Clarifications to the WLA Market Review further consultation document of 14 September 2017

25 October 2017

Purpose of this document

This document sets out stakeholder queries and clarifications in relation to the further Ofcom WLA charge control consultation of 14 September 2017 (the "Consultation"), which can be found at: https://www.ofcom.org.uk/__data/assets/pdf_file/0023/106448/Proposed-charge-control-for-wholesale-standard-and-superfast-broadband.pdf.

This note supplements the Consultation, and the Consultation should be read accordingly.

Cumulo (Question 3.1 of the Consultation)

We were asked to clarify the poundage rates used in our analysis and whether these were the same as the March consultation (Table A17.5).

For the Consultation, we updated the poundage rates used in Northern Ireland. These were slightly lower (by about 1p in each year) than those set out in Table A17.5 in the March consultation. The updated rates we used in the Consultation for Northern Ireland were: 57.8p in 2017/18, 59.8p in 2018/19, 61.6p in 2019/20, 62.9p in 2020/21 and 64.1p in 2021/22.

Revision to 2015/16 Long Run Incremental Cost (LRIC) to Fully Allocated Cost (FAC) ratios to include Financial Capital Maintenance (FCM) depreciation (Question 3.2 of the Consultation)

We were asked to explain the rationale for adjusting non-pay Cost Volume Elasticities (CVEs).

The changes to the non-pay CVEs between the March and September consultations have been very small. These are a result of us including the costs for "Other operating income" when calculating LRIC to FAC ratios within the September consultation calculations as CVEs are also applied to these costs. These costs are associated with the code PLOPNPOTZZC1ZZZZ within BT's LRIC model.

We were asked to detail how the 'Operating Capability Maintenance (OCM) depreciation' LRIC to FAC ratios were derived.

We compared the OCM depreciation in the LRIC model with FAC OCM depreciation as found within the 2015/16 Additional Financial Information Schedules 1-4 to determine the ratios. As a modelling simplification, we then used this ratio as a proxy for FCM depreciation. It is important to note that we did not use base year holding gains (as found in BT's Regulatory Financial Statements (RFS)) but modelled our own holding gains/losses (both actual and forecast).

We were asked to detail how the 'Mean Capital Employed' (MCE) LRIC to FAC ratios were derived and what they represent.

Similar to the explanation above, but net replacement cost (NRC) has been used as a proxy for MCE given that net current assets (NCA) are a small proportion of the MCE cost stack. In addition, we forecasted NCA a little differently in the top-down model (i.e. without using Asset Volume Elasticities (AVEs) and CVEs)) and we therefore did not consider it was appropriate to reflect BT's LRIC to FAC ratios for NCA in this instance.

Generic Ethernet Access (GEA) Bandwidth modification, GEA Cancel/amend/modify, Virtual Local Area Network (VLAN) modification (Questions 4.1 and 4.5 of the Consultation)

We were asked to clarify how the FAC and LRIC costs were derived for certain software change services such as GEA bandwidth modification, GEA cancel/amend/modify and VLAN modifications.

Our estimated LRIC and FAC for the GEA services that require software changes such as GEA Bandwidth modifications, GEA cancel/amend/modify and VLAN modifications are based on the FAC of the GEA Communications Provider (CP) to CP migration service.

BT was unable to provide detailed cost information for the majority of software change services. Given this and that we understand they are all automated services requiring system changes and their prices are currently aligned, we considered it was appropriate to assume (as a modelling simplification) the costs for these services were the same.

BT does allocate the costs for these software change services within its RFS but they are aggregated with a number of other smaller wholesale local access ancillary services (aside from the CP to CP migration service).

The base year FAC for the GEA CP to CP migration service was reported in BT's RFS (called VULA migrations). The RFS provides some detail on the different component costs for this service (see page 40 of BT's Current Cost Financial Statements 2016 including Openreach Undertakings) and we have a further confidential breakdown of its component costs.

Therefore, as we have the FAC for GEA CP to CP migration service we considered this to be a reasonable proxy for the FAC of software change services. The common cost contribution of these software change services has been calculated by subtracting the bottom-up model's LRIC from BT's FAC.

Our estimate of the LRICs for these software change services was derived from our bottom up model. This was based on the Service Management Centre cost assumption out of BT's confidential chief engineer's model (and does not include any costs related to the business support systems and operational support systems as these have been allocated to GEA rental costs within the bottom-up model). As with our estimates of FAC we have assumed the LRICs of the software change services are the same.

Co-mingling and tie-cable over-recovery (Questions 4.2 and 4.3 of the Consultation)

In relation to our discovery of the potential over-recovery of certain costs relating to co-mingling and tie cable services, we were asked to clarify how costs have been recovered and charges calculated, both historically and in our proposals for the next charge control period.

As set out in the Consultation, our analysis appears to show that BT has capitalised certain costs associated with surveying and provisioning of co-mingling services and labour costs incurred to install tie cable services. We understood it had already recovered these costs (see paragraphs 4.53 and 4.31 of the Consultation).

We therefore consulted on our proposal to remove these historic capitalised costs from both depreciation and MCE and to treat any in-year spend on these activities as operating costs.

As outlined in the Consultation, these proposed adjustments impact the 2015/16 costs for co-mingling and tie-cable services (and if, following responses to consultation, we decide to make these adjustments, they will also be reflected in the 2016/17 base year costs and our forecasts for the charge control period).

Our focus in making these adjustments has therefore been to determine the appropriate level of the charge control for co-mingling and tie-cable services for 2018/19 to 2020/21.

We have not undertaken any work to investigate this issue in the previous charge control as this falls outside the scope of this market review.