in my letter, however, in this instance our judgement is that it would not be

appropriate to use the 2013 RFS (as presented) as the basis for the cost model in the charge controls. This is not only because of the potential for material over-recovery from other regulated markets; although this is at the core of our concerns. It is also because of the other material reallocations between the WLA and WFAEL markets and to those markets from unregulated services.

My previous letter explained two concerns: first, concerns regarding the potential interdependence of the effects of the methodological changes and, secondly, the broader question of whether the changes represent a balanced approach to the review of allocations. Your letter does not seek to address these issues. Given our concerns, we would not be confident that applying and disapplying methodological changes on an item-by-item basis would produce a sufficiently accurate or suitable assessment of BT's relevant costs that could properly be used as the basis for the charge controls. In any event, such an analysis would not simply be a case of BT providing and Ofcom analysing then using new data. Such material changes would necessite a potentially iterative process of wider stakeholder engagement. The process suggested in your letter would not therefore avoid the possibility of material delays in setting the new charge controls.

As I said in my previous letter, our forthcoming consultation on the LLU/WLR charge controls will set out our proposals in this regard and will invite responses from all stakeholders. As part of that consultation we plan to publish copies of this correspondence (this letter together with my letter of 19 November 2013 and your letter of 26 November 2013) and a copy of the report prepared by Deloitte dated 15 October 2013. We consider that it is necessary to disclose this information as part of our consultation to ensure that stakeholders are appropriately informed and able to respond intelligently to our proposals. The project team will be in touch shortly in relation to any confidentiality issues.

As this is a matter for consultation, you will be invited to provide a response to our proposals and any such data as you consider appropriate. We will take all such information into account, together with responses received from other stakeholders in reaching our final decision on this issue.

In relation to your request for a meeting, I note that we are due to meet on 11 December 2013 and I would be happy to discuss this issue with you then.

Yours sincerely

Stuart McIntosh

cc. Ed Dolling,James Tickel BT; David Brown, David Clarkson Ofcom

Stuart McIntosh
Competition Partner
Ofcom
Riverside House
2a Southwark Bridge Road
London
SE1 9HA

Our ref:
Your ref:

18 December 2013

Dear Stuart

Ofcom's Use of BT's Published Current Cost Financial Statements for 2013 (the RFS)

Following on from our meeting on Monday 16 December, I wanted to confirm BT's position.

Simply put, Ofcom should use the most recent published RFS, i.e. the 2012-13 RFS as the starting point for determining the new LLU/WLR and WBA charge controls as per normal and good regulatory practice. To the extent that Ofcom has concerns about BT's year on year methodology changes Ofcom should review each of those on their merits. Ofcom's current approach will result in BT under recovering its efficiently incurred costs in the reviewed markets.

Charge control process

Ofcom's normal or standard process is to use BT's most recent published RFS as the starting point for a charge control's base year, making such changes as it deems appropriate following a transparent review of those costs and cost allocations. This is clearly good regulatory practice given the information is up-to-date, relevant and benefits from an unqualified audit opinion and all interested parties have an opportunity to comment. To date, Ofcom has provided no clear or compelling rationale to explain why it should not follow its normal approach, and specifically why BT's year on year methodology changes should be disregarded in their entirety without a proper analysis of the individual changes.

Methodology Reviews

Each year, as part of the preparation of its RFS, BT carefully reviews its cost allocation methodologies. This is a technical, complex and time consuming task that focuses on cost causality. Any necessary change identified is made if, and only if, it is clearly an improvement on what has gone before.

Richard Cameron
Deputy Group CFO

BT Group
pp A4.68, BT Centre
81 Newgate Street
London
EC1A 7AJ

Tel: +44 (0)20 7356 5150
Mob: +44 (0)70 7778 5783
Email: richard.cameron@bt.com

British Telecommunications plc
Registered office:
81 Newgate Street
London EC1A 7AJ
Registered in England No 1800000
www.bt.com

For 2012-13 this review naturally and appropriately focused on the products falling within the Fixed Access and WBA markets, given that these products would be the subject of careful scrutiny by both Ofcom and the CP community as part of the associated proposed charge control reviews. However, the reviews also took into account other factors, such as new data sources or organisational changes, impacting other products.

At our meeting, you questioned whether we had been selective, and therefore potentially biased, in our review of costs. This is just not the case. For example, when reviewing any annual change, such as re-organisations, economic or product developments, costs are reviewed in their entirety.

For example, last year, when BT Operate and BT Innovate and Design were combined to form BT Technology, Service and Operations (BT TSO), all relevant allocation methodologies were reviewed, not just a selection that might benefit BT. This was an exceptional organisational change, the review of which identified £61m of the £92m more appropriately re-allocated to Access Markets. Indeed, given the nature of shared cost allocation, it would be nigh on impossible to do otherwise. Further, BT was entirely open and transparent with Ofcom about this change – my Group Regulatory Finance (GRF) team presented the proposed change to Ofcom's David Brown and his team on 25 April. At this meeting, my team discussed new and old methodologies covering all of the operating costs, and provided an estimate of the year-on-year impact by regulated market of these changes. My team has been equally open and transparent on each of the other significant changes.

I trust that this gives you more confidence that when making changes to its methodologies, BT is evidence led, principled, and clearly even handed. For example, in 2012-13 54 methodology papers were approved. Of these papers 22% moved costs to non-regulated markets and a further 22% had no impact on regulated markets. By contrast, the CP community only ever argues that costs should be excluded. I am sure you would agree that BT has both a responsibility and duty to its shareholders and other stakeholders to ensure it is recovering its efficiently incurred costs.

All of our proposed methodology changes go through a robust internal governance process. BT's finance teams identify any new data sources, organisational changes, etc., that may trigger a proposed change in methodology. These proposals are then reviewed by the GRF team against the regulatory accounting principles and submitted for approval to the Accounting Separation Improvement Group (ASIG). Where the proposal is significant it is also reviewed by the Methodology Review Group (MRG). Only methodologies approved by one or both these two governance bodies are used in the production of the RFS.

The auditors, PwC, review every paper approved by ASIG and MRG, of which there were 54 papers in 2012-13. Papers are reviewed individually and the cumulative impact of all papers is also assessed. This ensures the impact on regulated markets can be assessed, even if the changes individually have a less than 5% impact on a regulated market.

For 2012-13, PwC gave an unqualified audit opinion and only noted four minor changes at the tri-partite meeting with Ofcom on 25 July 2013. If Ofcom had any real concerns about the methodology, it is surprising that Ofcom failed to request PwC to perform additional audit work, requests that Ofcom has made previously.

Additionally, for 2012-13 BT commissioned an independent expert report from Deloitte. Deloitte reviewed 16 of the most significant methodology changes, representing 95% of the impact of changes in allocation methodologies for regulated markets; Deloitte considered that only one change was not a clear improvement. A copy of this report was shared with you on 16 October 2013 and was published on our corporate website on 16th December 2013.

Given the above, the 2012-13 RFS is clearly the most appropriate starting point for the WLR/LLU and WBA charge controls.

Ofcom's approach will lead to cost under recovery

Ofcom must consider these methodology changes at some point; that point should clearly be the current WLR/LLU and WBA charge controls. Ignoring the methodology changes will lead to inappropriate costs recovery as:

- the next LLCC will start in April 2016 from a lower cost base, but the WLR/LLU higher cost base will not start until April 2017, meaning there will be one year where costs are not recovered

- there is approximately £90m of higher costs relevant to the WLR/LLU markets outside the LLCC markets that is also being excluded

and not addressing these issues will just store up problems for later. This is not good for consumers, not good for competition and is not an acceptable position.

Ofcom, as a good regulator, should review and consider the methodologies on their individual merits. BT has played its part in facilitating this, holding meetings with Ofcom since January 2013, to inform Ofcom about the proposed changes, before implementation. Further, Ofcom was sent a draft copy of the RFS on 17 July 2013 and BT published a report, on 3 October 2013, detailing the impact of each significant methodology change. BT expected Ofcom to consider carefully the information that BT was providing to it, as is Ofcom's usual practice, but BT now finds itself, over two months later, without any proper engagement by Ofcom on these methodology changes. I am surprised this has not happened.

Conclusion

It is not too late; there remains an adequate opportunity for Ofcom to review the 2012-13 methodologies. BT is prepared to do all it can to aid Ofcom; if required BT can prepare alternative scenarios of the impact of the methodologies, for example modelling the effect of certain of the significant methodology changes.

Yours sincerely

Richard Cameron

[redacted]

From: Stuart McIntosh
Sent: 19 December 2013 16:41
To: 'Richard Cameron (richard.cameron@bt.com)'
Cc: David Brown; David Clarkson
Subject: 2013 RFS

Richard,

I just wanted to confirm receipt of your letter dated 18th December regarding the RFS and the LLU/WLR and WBA Charge Controls.

As you will have seen, we have now published our consultation document today. I therefore suggest that we consider your letter as one input from BT to the consultation process which we will consider alongside other responses from BT and other stakeholders. We obviously recognise the importance of this issue and will consider the arguments and points in your letter very carefully.

Kind Regards,

Stuart

David Clarkson
Competition Policy Director

Direct line: 020 7783 4837
David.Clarkson@ofcom.org.uk

FAO: Mr Alan Lazarus

DIRECTOR OF REGULATORY AFFAIRS, OPENREACH
BRITISH TELECOMMUNICATIONS PLC
81 NEWGATE STREET
LONDON
EC1A 7AJ

CC:
Mr Mark Shurmer, Group Director, Regulatory Affairs
Mr Liam Nicholson, Head of Regulatory Projects
Ms Kathryn Elliott, Senior Specialist, Regulatory Affairs
Mr Michael Rickard, Group Regulatory Finance
Mr Jon Furmston, Director of Compliance

26 February 2014

Dear Alan,

Fixed Access Market Reviews - Approach to setting any future LLU and WLR Charge Controls: Base year data for cost modelling

I refer to question 4 of Ofcom's fifteenth notice under section 135 of the Communications Act (the "Act") 2003 (dated 24 January 2014) which required BT to confirm for the purposes of the above charge control review various 2012/13 cost data provided by BT in a report entitled "Report Requested by Ofcom describing certain changes to the Accounting Documents for the year ended 31 March 2013 and illustrating the resulting differences to the Current Cost Financial Statements had those changes not applied" dated 3 October 2013 (the "October Report"). A response to this request was required by 7 February 2014.

As you are aware, this confirmation (in conjunction with other information) is required to establish that the 2012/13 cost data on a 2011/12 basis provided in response to Ofcom's tenth notice under section 135 of the Act (dated 28 August 2014) are sufficiently robust for use as the base year data for our cost model for modelling the LLU and WLR charge controls. We explained in our December 2013 consultation[1] that if we should find that using the 2012/13 cost data on a 2011/12 basis was not feasible (for an unanticipated reason), we would need to consider reverting to using the 2011/12 RFS as the base year data for the LLU and WLR charge controls.

BT previously advised us on 11 February 2014 that in preparing its response to question 4 of the fifteenth notice, it had identified certain potentially material errors which delayed its response to this notice. This also delayed BT's response to other clarification questions relating to BT's response to the tenth notice. In a conversation with Mark Shurmer on Friday

[1] See paragraph 7.98 of our consultation "Fixed access market reviews: Openreach quality of service and approach to setting LLU and WLR Charge Controls" dated 19 December 2013.

21 February 2014 he confirmed that BT had identified a material error in the 2012/13 RFS data which had been propagated into the October Report and BT's response to the tenth notice. Further, in a follow-up conversation with Mark Shurmer on Monday 24 February 2014 I was informed that BT will not be in a position to provide corrected cost data in the required format until 14 March 2014.

As I am sure BT is aware, the data that we have requested is a key input to the charge control review, without which we cannot update the charge control model base year. The continuing delay in obtaining robust cost data means that, if we now wait until 14 March 2014, our implementation of the proposed charge controls from 1 July 2014 (the date we currently expect the controls to enter into force) will be delayed. Given the importance of timely implementation of the charge controls, particularly given that implementation is already behind schedule, we consider that further delay beyond this date is not appropriate.

Therefore, I am writing to advise you that to have any possibility of using the 2012/13 cost data on a 2011/12 basis as the base year for our cost modelling for the LLU and WLR charge controls, we would need BT to provide corrected cost data in the required format by 5pm on Monday 3 March 2014. For the avoidance of doubt this means that we require both: BT's response to question 4 of the fifteenth notice; and BT's corrected response to the tenth notice, by 5pm on Monday 3 March 2014. We would also ask that you confirm on the same timescale that this error has had no further impact on other 2012/13 cost data which BT has provided to us on a 2011/12 allocation basis (i.e. that there is no systemic error).

Where we consider that it is not possible to use the 2012/13 cost data on a 2011/12 basis, we will have no choice but to revert to using 2011/12 RFS data as the basis for our cost modelling.

Yours sincerely

David Clarkson
Competition Policy Director

Riverside House
2a Southwark Bridge Road
London SE1 9HA

Telephone + 44 (0)20 7981 3000
Facsimile + 44 (0)20 7981 3333

www.ofcom.org.uk

Mr David Clarkson
Competition Policy Manager
Competition and Markets
Ofcom
Riverside House
2a Southwark Bridge Road
London SE1 9HA

28 February 2014

Dear Dave,

Fixed Access Market Reviews – Approach to setting any future LLU and WLR Charge Controls: Corrected base year data for cost modelling

Thank you for your letter of 26 February 2014. I would like to stress at the outset that BT takes the submission of data extremely seriously and apologises unreservedly for the errors in our previous submissions of 2012/13 RFS data. BT's Group Regulatory Finance team, recognising the importance of providing Ofcom with this corrected data, is working as hard as it can, including weekend working, and prioritising this piece of work above all other work.

We appreciate Ofcom's tight deadlines and have no desire to cause any further delay. On that basis, focusing on what we understand Ofcom needs for its Charge Control modelling and following the conversations between you and Mark Shurmer and between ourselves on the 27 February, I confirm that we will submit all of the re-worked "s.135 template data" and corrected relevant sections to the "October Report" relating to WLR, WLA and ISDN2 by 5pm on Monday 3 March 2014, as set out in the annex to this letter. Due to the serial nature of the RFS model runs, there is a possibility that the LRIC data needed for calculating AVEs and CVEs may not be available until Tuesday 4 March; however we will try our utmost to submit all data on 3 March. I do though understand from our conversation that submitting the LRIC data a day later would be acceptable to Ofcom.

Although we stand by our position that Ofcom should use the latest available cost data as the input to the base year, we understand that in agreeing these dates, Ofcom has not committed to use our 2012/13 RFS cost data for the purposes of the Charge Control. We also recognise that to be usable the data must be submitted in a form and to a level of quality that Ofcom can immediately use in its modelling.

Alan Lazarus
Director of Regulatory Affairs
Openreach

Openreach
Kelvin House (pp 3.63D)
123 Judd Street
London WC1H 9NP

tel 0207 809 7461
fax 01908 862 006
mob 07718 801 492
alan.lazarus@openreach.co.uk

I do hope the corrective action we are taking is acceptable and please do contact me if you would like to discuss further.

Yours sincerely

Alan Lazarus
Director of Regulatory Affairs
Openreach

Annex

Information to be provided on Monday 3 March 2014:

1. Corrected seven templates previously provided on 4 October 2014 in response to Ofcom's 10th S.135 Information Request

2. Consolidated performance summary of 2012-13 applying 2011-12 methodologies (Page 6 of the October Report)

3. Corrected attribution of Wholesale Current Costs 2013 on 2011-12 methodologies by market (Page 10 of the October Report)

4. Corrected attribution of Wholesale Current Cost Mean Capital Employed 2013 on 2011-12 methodologies by market (Page 14 of the October Report)

5. Corrected service FAC for Wholesale Analogue Exchange Line Services, ISDN2, Wholesale Local Access (Page 37, Page 42 and Page 69 of the October Report)

6. Corrected calculation of Service FAC by component and service for Wholesale Analogue Exchange Line Services, ISDN2, Wholesale Local Access (Page 39, Page 44 and Page 71 of the October Report)

Mr David Clarkson
Competition Policy Director
Ofcom
Riverside House
2a Southwark Bridge Road
London SE1 9HA

BY EMAIL

3 March 2014

Dear Dave,

Fixed Access Market Reviews – Approach to setting any future LLU and WLR Charge Controls: Corrected base year data for cost modelling

Further to my letter of 28 February 2014, I have attached the:

- seven re-worked "s.135 template data";
- corrected relevant sections to the "October Report" relating to WLR, WLA and ISDN2; and
- LRIC data that is needed for calculating AVEs and CVEs.

We are pleased that it has been possible to provide the LRIC data today (rather than tomorrow) and we believe this submission is in a form and to a level of quality that Ofcom can immediately use in its modelling.

You asked that we confirm on the same timescale that this error has had no further impact on other 2012/13 cost data which BT has provided to you on a 2011/12 allocation basis (i.e. that there is no systemic error). I can confirm that 16 responses since October 2013 are potentially affected. Further to my voicemail, we are working through these responses and will send revised answers by close of business tomorrow.

BT recognises the importance of providing Ofcom with this corrected data in order to enable Ofcom to update their model. Given Ofcom's tight timescales, I would like to re-iterate that BT's Group Regulatory Finance team has worked as hard as it can over the weekend and prioritised this piece of work above all other work.

Alan Lazarus
Director of Regulatory Affairs
Openreach

Openreach
Kelvin House (pp 3.63D)
123 Judd Street
London WC1H 9NP

tel 0207 809 7461
fax 01908 862 006
mob 07718 801 492
alan.lazarus@openreach.co.uk

Although we understand that in agreeing these dates, Ofcom has not committed to use our 2012/13 RFS cost data for the purposes of the Charge Control, I would like to stress our position that Ofcom should use the latest available cost data as the input to the base year. BT will also update the “s.135 template data” using the current 2012/13 RFS methodologies and provide these by 14 March 2014, to enable Ofcom to consider this as the most up to date data available.

I would like to thank you again for extending to BT an opportunity to correct for the error identified.

Yours sincerely

Alan Lazarus
Director of Regulatory Affairs
Openreach

Mr David Clarkson
Competition Policy Director
Ofcom
Riverside House
2a Southwark Bridge Road
London SE1 9HA

BY EMAIL

4 March 2014

Dear Dave,

Fixed Access Market Reviews – Approach to setting any future LLU and WLR Charge Controls: Corrected base year data for cost modelling

Further to my letter of 3 March 2014, we have reviewed the s135 responses sent to Ofcom after we provided the October Report to you. Yesterday we said that 16 of those responses would potentially be affected. Following our review today I can confirm the following submissions have been affected. I have attached revised submissions for each of these as detailed below.

- Charge Control 11th S135 – Questions 1, 9b, 9c, 9g and 23
- Charge Control 12th S135 – Questions 5, 6, 9 and 12
- Charge Control 13th S135 – Questions 1 and 9a
- Charge Control 14th S135 – Question 9c
- FAMR 8th S135 – Questions 5b and 5c
- FAMR 9th S135 – Questions 1 and 14

Yours sincerely

Alan Lazarus
Director of Regulatory Affairs
Openreach

Alan Lazarus
Director of Regulatory Affairs
Openreach

Openreach
Kelvin House (pp 3.63D)
123 Judd Street
London WC1H 9NP

tel 0207 809 7461
fax 01908 862 006
mob 07718 801 492
alan.lazarus@openreach.co.uk

British Telecommunications plc
Registered Office:
81 Newgate Street, London EC1A 7AJ
Registered in England and Wales no. 1800000

www.bt.com

Stuart McIntosh
Group Director, Competition

Direct line: 020 7981 3647
Stuart.McIntosh@ofcom.org.uk

FAO: Mr Alan Lazarus

DIRECTOR OF REGULATORY AFFAIRS, OPENREACH
BRITISH TELECOMMUNICATIONS PLC
81 NEWGATE STREET
LONDON
EC1A 7AJ

CC:
Mr Mark Shurmer, Group Director, Regulatory Affairs
Mr Liam Nicholson, Head of Regulatory Projects
Ms Kathryn Elliott, Senior Specialist, Regulatory Affairs
Mr Michael Rickard, Group Regulatory Finance
Mr Jon Furmston, Director of Compliance

5 March 2014

Dear Alan,

Fixed Access Market Reviews - Approach to setting any future LLU and WLR Charge Controls: Base year data for cost modelling

I refer to David Clarkson's letter of 26 February 2014, and your letters in response of 28 February 2014, 3 March 2014 and 4 March 2014, regarding the RFS base year data that Ofcom requires in order to undertake the cost modelling necessary for the proposed LLU and WLR charge controls.

I am writing to inform you that we do not consider that this data is sufficiently robust to be used in our cost model. This is due to the significant changes that the corrections introduce to data supplied by BT since October 2013, including changes to other s.135 responses over and above the Eleventh s.135 response (which was not previously anticipated). We have also identified a material inconsistency in the information provided and the omission of data that we believe should have been included in your response.[1]

In seeking to use the 2012/13 cost data with 2011/12 allocations as the base year data in our modelling of the proposed LLU and WLR charge controls, we have undertaken a significant amount of work to scrutinise, interrogate and reconcile the data provided by BT in the

[1] In the data provided on 3 March 2014, the sum of NCA by service is [✂] [£250m to £280m] whereas the sum of NCA by component is [✂] [£240m to £270m] (a difference of [✂] [£20m to £30m]). We would expect these numbers to be the same, as they are in the 2011/12 data provided by BT. See workbook <<Fixed Templates to go to Ofcom (2ofe).xlsx>>, worksheet <<Q9>>, Column B. The data we believe is missing is the Appendix 1.1 - network activity statement requested in question 4 of our Fifteenth s.135 request dated 24 January 2014. We believe this data is missing because we expected that the nature of the error BT had identified would necessitate restatement of pages 109 to 112 of the 3 October Report.

3 October Report and subsequently in responses to section 135 requests for the purposes of establishing the robustness of that data. That work has led to the discovery by BT of a material error in the 2013 RFS, which has in turn led to the restated figures provided on 3 and 4 March 2014.

David Clarkson's letter of 26 February 2014 made clear that to have any possibility of using the 2012/13 cost data on a 2011/12 basis as the base year for our cost modelling for the LLU and WLR charge controls, we required BT to provide corrected cost data in the required format by 5pm on Monday 3 March 2014. You acknowledged this and agreed that the data would be submitted in a form and to a level of quality that Ofcom could immediately use in its modelling. BT provided the corrected data under cover of its letters of 3 and 4 March 2014.

In light of the problems with the data identified above, we do not have confidence that it can form a sufficiently robust basis for our cost modelling. In order to set revised charge controls by 1 July 2014, the date that we currently expect new charge controls to enter into force, we are working to a carefully planned timetable that would be jeopardised by the further investigation necessary of the 2012/13 cost data (as restated), without necessarily producing a better outcome in terms of the cost modelling. For your information, the key milestones that Ofcom is working towards are as follows: 10 March 2014, charge control model completed and subjected to internal peer review; 31 March 2014, charge control model sent for external audit; 21 April 2014, finalising charge control model following external audit; 12 May 2014, notification to the European Commission under the Article 7 procedure of the Framework Directive (minimum 4 week process); 16 June 2014, review of any comments received from the European Commission; and 30 June (on or before 1 July 2014), publication of Fixed Access Market Reviews statement including charge controls for LLU and WLR services.[2]

Therefore, it is our view that seeking to update the model using 2012/13 cost data (as now restated) on the basis of 2011/12 allocation methodologies would introduce an unacceptable risk of error into the charge control modelling and result in further material delays to the setting of revised charge controls to the detriment of legal and regulatory certainty. As we have previously explained to you, the timely implementation of the charge controls is of central importance to Ofcom given the competition concerns provisionally identified in the Fixed Access Market Reviews and the fact that new controls are already delayed beyond the expiry of the existing controls. We consider that our statutory duties to further the interests of citizens and consumers in these markets are best served by using the most robust data available on BT's relevant costs to set the charge controls in a timely manner. We have therefore taken the decision to proceed to finalise the charge controls using the 2011/12 data contained in the 2012 RFS to form the base year of the cost model.

We appreciate the efforts that you and your team have made to supply the revised data in a short period of time. Please note that in light of our decision to use the 2011/12 data, we no

[2] All dates are by week commencing.

Riverside House
2a Southwark Bridge Road
London SE1 9HA

Telephone + 44 (0)20 7981 3000
Facsimile + 44 (0)20 7981 3333

www.ofcom.org.uk

longer require responses to a number of our outstanding clarification queries in respect of the 2012/13 data. The team will be in contact with you separately to confirm these details.

Yours sincerely

Stuart McIntosh
Group Director, Competition

Riverside House
2a Southwark Bridge Road
London SE1 9HA

Telephone + 44 (0)20 7981 3000
Facsimile + 44 (0)20 7981 3333

www.ofcom.org.uk

Mr Stuart McIntosh
Group Director, Competition
Ofcom
Riverside House
2a Southwark Bridge Road
London SE1 9HA

6 March 2014

Dear Stuart

Thank you for your letter of 5 March 2014. We will be responding separately to the substantive points made but I wanted to immediately address two issues you cite as reasons for not using the updated submission (3 March 2014) in your charge control modelling, namely:

- an apparent material inconsistency between the Net Current Assets (NCA) by service and the NCA by component; and
- your view that we did not provide Appendix 1.1 as expected[1] and that an update to the cost model , using the data submitted on Monday 3 March, cannot be considered because of this.

Taking these in turn:

Inconsistency between the Net Current Assets (NCA) by service and the NCA by component

You say that there is an unexpected inconsistency between the Net Current Assets (NCA) by service and the NCA by component. In fact, this is to be expected and is consistent with previous information provided to Ofcom. In those submissions the NCA by service[2] related to the services specified by Ofcom which included Special Fault Investigations (SFI), Broadband Boost (BBB) and Time Related Charges (TRC). The NCA by component [3] does not include these services i.e. it includes only those services reported in the RFS for the

[1] Network activity statement (pages 109 to 112 of the October Report
[2] 1st S135, February 2013 (see file "Final Annex 3.pdf"
[3] 17th S135 February 2014 (see File starting "2012")

Alan Lazarus
Director of Regulatory Affairs
Openreach

Openreach
Kelvin House (pp 3.63D)
123 Judd Street
London WC1H 9NP

tel 0207 809 7461
fax 01908 862 006
mob 07718 801 492
alan.lazarus@openreach.co.uk

British Telecommunications plc
Registered Office:
81 Newgate Street, London EC1A 7AJ
Registered in England and Wales no. 1800000

www.bt.com

Wholesale Analogue Exchange Line Service (WAEL) Market and the Wholesale Local Access (WLA) Market. Therefore a difference is to be expected.

Further, Ofcom was made aware, in an email response to a clarification question on 24 January 2014,[4] that to treat service costs correctly within their model Ofcom had to model NCA by component and not by Service. For these reasons we do not understand why Ofcom would consider an expected difference between the two clearly different views of NCA to be a good justification to ignore the 2012/13 cost submission.

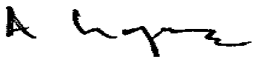
"Missing" Appendix 1.1 – network activity statement (pages 109 to 112 of the October Report

Our 3 March 2014 submission of the templates required to update the model includes all of the cost data associated with Appendix 1.1 for the WAEL market and the WLA market. The volume data has not changed. The combination of the volume data that you already have and the template (cost) data provided on the 3 March 2014 provides all of the information that is necessary to update the Ofcom model. For the avoidance of doubt, with the information that BT has provided, Ofcom can check the relevant component costs when multiplied by usage factors in order to reconcile to the WAEL and WLA service Fully Allocated Cost (FAC).

It is worth noting that when I wrote to confirm[5] the specific pages of the October report BT intended supplying on Monday 3 March, in response to that letter you did not point out that Ofcom also expected pages 109 to 112 of the October report to be restated in that submission, although you did point out that an analysis of follow-on S.135 responses was missing from our intended submission.[6] That said, even though it is not clear what further use Ofcom would have for Appendix 1.1 in updating the cost model, should Ofcom still require the schedule, we will provide it immediately.

Your letter clearly raises wider issues and additional reasons for rejecting the use of 12/13 RFS data for charge control purposes, which we will respond to in due course, but I wanted to put on record our view that the two issues covered in this letter do not, in and of themselves, constitute valid reasons for such a decision.

Yours sincerely



Alan Lazarus
Director of Regulatory Affairs
Openreach

[4] Email from Mike Rickard (BT) and Chris Dodds (Ofcom) 24 Jan 2014
[5] Letter from Alan Lazarus (Openreach) to David Clarkson (Ofcom) 28 February 2014
[6] Email from Paul Jacobus (Ofcom) acting for David Clarkson (Ofcom) to Alana Lazarus (Openreach) 28 February 2014

Ofcom

David Clarkson
Competition Policy Director

Direct line: 020 7783 4837
David.Clarkson@ofcom.org.uk

FAO: Mr Alan Lazarus

DIRECTOR OF REGULATORY AFFAIRS, OPENREACH
BRITISH TELECOMMUNICATIONS PLC
81 NEWGATE STREET
LONDON
EC1A 7AJ

CC:
Mr Mark Shurmer, Group Director, Regulatory Affairs
Mr Liam Nicholson, Head of Regulatory Projects
Ms Kathryn Elliott, Senior Specialist, Regulatory Affairs
Mr Michael Rickard, Group Regulatory Finance
Mr Jon Furmston, Director of Compliance

10 March 2014

Dear Alan

Fixed Access Market Reviews - Approach to setting any future LLU and WLR Charge Controls: Base year data for cost modelling

Thank you for your letter of 6 March 2014, responding to Stuart McIntosh's letter of 5 March 2014 on RFS base year data.

For the record, we consider that your 6 March letter gives rise to a number of further questions around the revised information BT has provided which we would expect to incur considerable extra work and require further information in order to answer. However, given the position set out in our 5 March letter. we are not proposing to pursue this any further at this time.

Yours sincerely

D Clarkson.

David Clarkson
Competition Policy Director

Mr David Clarkson
Competition Policy Director
Competition and Markets
Ofcom
Riverside House
2a Southwark Bridge Road
London SE1 9HA

BY EMAIL

14 April 2014

Dear David

Fixed Access Market Reviews – Approach for setting any future WLR LLU Charge Controls: base year data for cost modelling

Following on from our correspondence regarding an error made in the 2012/13 RFS concerning the treatment of certain Openreach costs relating to pay, my team submitted financial tables and reports into your team on 3 March 2014 and 4 March 2014. These submissions were based upon the 2012/13 RFS using 2011/12 methodologies, adjusting for that Openreach pay issue.

As of today, you have not asked me to provide you with corrected input schedules for use in the WLR LLU Charge control model based upon the 2012/13 RFS as published. The published RFS of course represents the most up to date and robust set of available cost data, including cost data for use in setting a charge control. The auditors gave an unqualified report upon the 2012/13 RFS and Deloitte's independent review concluded that all changes, bar one small change, were an improvement over the previous methodologies. I remain convinced that the published 2012/13 RFS (adjusted for the Openreach pay issue) represents the best available cost information.

Prior to submission, the schedules were reviewed by Openreach's Regulatory Disclosure Committee. The RDC raised a question in respect of one component pay CVE and which my Group Regulatory Affairs colleagues are investigating. Rather than delay the provision of the corrected data, the RDC has agreed the submission of the schedules whilst this small issue is checked. We will clarify the position on this issue by 17 April 2014.

Alan Lazarus
Director of Regulatory Affairs
Openreach

Openreach
Kelvin House (pp 3.63D)
123 Judd Street
London WC1H 9NP

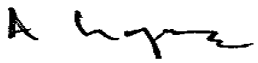
tel 0207 809 7461
fax 01908 862 006
mob 07718 801 492
alan.lazarus@openreach.co.uk

Accordingly, I attach revised input schedules based upon the 2012/13 RFS as published, corrected for the Openreach pay issue, as you would need these to update your charge control model to reflect this financial year. These schedules are:

- 2012/13 RFS, adjusted for Openreach pay issue; and
- 7 Input templates based upon the above report, including additional RAV input.

I still believe you have the opportunity to incorporate the most appropriate financial data from published 2012/13 RFS within your charge control modelling and thereby, set the WLR LLU Charge controls at the most appropriate level.

Yours sincerely,



Alan Lazarus
Director of Regulatory Affairs Openreach

David Clarkson
Competition Policy Director

Direct line: 020 7783 4837
David.Clarkson@ofcom.org.uk

FAO: Mr Alan Lazarus

DIRECTOR OF REGULATORY AFFAIRS, OPENREACH
BRITISH TELECOMMUNICATIONS PLC
81 NEWGATE STREET
LONDON
EC1A 7AJ

CC: Mr Liam Nicholson, Head of Regulatory Projects
Ms Kathryn Elliott, Senior Specialist, Regulatory Affairs
Mr Jon Furmston, Director of Compliance
Mr Michael Rickard, Head of Regulatory Finance
Mr Ed Dolling, Director of Regulatory Finance

16 April 2014

Dear Alan

Fixed Access Market Reviews – Approach to setting any future LLU and WLR Charge Controls: base year data for cost modelling

Thank you for your letter dated 14 April 2014, which contained further financial data from BT's 2012/13 RFS.

As we explained in Stuart McIntosh's letter to Mark Shurmer of 19 November 2013, we do not consider it would be appropriate to use the 2012/13 RFS as presented as the basis of the LLU/WLR and WBA controls because of the effect of the material methodological changes undertaken by BT in the 2012/13 RFS. We have subsequently considered responses to our December 2013 LLU and WLR Consultation which set this out, including our correspondence with you on this issue. As you are aware, from Stuart's letter of 5 March 2014, we have decided to proceed to finalise the LLU/WLR charge controls using data from the 2011/12 RFS to form the base year of the cost model.

We do not therefore require the revised input schedules based upon the 2012/13 RFS, as we will not be using these for cost modelling purposes for the LLU and WLR Charge Controls. It is for this reason we have not required these from BT.

I also note that even were we to consider it appropriate to use this data, this data is any event being provided too late to incorporate into our charge control modelling.

Yours sincerely

D. Clarkson.

David Clarkson
Competition Policy Director