BT Cumulo Rates

Non-confidential summary of BT presentation to Ofcom Aug 2011

Cumulo Rates

- Cumulo rates are the non domestic rates BT pays on its UK rateable network assets
- Main rateable assets are duct, fibre & copper and exchange buildings (payphones, street cabinets etc)
- Non domestic rates are administered independently by different people in different UK countries
- Non domestic rates are not discretionary: covered by legislation (e.g. 1988 Local Government Finance Act)
  - All businesses should pay non domestic rates
- Liabilities = Rateable value (RV) x Rate poundage
  - RVs are reassessed every 5 years (next in 2015)
    - A hypothetical tenancy with a hypothetical landlord
  - Several ways of assessing RVs but RV is proxy for a rent
  - Rate poundage generally goes up by inflation every year
  - BT network assets are assessed together (hence Cumulo)
- There is a rating world with its own rules

Cumulo Allocations in the Regulatory Financial Statements

- Cumulo rates are the non domestic rates BT pays on its UK rateable network **assets**
  - UK rateable **assets** are used by BT's UK "wholesale activities"
  - BT plc's Cumulo liability is currently assessed by the rating authorities using a "profits basis" valuation approach for all UK "wholesale activities"
    - Access markets, Other Wholesale markets and Wholesale residual
- Philosophy:
  - Key allocation basis is profit weighted NRCs of rateable network assets
    - Use start year CCA NRCs
    - Specific Classes of Work (COWs)
    - Coverage defined by the Plant and Machinery order
- Rebates are allocated differently to base liabilities
  - Most rebates are the result of appeals associated with increasing MPF
  - BT's RV decreased due to loss of wholesale value "downstream" from access
  - Allocation of rebates therefore focussed on profit weighted NRCs of "non-access assets"
- BT evidence to Competition Commission

Cumulo Allocations – 3 Stage Process

Stage 1

- Start from actual BT plc P&L Cumulo Costs (note – not transfer charges)
  - Actual Costs = Transfer Charge + Regulatory Adjustment
- Split costs into
  - Type 1 = base liabilities at start of the rating list: to be allocated on all rateable COWs
  - Type 2 = reductions from and rebates on the base liabilities: allocated on relevant COWs only

Stage 2

- Allocate Cumulo by LOB across COWs
  - Separately for Type 1 and Type 2 costs
  - Using profit weighted NRCs

Stage 3

- Allocate COW costs to services
  - Apply LOB specific COW bases
  - Then Standard process
    - LOB Cow → Plant groups, Plant Groups → Components, Components → Services

Stage 2 – Illustrative Example

(2a) Market Returns

	Access	Wholesale	Residual
	10%	15%	20%

(2b) Opening NRCs by COW

	Access	Wholesale	Residual
Copper, Fibre etc	£3,000m	£300m	£0m
Duct etc	£5,000m	£1,000m	£500m
Exchanges	£1,000m	£500m	£0m
Total	£9,000m	£1,800m	£500m

(2c) Profit weighted NRCs

	Total
Copper, Fibre etc	£345m
Duct etc	£750m
Exchanges	£175m
Total	£1,270m

(2d) COW allocations (base allocations)

	Landlord	OR	Operate
Copper, Fibre etc	95%	90%	10%
Duct etc	100%	90%	10%
Exchanges	100%	10%	90%

(2e) Allocated PWNRCs

	OR	Operate	Total
Copper, Fibre etc	£295m	£33m	£328m
Duct etc	£675m	£75m	£750m
Exchanges	£18m	£158m	£175m
Total	£987m	£265m	£1,253m

(2f) Cumulo Allocation

	OR	Operate	Total
Copper, Fibre etc	24%	3%	26%
Duct etc	54%	6%	60%
Exchanges	1%	13%	14%
Total	79%	21%	100%

- Stage 2 of the RFS process allocates the BT plc Cumulo P&L charge by LOB across COW

Cumulo Forecasts

- Future liabilities will be dependent on
  - The Rateable Values set at the start of the list in each country
  - Forecasts of the effects of current and future appeals as a result of MCCs
    - MCC effects over the life of the 2010 rating list can be categorised into those associated with
      - MPF growth
      - NGA growth
      - Other asset growth
  - Rate poundages
    - Increase by RPI growth of previous September
  - Transition Rules