

## **BT Regulatory Financial Reporting**

Regulatory reporting directions covering the physical infrastructure and business connectivity markets from 2019/20

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**STATEMENT:**

Publication date: 12 July 2019

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# 1. Overview

**On 28 June 2019 Ofcom published its decisions in its review of physical infrastructure and business connectivity services. This document set out detailed regulatory financial reporting requirements for these markets for 2019/20 and following years.**

This document covers the elements of the regulatory financial reporting directions which were consulted on in Section 4 ‘Regulatory financial reporting in relation to the physical infrastructure market’ and Section 5 ‘Regulatory financial reporting in relation to the business connectivity markets’ of the 2018 BT RFR Consultation.<sup>1</sup>

Our decisions are in line with our long-term strategy set out in our Strategic Review of Digital Communications<sup>2</sup> and our July 2018 Strategic Policy Position.<sup>3</sup> We have continued to increase our focus on Openreach while ensuring the published RFS continues to report relevant information.

We have recently started a wider review of BT’s regulatory financial reporting alongside the Fixed Telecoms Market Review, which will consider reporting requirements from 2021.<sup>4</sup> The regulatory reporting requirements we impose as a result of this wider review may in due course supersede the requirements we are imposing as part of the current review.

## **What we have decided – in brief**

**Regulatory accounting principles; transparency; audit of the RFS; Reconciliation Report; adjusted financial performance:** we have decided to extend the current obligations to the physical infrastructure and business connectivity markets.

**Consistency with regulatory decisions:** we have decided to update the requirements to reflect regulatory and commercial changes that impact regulatory financial reporting in the physical infrastructure and business connectivity markets.

**Preparation, delivery, publication, form and content of the RFS:** we have decided to introduce detailed reporting requirements for the physical infrastructure and business connectivity markets. This reporting reflects the regulatory remedies imposed in the respective markets.

**Network components:** we have updated the list of network components so they remain relevant and up-to-date following changes in the physical infrastructure and business connectivity markets.

**This overview is a simplified high-level summary only. The decisions we have taken and our reasoning are set out in the full document.**

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<sup>1</sup> Ofcom, *BT Regulatory Financial Reporting: Proposed regulatory reporting directions covering all regulated fixed telecoms markets*, 4 December 2018, [https://www.ofcom.org.uk/data/assets/pdf\\_file/0018/129060/Consultation-BT-regulatory-financial-reporting.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0018/129060/Consultation-BT-regulatory-financial-reporting.pdf) (2018 BT RFR Consultation).

<sup>2</sup> Ofcom, *Making communications work for everyone: Initial conclusions from the Strategic Review of Digital Communications*, 25 February 2016, [https://www.ofcom.org.uk/data/assets/pdf\\_file/0016/50416/dcr-statement.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0016/50416/dcr-statement.pdf).

<sup>3</sup> Ofcom, *Regulatory certainty to support investment in full-fibre broadband: Ofcom’s approach to future regulation*, 24 July 2018, [https://www.ofcom.org.uk/data/assets/pdf\\_file/0025/116539/investment-full-fibre-broadband.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0025/116539/investment-full-fibre-broadband.pdf).

<sup>4</sup> We held a workshop with industry on 8 October 2018 to discuss future regulatory financial reporting regime on BT and will continue to engage with industry as we develop our proposals.

## Background

- 1.1 BT is subject to regulatory financial reporting requirements across all of the fixed telecoms markets in which it is regulated, comprising:
- physical infrastructure;
  - wholesale local access;
  - business connectivity;
  - narrowband; and
  - wholesale broadband access.
- 1.2 These requirements are imposed on BT by way of an SMP condition set in each regulated market and a suite of directions imposed in each market pursuant to the associated SMP condition. The SMP condition sets out our general regulatory financial reporting requirements, including accounting separation and cost accounting. The directions then set out our detailed regulatory financial reporting requirements.
- 1.3 Broadly, the SMP condition and directions are the same across all regulated markets.<sup>5</sup> However, they are implemented separately for each regulated market and we have introduced some detailed requirements that are specific for individual markets.
- 1.4 On 4 December 2018 we published the 2018 BT RFR Consultation. That consultation set out proposals to improve BT's reporting obligations which are common across all regulated markets (including new markets we proposed to identify under the physical infrastructure market review and the business connectivity market review). The proposals were intended to ensure that BT continues to provide up-to-date information to Ofcom and stakeholders as part of its regulatory financial reporting, and to better align the directions in all regulated markets.<sup>6</sup> On 20 March 2019 we published the March 2019 BT RFR Statement which imposed these reporting obligations across the wholesale local access, narrowband and wholesale broadband access markets for 2018/19 onwards.<sup>7</sup> In this statement we extend those requirements to the physical infrastructure and business connectivity markets.
- 1.5 In the 2018 BT RFR Consultation we also proposed market-specific requirements arising out of the physical infrastructure and business connectivity market review consultations.<sup>8</sup>

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<sup>5</sup> The Consistency with Regulatory Decisions and RAV Direction only applies to the narrowband and wholesale broadband access markets in relation to the requirement that BT prepares the RFS on a RAV basis. The Adjusted Financial Performance Direction does not apply to the narrowband and wholesale broadband access markets.

<sup>6</sup> We received nine responses to the 2018 BT RFR Consultation. Non-confidential responses are available at <https://www.ofcom.org.uk/consultations-and-statements/category-1/bt-regulatory-financial-reporting>.

<sup>7</sup> BT Regulatory Financial Reporting: Regulatory reporting directions covering the wholesale local access, narrowband and wholesale broadband access markets for 2018/19 and following years, 20 March 2019, [https://www.ofcom.org.uk/data/assets/pdf\\_file/0019/141607/bt-rfr-statement.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0019/141607/bt-rfr-statement.pdf)

<sup>8</sup> Ofcom, *Physical Infrastructure Market Review: Access to ducts and poles to support investment*, 2 November 2018, [https://www.ofcom.org.uk/data/assets/pdf\\_file/0014/125420/PIMR-consultation.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0014/125420/PIMR-consultation.pdf), (2018 PIMR Consultation) and Ofcom, *Business Connectivity Market Review*, 2 November 2018, <https://www.ofcom.org.uk/consultations-and->

We have published our conclusions on these market reviews in the 2019 PIMR and BCMR Statement.<sup>9</sup> In this statement we impose those market specific requirements in respect of the physical infrastructure and business connectivity markets.

- 1.6 The directions which implement these decisions are set out at Annex 1. For completeness and so that stakeholders have the relevant provisions in a single location, the Preparation, Delivery, Publication, Form and Content of the RFS Direction reproduces the requirements we imposed in the March 2019 BT RFR Statement with respect to the wholesale local access, narrowband and wholesale broadband access markets. However, their inclusion does not modify or replace the requirements set in the March 2019 BT RFR Statement.

## Summary of decisions

- 1.7 We have decided to impose a new set of directions across the physical infrastructure and business connectivity markets.
- 1.8 In the March 2019 BT RFS Statement, we imposed eight<sup>10</sup> identical directions in the wholesale local access, narrowband and wholesale broadband access markets. We have decided to impose five of these directions, without amendment, in the physical infrastructure and business connectivity markets. These directions relate to the following elements of BT's regulatory financial reporting:
- a) regulatory accounting principles;
  - b) transparency;
  - c) audit of the RFS;
  - d) Reconciliation Report; and
  - e) adjusted financial performance.
- 1.9 The remaining three directions contain obligations specific to the physical infrastructure and business connectivity markets. These obligations are substantially the same as those on which we consulted in the 2018 BT RFR Consultation, although we have made a small number of changes in response to stakeholders' comments to our consultation, which are discussed in this statement.<sup>11</sup> These directions relate to the following elements of BT's regulatory financial reporting:

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[statements/category-1/business-connectivity-market-review](#), (2018 BCMR Consultation). In particular, see Section 4 of the 2018 PIMR Consultation and Section 11, Volume 1 of the 2018 BCMR Consultation.

<sup>9</sup> Ofcom, *Promoting competition and investment in fibre networks: review of the physical infrastructure and business connectivity markets Physical Infrastructure Market Review (PIMR), Business Connectivity Market Review (BCMR), and Leased Lines Charge Control (LLCC)*, 28 June 2019, [https://www.ofcom.org.uk/data/assets/pdf\\_file/0029/154595/pimr-bcmr-llcc-final-statement-introduction.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0029/154595/pimr-bcmr-llcc-final-statement-introduction.pdf) (2019 PIMR and BCMR Statement).

<sup>10</sup> The Adjusted Financial Performance Direction was not imposed in the narrowband and wholesale broadband access markets.

<sup>11</sup> We also discuss market specific adjustments for the purposes of the Adjusted Financial Performance direction.

- a) consistency with regulatory decisions;<sup>12</sup>
  - b) preparation, delivery, publication, form and content of the RFS; and
  - c) network components.
- 1.10 Overall, our decisions in this statement ensure consistent regulatory financial reporting requirements apply across the abovementioned markets, reduce the amount of information that BT is required to publish, and make the RFS more useful to us and stakeholders when considered against the regulatory requirements of these market reviews.
- 1.11 We summarise, at a high-level, the main decisions in relation to the physical infrastructure and business connectivity markets below.

## Consistency with regulatory decisions

### Physical infrastructure markets

- 1.12 We have decided to impose a requirement for BT to map its physical infrastructure inventory to its financial records.
- 1.13 We have also decided that BT must separately record all network adjustments within its RFS.
- a) Network adjustments above the financial limit of £4,750 per km must be treated as an expense within the PI market<sup>13</sup> and BT must not attribute these costs to any services within the PI market.
  - b) Network adjustments below the financial limit of £4,750 per km should be attributed to all services that use physical infrastructure.

### Business connectivity markets

- 1.14 We set out how BT should value its fibre assets, account for Excess Construction Charges, Openreach repayments works, and that EE integration costs must not be attributed to regulated services.

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<sup>12</sup> We have not revoked certain directions made under the wholesale local access, narrowband, and wholesale broadband access market reviews, specifying the requirements in relation to consistency with regulatory decisions and regulatory asset value. This is because these tend to be point in time directions with continuing effect which are not amenable to consolidation.

<sup>13</sup> In the 2019 PIMR Statement we identified four distinct geographic physical infrastructure markets. We refer to these markets as “physical infrastructure markets”. In this statement we have decided that BT must report on a single national physical infrastructure market. We refer to this market as the “PI market”.

## Preparation, delivery, publication, form and content of the RFS

### Physical infrastructure markets

- 1.15 In relation to public market level reporting, we have decided that BT must report on a single national market called 'PI market'. BT must also publish an appendix in the RFS from 2019/20 containing detailed information in respect of network adjustments.<sup>14</sup>
- 1.16 In relation to public service level reporting, we have decided that BT must report:
- a) In 2019/20 the volumes, revenues and costs for certain services<sup>15</sup> (internal and external); and
  - b) In 2020/21 the volumes, revenues and costs for certain disaggregated services<sup>16</sup> where the disaggregated revenues (internal and external) exceed £5m.
- 1.17 In relation to private reporting, we have decided that BT must report to Ofcom separate AFIs where the information is not included in the Data File.<sup>17</sup>

### Business connectivity markets

- 1.18 In relation to public market level reporting, we have decided that BT must report market level (and technical area) information for all business connectivity markets subject to pricing remedies.
- 1.19 In relation to public service level reporting, we have decided that BT must report:
- a) aggregated service level reporting at the basket and sub-basket level.
  - b) service level and FAC network component cost reporting for dark fibre services, dark fibre reference services and certain other active services.<sup>18</sup>
- 1.20 In relation to private reporting, we have decided that BT must report to Ofcom separate AFIs where the information is not included in the Data File.

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<sup>14</sup> In respect of network adjustments below and above the financial limit, BT must separately disclose the internal and external MCE. In respect of network adjustment that have been expensed in the PI market, BT must disclose what the MCE would have been.

<sup>15</sup> Physical Infrastructure for Active Services, PIA rentals, PIA ancillary charges, New Build and enabling works above the financial limit, and Other PIA charges.

<sup>16</sup> The services Physical Infrastructure for Active Services, PIA Rentals and PIA Ancillary Charges shall be disaggregated by (i) spine duct (ii) lead in duct (iii) poles (iv) manholes and (v) junction boxes.

<sup>17</sup> i) Additional Detailed Service Reporting for PI market Services: information in the same format as the disaggregated service level information (see paragraph 1.16b above) where disaggregated service revenues are above £1m. This AFI must be provided from 2020/21; ii) Updated Inputs for Calculation of the Maximum PIA Rental Charges: information used to populate our pricing model; and iii) Network adjustments: information in the same format as the appendix (see paragraph 1.15) where the relevant MCE is above £1m. Once the relevant MCE is above £5m, BT no longer needs to provide this AFI.

<sup>18</sup> EAD and EAD LA rentals and EAD Main Link.

## Network components

- 1.21 We have decided to direct BT to use a new list of network components that includes network components directed in the March 2019 BT RFS Statement, plus some new components that arose out of our physical infrastructure and business connectivity market reviews.<sup>19</sup>

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<sup>19</sup> i) "PIMR Cost" – network component captures infrastructure costs within the PIMR market that are attributed to both PIMR services and downstream active services; ii) "PIMR Costs – Downstream Asset" – network component captures the PIMR transfer charge which BT capitalises within downstream markets.



## 2. Introduction

### The purpose of regulatory financial reporting

- 2.1 In the 2014 Regulatory Financial Reporting Statement<sup>20</sup> 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>21</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>22</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>23</sup>
- 2.4 In the 2014 Regulatory Financial Reporting Statement we set out the SMP condition that sought to ensure that the basis of preparation of BT's RFS and the scope and format of reporting continued to provide the information we need and that it had the attributes of good reporting.
- 2.5 In the 2014 Regulatory Financial Reporting Statement we also set out the Regulatory Accounting Principles.<sup>24</sup> These are fundamental reporting principles with which BT's regulatory financial reporting must comply.
- 2.6 In the 2015 Directions Statement<sup>25</sup> we set out a set of detailed directions, including the Regulatory Accounting Principles Direction, implementing the 2014 Regulatory Financial

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<sup>20</sup> Ofcom, *Regulatory Financial Reporting*, 20 May 2014, [https://www.ofcom.org.uk/\\_data/assets/pdf\\_file/0025/78460/financial-reporting-statement-may14.pdf](https://www.ofcom.org.uk/_data/assets/pdf_file/0025/78460/financial-reporting-statement-may14.pdf) (2014 Regulatory Financial Reporting Statement).

<sup>21</sup> 2014 Regulatory Financial Reporting Statement, paragraph 2.28.

<sup>22</sup> 2014 Regulatory Financial Reporting Statement, paragraph 2.41.

<sup>23</sup> 2014 Regulatory Financial Reporting Statement, paragraph 2.42.

<sup>24</sup> 2014 Regulatory Financial Reporting Statement, Section 3 and Annex 3.

<sup>25</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)

Reporting Statement into the wholesale local access and wholesale broadband access markets.

## BT's regulatory financial reporting framework

- 2.7 Following the 2014 Regulatory Financial Reporting Statement, as part of each market review, we have imposed regulatory financial reporting requirements on BT through a common set of SMP conditions and directions.<sup>26</sup> This preserves the integrity and consistency of BT's regulatory financial reporting.
- 2.8 We describe below the contents and the purpose of the SMP condition and directions that we typically impose on BT.

### SMP condition

- 2.9 The "Regulatory Financial Reporting" SMP condition we impose on BT in relation to its regulatory financial reporting includes general requirements for accounting separation and cost accounting.<sup>27</sup> The SMP condition also requires BT to produce the RFS and other accounting documents as directed by Ofcom.
- 2.10 The purpose of this SMP condition is to ensure that sufficient and robust information is provided by BT both publicly and privately for Ofcom to enable us to perform our duties and for stakeholders to have confidence that BT has complied with its SMP conditions. More specifically, this SMP condition serves as a basis for imposing directions on BT that set out detailed regulatory financial reporting requirements.

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<sup>26</sup> The latest SMP conditions and directions that impose on BT regulatory financial reporting requirements for each regulated market are set out respectively in the following statements:

- 2019 PIMR and BCMR Statement;
- Ofcom, *Wholesale Local Access Market Review: Statement*, 28 March 2018, <https://www.ofcom.org.uk/consultations-and-statements/category-1/wholesale-local-access-market-review>, (2018 WLA Statement);
- Ofcom, *Narrowband Market Review: Statement*, 30 November 2017, <https://www.ofcom.org.uk/consultations-and-statements/category-1/narrowband-market-review>, (2017 NMR Statement); and
- Ofcom, *Wholesale Broadband Access Market Review 2018*, 31 July 2018, <https://www.ofcom.org.uk/consultations-and-statements/category-1/wholesale-broadband-access-market-review>, (2018 WBA Statement).

<sup>27</sup> See 2019 PIMR and BCMR Statement legal instruments, Schedule 1 Condition 11 (PIMR) and Schedule 3 Condition 11 (BCMR), [https://www.ofcom.org.uk/data/assets/pdf\\_file/0026/154592/annex-26-legal-instruments.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0026/154592/annex-26-legal-instruments.pdf); Condition 12 in the 2018 WLA Statement legal instruments, [https://www.ofcom.org.uk/data/assets/pdf\\_file/0024/112488/wla-statement-annex-33.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0024/112488/wla-statement-annex-33.pdf); Condition 9 in the 2017 NMR Statement legal instruments, [https://www.ofcom.org.uk/data/assets/pdf\\_file/0022/108355/final-statement-narrowband-market-review-annexes-9-10.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0022/108355/final-statement-narrowband-market-review-annexes-9-10.pdf); and Condition 7 in the 2018 WBA legal instruments, [https://www.ofcom.org.uk/data/assets/pdf\\_file/0032/116996/wba-annex-1.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0032/116996/wba-annex-1.pdf).

## Directions

2.11 Typically, we impose on BT a set of eight directions in order to implement our detailed regulatory financial reporting requirements. There are exceptions in some of the markets where certain directions are not relevant. We discuss these in turn below.

### Regulatory Accounting Principles Direction

2.12 The Regulatory Accounting Principles (RAP) are guiding principles with which BT's Regulatory Financial Reporting must comply. The principles and the order in which they apply are:

- i) Completeness;
- ii) Accuracy;
- iii) Objectivity;
- iv) Consistency with regulatory decisions;
- v) Causality;
- vi) Compliance with the statutory accounting standards; and
- vii) Consistency of the RFS as a whole and from one period to another.<sup>28</sup>

2.13 The RAP establishes the basic attributes for BT's regulatory financial reporting and provide a necessary reference point in the absence of more specific guidance. To preserve the integrity and consistency of the RFS we consider that the RAP should be implemented across all regulated markets as there are significant advantages to BT and other stakeholders of BT applying one set of principles across all markets.

### Consistency with Regulatory Decisions and Regulatory Asset Value Direction

2.14 This direction is based on principle four of the RAP which requires that regulatory financial reporting is consistent with our regulatory decisions.<sup>29</sup> The direction specifies which regulatory decisions should be reflected in the RFS. In general, we would expect regulatory decisions to be reflected in the RFS unless there were good reasons not to.

2.15 We do not consider that the requirement for consistency means 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). Also, attempting to model the impact of some adjustments, such as steady state valuation adjustments, and how they might uplift costs in later years,

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<sup>28</sup> 2014 Regulatory Financial Reporting Statement, Section 3 and Annex 3.

<sup>29</sup> In the 2014 Regulatory Financial Reporting Statement and the 2015 Directions Statement we explained why Regulatory Financial Reporting should, as far as possible, be consistent with our regulatory decisions as set out in Regulatory Accounting Principle number four. See 2014 Regulatory Financial Reporting Statement, Annex 3, available at [https://www.ofcom.org.uk/\\_data/assets/pdf\\_file/0025/78460/financial-reporting-statement-may14.pdf](https://www.ofcom.org.uk/_data/assets/pdf_file/0025/78460/financial-reporting-statement-may14.pdf) and 2015 Directions Statement, Section 3, [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)

would require BT to make difficult judgements about how we might approach these costs on an ongoing basis.

- 2.16 This direction also requires the RFS to be prepared on a Regulatory Asset Value (RAV) basis. The RAV was implemented in 2005 to ensure that there is no over recovery of costs associated with BT's copper and duct access network assets that existed before 1 August 1997. The value of RAV is based on the historical cost accounting value for the pre-1997 assets, indexed each year in line with the Retail Price Index. Over time the RAV will gradually disappear as the pre-1997 assets come to the end of their accounting life. It now only affects access duct as the pre-1997 copper assets, which have an accounting life of 18 years, are all fully depreciated.<sup>30</sup>
- 2.17 The direction ensures that regulatory financial reporting continues to provide the information necessary for us to make informed regulatory decisions.

### Transparency Direction

- 2.18 This direction requires BT to ensure that any information, material or explanatory document it prepares in respect of the RFS is sufficiently transparent, such that a suitably informed reader can gain a clear understanding of the information presented.
- 2.19 The direction provides confidence to stakeholders that BT has complied with its SMP conditions and adds credibility to the regulatory financial reporting regime. It allows stakeholders to better contribute to the regulatory regime, for example by providing more informed inputs during consultation periods.

### Audit of the RFS Direction

- 2.20 This direction sets out the standard of audit review that BT is required to obtain for the financial information contained in the RFS.
- 2.21 Audit of the RFS gives confidence that the RFS provides a fair reflection of BT's financial performance, is free from material error and has been prepared following the accounting methodology statements published by BT and relevant directions issued by Ofcom.<sup>31</sup>
- 2.22 The direction gives confidence to stakeholders that BT has complied with its SMP conditions and adds credibility to the regulatory financial reporting regime.

### Reconciliation Report Direction

- 2.23 This direction requires BT to publish a reconciliation report within the RFS which sets out the impact of all material changes and errors discovered in the RFS with an accompanying assurance report from their regulatory auditors.

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<sup>30</sup> For further details see 2014 Regulatory Financial Reporting Statement, paragraphs 3.87-3.91 and Section 6.2.5 of BT's 2015/16 Accounting Methodology Document.

<sup>31</sup> 2014 Regulatory Financial Reporting Statement, Section 5.

- 2.24 The reconciliation report provides stakeholders with transparency of changes that BT makes to the RFS. It aids the understanding of and promotes confidence in regulatory financial reporting and allows stakeholders to contribute to the regulatory regime.

### **Adjusted Financial Performance Direction**

- 2.25 In the 2015 Directions Statement, we said that if not all regulatory decisions were reflected in the RFS, differences could arise between the reported view of BT's financial performance and the view we took when making regulatory decisions.<sup>32</sup> We therefore decided that BT must prepare the Adjusted Financial Performance schedule to show the impact of certain regulatory decisions not reflected in the RFS.
- 2.26 The direction ensures that regulatory financial reporting continues to provide the information necessary for us to make informed regulatory decisions. It allows stakeholders to better contribute to the regulatory regime, for example by providing them with a better understanding of a BT's financial performance from a regulatory perspective.

### **Preparation, Delivery, Publication, Form and Content of the RFS Direction**

- 2.27 This direction sets out what financial information BT is required to provide for each regulated market in the published RFS and in private to Ofcom.<sup>33</sup> Some elements of this financial information relate to all markets<sup>34</sup>, while others relate only to specific markets.
- 2.28 This direction plays an important role in ensuring that the RFS provides relevant information to stakeholders. It ensures that that regulatory financial reporting gives reasonable confidence to stakeholders that BT has complied with its SMP obligations, allow them to contribute to the regulatory regime, and is consistent with the level of the remedy. The direction also ensures that information is provided to us in the published RFS and in private that is needed for monitoring of compliance with remedies (for example verifying volume weights used in compliance basket submissions).

### **Network Components Direction**

- 2.29 This direction specifies all network components used by BT to prepare the RFS. Network components are used by BT to attribute costs to services in regulated markets.
- 2.30 This direction ensures 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 direction also ensures that Ofcom and stakeholders obtain information to monitor compliance with remedies (for example on non-discrimination) and understand how costs have been attributed to markets and services (including internal vs external).

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<sup>32</sup> 2015 Directions Statement, paragraph 3.36.

<sup>33</sup> Private information provided to Ofcom under this direction includes Additional Financial Information (AFI) schedules and Compliance schedules.

<sup>34</sup> For example, the reconciliation of the RFS to BT Group's statutory accounts.

## Scope of this document

- 2.31 As mentioned above, our 2018 BT RFR Consultation covered regulatory financial reporting in the wholesale local access market, narrowband and wholesale broadband access markets, as well as regulatory financial reporting in the physical infrastructure and business connectivity markets.
- 2.32 As noted above, we published our decisions on regulatory financial reporting across the wholesale local access, narrowband and wholesale broadband access markets in the March 2019 BT RFR Statement.
- 2.33 The focus of this statement is on regulatory financial reporting across the physical infrastructure and business connectivity markets. Our broader decisions in relation to these markets were published on 28 June 2019 in our 2019 PIMR and BCMR Statement.

## Summary of changes to directions

- 2.34 We summarise in Table 2.1 the changes we have made to the directions previously imposed in the business connectivity markets and newly imposed in the physical infrastructure markets.

**Table 2.1: Summary of directions**

	Market review	
	PIMR	2016 BCMR
Regulatory Accounting Principles	New	No change
Consistency with Regulatory Decisions and RAV	New	Specific changes
Transparency	New	No change
Audit of the RFS	New	General change
Reconciliation Report	New	General changes
Adjusted Financial Performance	New	No change
Preparation, Delivery, Publication, Form and Content of the RFS	New	General and Specific changes
Network Components	New	Specific changes

- **New:** A direction is imposed for the first time in this market.
- **General changes:** Changes to general reporting requirements as per March 2019 BT RFR Statement.
- **No change:** The new requirements are the same as those imposed in the March 2019 BT RFR Statement.
- **Specific changes:** New requirements arising out of the relevant market review.

Source: Ofcom.

## Implementation of our decisions

- 2.35 The decisions set out in this section will take effect immediately. Our decisions will therefore impact the preparation of the 2019/20 RFS, to be delivered in July 2020.
- 2.36 As noted above, the directions which implement these decisions are set out at Annex 1. For completeness and so that stakeholders have the relevant provisions in a single location, the Preparation, Delivery, Publication, Form and Content of the RFS Direction reproduces requirements we imposed in the March 2019 BT RFR Statement with respect to the wholesale local access, narrowband and wholesale broadband access markets. However, this does not modify or replace those requirements. Furthermore, as a result of our decisions in relation to business connectivity and physical infrastructure markets, we have amended the Network Components Direction imposed in the March 2019 BT RFR Statement and imposed certain requirements in the in the wholesale local access, narrowband and wholesale broadband access markets via the Consistency with Regulatory Decisions and Regulatory Asset Value Direction. These decisions were within the scope of the 2018 BT RFR Consultation.<sup>35</sup>

## Regulatory framework

- 2.37 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.
- 2.38 We set out the relevant regulatory framework in our statements for each market review, including our 2019 PIMR and BCMR Statement.

## Impact assessment and equality impact assessment

### Impact assessment

- 2.39 Impact assessments provide a valuable way of assessing the options for regulation and showing 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 have to carry out impact assessments in cases where our conclusions would be likely to have a significant effect on businesses or the general public, or where there is a major change in

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<sup>35</sup> In the 2018 BT RFR Consultation, we proposed that these directions be applied in all markets (see Draft Direction 2, paragraph 2, and Draft Direction 5, paragraphs 2 and 4). With respect to the Network Components Direction, we proposed a list of network components which included components which were specific to business connectivity and physical infrastructure markets. We also said in our March 2019 BT RFR Statement that “We will make our decision relating to [network components which are specific to business connectivity and physical infrastructure markets] in the upcoming statements on these market reviews” (paragraph 3.96). With respect to the Consistency with Regulatory Decisions and Regulatory Asset Value Direction, we proposed to set requirements in relation to Cumulo, Fixed Asset Mapping, Access Fibre Valuation, EE Integration Costs and Repayment Works, and are now giving effect to this proposal.

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.

- 2.40 We set out our impact assessment in relation to those proposals on which we are making a final decision in the 2018 BT RFR Consultation. In this document we consider relevant responses and set out our conclusions on the impact of those changes.

### **Equality impact assessment**

- 2.41 Ofcom is required by statute to assess the potential impact of all our functions, policies, projects and practices on equality. EIAs also assist us in making sure that we are meeting our principal duty of furthering the interests of citizens and consumers regardless of their background or identity.
- 2.42 It is not apparent to us that the outcome of our review 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.



## 3. Regulatory financial reporting in relation to the physical infrastructure and business connectivity markets

- 3.1 In the 2018 BT RFR Consultation we proposed a set of eight regulatory financial reporting directions that would apply to BT in all regulated markets (including new markets we proposed to identify under the physical infrastructure market review and the business connectivity market review). In the March 2019 BT RFR Statement we imposed<sup>36</sup> these directions across the wholesale local access, narrowband and wholesale broadband access markets.
- 3.2 In this section, we set out our decision to impose on BT five regulatory financial reporting directions in relation to the physical infrastructure and business connectivity markets which are unchanged from our decision in the March 2019 BT RFR Statement. These directions are:
- the Regulatory Accounting Principles Direction;
  - the Transparency Direction;
  - the Audit of the RFS Direction;
  - the Reconciliation Report Direction: and
  - the Adjusted Financial Performance Direction.
- 3.3 We also discuss in this section our cumulo requirements following from our decisions in the 2019 PIMR and BCMR Statement.

### Regulatory Accounting Principles (RAP) Direction

#### 2018 BT RFR Consultation

- 3.4 In sections 4 and 5 of the 2018 BT RFR Consultation we proposed to impose the RAP Direction in the physical infrastructure and business connectivity markets.

#### Stakeholder comments

- 3.5 Respondents to the consultation did not raise any concerns with our proposal.

#### Our reasoning and decision

- 3.6 In the March 2019 BT RFR Statement we imposed the RAP Direction in the wholesale local access, narrowband and wholesale broadband access markets. We have decided that that the same direction should apply in respect of the physical infrastructure and business

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<sup>36</sup> The Consistency with Regulatory Decisions and RAV Direction only applies to the narrowband and wholesale broadband access markets in relation to the requirement that BT prepares the RFS on a RAV basis. The Adjusted Financial Performance Direction does not apply to the narrowband and wholesale broadband access markets.

connectivity markets. We consider that this will preserve the integrity and consistency of the RFS across all regulated markets.

## Transparency Direction

### 2018 BT RFR Consultation

3.7 In sections 4 and 5 of the 2018 BT RFR Consultation we proposed to direct BT to apply in the physical infrastructure and business connectivity markets the Transparency Direction.

### Stakeholder comments

3.8 Respondents to the consultation did not raise any concerns with our proposal.

### Our reasoning and decision

3.9 In the March 2019 BT RFR Statement we imposed the Transparency Direction in the wholesale local access, narrowband and wholesale broadband access markets. We have decided that that the same direction should apply in respect of the physical infrastructure and business connectivity markets. This direction ensures that stakeholders can get a clear understanding of BT's RFS and its compliance with the SMP conditions.

3.10 In relation to the physical infrastructure markets, the direction is of particular importance for stakeholders interested in the unrestricted Physical Infrastructure Access (PIA) remedy. Given that these markets are new, we expect stakeholders to be interested in the attribution methods which BT will use to attribute costs to the new PIA services.

3.11 The direction is also important for the business connectivity markets. For example, the direction will provide transparency in markets and technical areas where we propose to relax the SMP conditions or where we propose a dark fibre access remedy.

## Audit of the RFS Direction

### 2018 BT RFR Consultation

3.12 In sections 4 and 5 of the 2018 BT RFR Consultation we proposed to direct BT to apply in the physical infrastructure and business connectivity markets the Audit of the RFS Direction.

3.13 The direction we consulted on allowed for two types of opinion to be used for the regulatory audit: "Fairly Presents In Accordance with" (FPIA) and "Properly Prepared In Accordance with" (PPIA) opinion.

### Our reasoning and decision

3.14 In our March 2019 BT RFR Statement we decided to only direct BT to provide PPIA opinions on the RFS. This decision stemmed from the introduction by the Financial Reporting

Council of a new accounting standard from 1 January 2017, and mirrored an equivalent decision taken in the 2019 KCOM RFR Statement. The full reasons for this decision are set out in the 2019 BT RFR Statement at paragraphs 3.23-3.26.

- 3.15 For the reasons set out in the March 2019 BT RFR Statement, we have decided that that the same direction should apply in respect of the physical infrastructure and business connectivity markets. This direction is important for giving stakeholders confidence that the information in the RFS provides a fair reflection of financial performance, is free from error and has been prepared following the accounting methodology statements published by BT and relevant directions issued by Ofcom.

## Reconciliation Report Direction

### 2018 BT RFR Consultation

- 3.16 In the 2018 BT RFR Consultation we proposed two changes to the Reconciliation Report Direction that impact all regulated markets, as follows:
- an increase in the materiality threshold from £1m to £5m; and
  - the removal of schedules included in the RFS that were previously in the Reconciliation Report annex, including the removal of the percentage change tables.

### Stakeholder responses

- 3.17 While BT agreed with our proposal to increase the materiality threshold<sup>37</sup>, Vodafone and one confidential respondent ([redacted]) disagreed.<sup>38</sup> Vodafone and one confidential respondent ([redacted]) also raised some concerns in relation to the proposed removal of schedules.<sup>39</sup> We summarised these responses in the March 2019 BT RFR Statement.<sup>40</sup>

### Our reasoning and decision

- 3.18 In the March 2019 BT RFS Statement we decided to remove certain schedules included in the RFS that were previously in the Reconciliation Report appendix, including the removal of the percentage change tables, because we considered that this information is not necessary.<sup>41</sup> We explained that the calculations showing the percentage impact of methodology changes and errors were not complex or difficult for a reasonably informed reader of the RFS to calculate for themselves.

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<sup>37</sup> BT's response to the 2018 BT RFR Consultation, paragraph 3.19.

<sup>38</sup> Vodafone response to the 2018 BT RFR Consultation, paragraph 60; [redacted] Confidential response to the 2018 BT RFR Consultation, page 5.

<sup>39</sup> Vodafone response to the 2018 BT RFR Consultation, paragraph 62; [redacted] Confidential response to the 2018 BT RFR Consultation, page 5.

<sup>40</sup> March 2019 BT RFR Statement, paragraphs 3.30-3.32 and paragraphs 3.39-3.41.

<sup>41</sup> March 2019 BT RFR Statement, paragraphs 3.42-3.44.

- 3.19 Consistent with our decision in the March 2019 BT RFS Statement, we have decided that the schedules that will remain in the Reconciliation Report appendix are:
- Reconciliation Report: Impact of Methodology Changes and Errors (Introduction, description of methodology changes and description of errors);<sup>42</sup>
  - Reconciliation Report: Impact of Methodology Changes (restating the current year using the old methodologies);<sup>43</sup> and
  - Reconciliation Report: Impact of Methodology Changes on Revenue (restating the prior year for methodology changes and errors arising in the current year).<sup>44</sup>
- 3.20 Also consistent with our decision in the March 2019 BT RFS Statement,<sup>45</sup> we have decided not to increase the materiality threshold for the publication in the RFS of aggregated errors and methodology changes from £1m to £5m. We will monitor the size of the aggregated errors and methodology changes and will consider proposing an increase to the materiality threshold in the future, if the volume and aggregated amount of these changes and errors remain at their current levels.
- 3.21 The Reconciliation Report Direction will ensure transparent and consistent reporting in BT's RFS in these markets. We consider that stakeholders should be able to identify and understand errors and methodological changes from BT's previous RFS, for example, with respect to PIA services, and any potential re-attribution of costs that may arise from the introduction of the new PI market and network components.

## Adjusted Financial Performance Direction

### 2018 BT RFR Consultation

- 3.22 In sections 4 and 5 of the 2018 BT RFR Consultation we proposed to direct BT to apply in the physical infrastructure and business connectivity markets the Adjusted Financial Performance Direction.

### Stakeholder comments

- 3.23 Respondents to the consultation did not raise any concerns with our proposal.

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<sup>42</sup> Currently found on pages p109, 113 to 115 and 131 in the 2017/18 RFS.

<sup>43</sup> Currently found on pages p116, 118 and 120 in the 2017/18 RFS. These are used to disclose the changes to Regulatory Accounting Methodology.

<sup>44</sup> Currently found on pages p110, 111 and 112 in the 2017/18 RFS. These are used to disclose the methodology changes and errors corrected in the prior year comparatives.

<sup>45</sup> March 2019 BT RFR Statement, paragraphs 3.33-3.35.

## Our reasoning and decision

- 3.24 In the March 2019 BT RFR Statement we imposed the Adjusted Financial Performance Direction in the wholesale local access market.<sup>46</sup>
- 3.25 We have decided that that the same direction should apply in respect of the physical infrastructure and business connectivity markets. The direction will ensure transparent and consistent reporting in BT's RFS across the regulated markets.
- 3.26 We have also decided to direct BT to reflect certain adjustments in relation to the physical infrastructure and business connectivity markets in the RFS or in the Additional Financial Performance schedules. We discuss these in section 4 and 5 below.

## Cumulo rates

- 3.27 Our cumulo requirements follow from our decisions in the 2019 PIMR and BCMR Statement. We therefore address these requirements in this section, although they have implications across all markets.
- 3.28 Cumulo rates are the non-domestic rates that BT pays on its rateable network assets (primarily passive assets such as duct, fibre, copper and exchange buildings) in the UK. It is called a 'cumulo' assessment because all the rateable assets are valued together. Within the RFS BT attributes its cumulo rates costs across services in accordance with our directions.<sup>47</sup> When setting charge controls we generally include recovery of an appropriate share of BT's forward looking cumulo costs.
- 3.29 With respect to duct and other PIA assets, it is the occupation of those assets (for example, by lighting fibre, or by connecting equipment to copper lines) that triggers the rating liability, not the existence of the asset. With respect to dark fibre, rating precedent has determined that as a general principle, the person who lights the fibre is in rateable occupation.<sup>48</sup>

## 2018 BT RFR Consultation

- 3.30 In the 2018 PIMR Consultation we proposed four new physical infrastructure markets and an unrestricted PIA remedy, and in our 2018 BCMR Consultation we proposed a dark fibre remedy for inter-exchange connectivity.

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<sup>46</sup> In our 2019 BT RFR Statement we explained that this direction did not previously apply in the narrowband and wholesale broadband access markets because in the 2017 NMR Statement we did not make any regulatory decisions that needed to be reflected in the additional financial performance schedule, and in the 2018 WBA Statement we did not impose any charge controls in these markets. See footnotes 32 and 33. Therefore, we did not impose this direction in these markets.

<sup>47</sup> The most recent requirements on BT in relation to attribution of cumulo rates are set out in the 2018 WLA Statement, Annex 33.

<sup>48</sup> 2018 BCMR Consultation, paragraph A20.72, and paragraph 5.2 of Section 871 of the VOA's 2017 Rating Manual: <https://www.gov.uk/guidance/rating-manual-section-6-part-3-valuation-of-all-property-classes/section-871-telecommunications-fibre-optic-networks>.

- 3.31 PIA and dark fibre prices do not include any contribution to BT's cumulo rates costs. However, in contrast BT is currently required to attribute cumulo costs across all the rateable assets including physical infrastructure assets such as PIA assets (duct, manholes, junction boxes and poles), as well as other passive assets such as copper and fibre. We proposed two changes to the current cumulo attribution requirement from 2019/20 to address this contradiction:
- a) First, BT's cumulo costs should be attributed across those rateable assets that have not been included within the physical infrastructure markets. This implied that BT's cumulo costs would not be attributed to PIA services.
  - b) Secondly, BT's cumulo costs should not be attributed to dark fibre services provided to telecoms providers other than BT.<sup>49</sup>

## Stakeholder responses

- 3.32 Stakeholders responded on three issues:
- a) passive elements omitted from the attribution base for internal services;
  - b) inadvertent indirect attribution to passive elements within external active services; and
  - c) attributions to dark fibre.

### Passive elements omitted from the attribution base for internal services

- 3.33 Vodafone wanted Ofcom to ensure that, whilst BT should attribute cumulo costs to the active services it purchased, the attribution should reflect the use of all the rateable assets, including assets used to supply PIA services such as duct in addition to the active element.

### Inadvertent indirect attribution to passive elements within external active services

- 3.34 Vodafone<sup>50</sup> also noted that cumulo costs should be attributed across all active products in line with the general principle that it is the occupation of those assets that triggers the rating. It noted that active product cost stacks include passive infrastructure asset costs but also that dark fibre products sold to telecoms providers would also include infrastructure costs in their price and was concerned that currently telecoms providers might pay contributions to cumulo rates on any passive access products they purchased indirectly. This concern was shared by UKCTA.<sup>51</sup>

### Attributions to dark fibre

- 3.35 BT<sup>52</sup> agreed that the implementation of the PIA and dark fibre remedies will have implications for the attribution of cumulo rates costs and that cumulo costs should not be attributed to PIA services. However, it did not agree that cumulo costs should be attributed

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<sup>49</sup> Dark fibre services consumed by other parts of BT should receive an attribution of BT's cumulo rates costs.

<sup>50</sup> See Vodafone response to the 2018 BT RFR Consultation, paragraphs 54-57.

<sup>51</sup> UKCTA response to the 2018 BT RFR Consultation, page 3.

<sup>52</sup> BT response to the 2018 BT RFR Consultation, paragraphs 3.11 to 3.16.

to internal dark fibre services. It proposed that any cumulo liabilities incurred on internal dark fibre should be attributed to the downstream services, thereby making the treatment consistent with that of external dark fibre services and PIA services. It also proposed revised wording to the legal instruments to achieve this.

- 3.36 TalkTalk<sup>53</sup> noted that BT incurs cumulo costs on Ethernet (or WDM) circuits that use dark fibre services. However, when BT sells dark fibre services to other telecoms providers it would not incur cumulo costs. TalkTalk interpreted our proposals to mean that when BT does incur cumulo costs these would be attributed to dark fibre services. It felt it would be more appropriate for these costs to be attributed to the Ethernet service (not the dark fibre service) since it is the addition of Ethernet equipment (and the associated lighting of the fibre) that results in BT being liable for cumulo costs

## Our reasoning and decisions

- 3.37 In Volume 1 of the 2019 PIMR and BCMR Statement we identified four new physical infrastructure markets and imposed the unrestricted PIA remedy. Rating liability when duct is occupied will be triggered by an operator when it installs fibre in the duct, connects equipment to that fibre and so lights it. We therefore require, as in our consultation proposals, that none of BT's cumulo costs should be attributed to services within the PI market.

### Passive elements omitted from the attribution base for internal services

- 3.38 Currently we direct BT to attribute its cumulo rates costs using the Profit Weighted Net Replacement Cost methodology.<sup>54</sup> Under this methodology costs are attributed to rateable assets – both physical infrastructure assets within the PI market (such as duct) and physical infrastructure assets outside the PI market (such as copper and fibre). Our first consultation proposal was to exclude the net replacement costs of rateable physical infrastructure assets used to provide PIA services, notably duct, within the attribution of BT's cumulo costs. This would mean that no cumulo costs would be attributed to PIA services. Cumulo costs would be attributed across services using the costs of the other rateable physical infrastructure assets: mainly, copper, fibre and exchange buildings.
- 3.39 A consequence of this proposal, as Vodafone noted, is that it reduces the impact of rateable physical infrastructure assets in the PI market, mainly duct, within the attribution. So, for example, an active service that used a lot of duct might receive the same attribution of cumulo costs as an active service that used no duct. BT's cumulo costs however reflect the use of all of BT's rateable assets, including physical infrastructure assets in the PI market such as duct. There is then a strong argument that attributions of BT's cumulo costs

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<sup>53</sup> TalkTalk response to the 2018 BT RFR Consultation, paragraph.

<sup>54</sup> We have discussed this methodology and its history extensively in other consultations and statements. See for example Annex 23 of the 2018 WLA Statement and Annex 17 of the 2017 WLA Consultation.

should reflect each service's use of all the rateable assets, including physical infrastructure assets in the PI market.<sup>55</sup>

- 3.40 In practice neither our definition of cumulo rateable assets nor how we specified net replacement costs within the cumulo attribution formulae within the proposed directions excluded physical infrastructure assets in the PI market, contrary to what we had proposed. BT's response however sought to update our proposal and clarify that net replacement costs should include assets associated with the internal charges for passive services.<sup>56</sup> We agree that BT's suggestion presents an improvement and so we have decided to adopt it. We have therefore amended our direction to clarify that the NRC of the rateable assets include assets within the internal charges for passive services. This then addresses both BT's and Vodafone's concerns: a service's attribution of BT's cumulo costs will reflect the use of all rateable assets, including those used to provide PIA services.

#### **Inadvertent indirect attribution to passive elements within external active services**

- 3.41 In the 2019 PIMR and BCMR Statement we imposed a dark fibre remedy for inter-exchange connectivity. The liability on any dark fibre rented from Openreach will be incurred by the telecoms provider renting the fibre when it connects equipment to and then "lights" the fibre. The prices that we have set for dark fibre services as part of the BCMR do not include any contribution to BT's cumulo rates costs.<sup>57</sup> As a corollary we require that none of BT's cumulo rates costs are attributed to dark fibre services that it sells to other telecoms providers. This then addresses the concerns raised by Vodafone and UKCTA.

#### **Attributions to dark fibre**

- 3.42 There is an issue with dark fibre that may be purchased and subsequently lit by other parts of BT. These internal dark fibres may be used for a variety of purposes. The rates liability for such fibre, when lit, would fall on BT Group and so such fibres should at some stage receive an attribution of BT's cumulo rates costs. The treatment of internal dark fibre is then potentially different to that for dark fibre rented to other telecoms providers. Our second proposal sought to make this distinction to ensure that dark fibre used to provide internal dark fibre services would attract an appropriate attribution of BT's cumulo costs, analogous to the attribution to other active services. As noted above, BT acknowledged that dark fibre it rented should attract rates but disagreed with how this attribution should occur.
- 3.43 BT's suggestion was to also exclude fibre used to provide external dark fibre services.<sup>58</sup> We are not convinced that this would result in services that used internal dark fibre ultimately receiving any attribution of BT's cumulo costs. For this to happen the downstream service and the dark fibre input service would have to be identified along with the NRC of the

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<sup>55</sup> Further, our proposal would have changed the attribution of BT's cumulo costs to services, though any changes would have been small as attributions of duct costs to services generally follow the attribution of the cables within those ducts.

<sup>56</sup> BT response to the 2018 BT RFR Consultation, Annex 1, paragraph 8.2.

<sup>57</sup> Section 4, Volume 3 and Annex 20 of the 2019 PIMR and BCMR Statement.

<sup>58</sup> BT response to the 2018 BT RFR Consultation, Annex 1, paragraph 8.1.



relevant assets of the input dark fibre service. This may be possible – these services are new and will need new reporting requirements – but it is not guaranteed. We have therefore decided not to adopt BT’s proposal but to retain our original second proposal above. The result of this decision is that the cost stack for internal dark fibre services would include an extra amount for attribution of cumulo rates. This may appear at odds with rating precedent, but it will guarantee that an appropriate amount of BT’s cumulo rates costs is effectively attributed to downstream ‘lit’ services, which is the issue we are trying to address.

- 3.44 Our second proposal also addresses TalkTalk’s concern. Rates will be attributed to the downstream BT service on the basis that the dark fibre rented from Openreach will be lit. We also do not know how TalkTalk’s proposal could be implemented. The BT internal “lit” service may not be an Ethernet service, there are many types of equipment that can be used to light the fibre and it is difficult to associate rates with equipment costs as general electronic equipment are not rateable assets.
- 3.45 We intend to monitor the impact of our decisions in BT’s 2019/20 RFS and if necessary re-consult on the attribution of BT’s cumulo rates costs as part of the Fixed Telecoms Market Review.

## 4. Regulatory financial reporting specific to the physical infrastructure markets

- 4.1 As noted in Section 3, in the 2018 BT RFR Consultation we proposed to impose on BT a set of eight regulatory financial reporting directions that would apply in all regulated markets (including new markets we proposed to identify under the physical infrastructure market review and the business connectivity market review). In the March 2019 BT RFR Statement we imposed these directions across the wholesale local access, narrowband and wholesale broadband access markets.<sup>59</sup>
- 4.2 In Section 3, we set out our decision to impose on BT five regulatory financial reporting directions in relation to the physical infrastructure and business connectivity markets which are unchanged from our decision in the March 2019 BT RFR Statement.
- 4.3 In this section, we set out decisions in relation to the remaining three regulatory financial reporting directions that contain obligations that are specific to the physical infrastructure markets. These directions are:
- the Consistency with Regulatory Decisions and Regulatory Asset Value Direction;
  - the Preparation, Delivery, Publication, Form and Content of the RFS Direction; and
  - the Network Components Direction.

We also discuss market specific adjustments for the purposes of the Adjusted Financial Performance direction.

### Consistency with Regulatory Decisions and Regulatory Asset Value Direction and Additional Financial Performance Direction

- 4.4 In Section 5, Volume 1 of the 2019 PIMR and BCMR Statement, we explain that the PIA network access obligation includes a requirement on Openreach to make certain adjustments to its network. These adjustments are those necessary to make Openreach's physical infrastructure network available to telecoms providers for the purpose of deploying their own networks.
- 4.5 In Section 6, Volume 1 of the 2019 PIMR and BCMR Statement we decided that the costs of network adjustments should be recovered from all users of the infrastructure up to a financial limit of £4,750 per km. Any network adjustment costs incurred above the financial limit should be recovered directly from the telecom's provider requesting the network adjustment, through ancillary charges.

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<sup>59</sup> The Adjusted Financial Performance Direction was not imposed in the narrowband and wholesale broadband access markets.

- 4.6 In this section we set out our decisions on the specific regulatory financial reporting requirements relating to network adjustments carried out by Openreach (above and below the financial limit of £4,750 per km). The purpose of these requirements is to allow Ofcom and stakeholders to monitor BT's compliance with its requirements for how network adjustments costs should be recovered, and the requirement for no-undue discrimination, as set out in the 2019 PIMR and BCMR Statement.<sup>60</sup>

## Scope of network adjustments reporting

### 2018 BT RFR Consultation

- 4.7 In the 2018 BT RFR Consultation we noted that "the no-undue discrimination requirement proposed in the 2018 PIMR Consultation applies to all network adjustments carried out to support BT's own downstream services, irrespective of whether they relate to the fibre or copper networks.<sup>61</sup> Therefore, network adjustment costs incurred to support any of BT's downstream services should be recovered in the same way as network adjustments requested by other telecoms providers, unless BT can demonstrate that a different approach can be justified".<sup>62</sup> We proposed that our financial reporting requirements reflect this.<sup>63</sup>

### Stakeholder responses

- 4.8 Stakeholders generally agreed with our proposal.
- 4.9 BT said that "the reporting of internal network adjustments should be limited to FTTP roll out and should exclude those network adjustments incurred in the provision of other technologies. The reporting of network adjustments in this way will allow users of the RFS to benchmark network adjustments incurred in rolling out [BT's] Fibre Cities / FTTP programme with those incurred by operators building alternative FTTP networks using DPA".<sup>64</sup>
- 4.10 UKCTA was concerned that in the past BT has been able to revalue its passive assets upwards (through commissioning hypothetical re-build studies), which it felt could have a serious impact on the price of passive services in the longer term.<sup>65</sup>

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<sup>60</sup> See Volume 1, 2019 PIMR and BCMR Statement, paragraphs 4.22-4.39 and 6.4-6.24.

<sup>61</sup> The no-undue discrimination requirement imposed in the 2018 WLA Statement similarly applies to all network adjustments carried out to support BT's own downstream services which fall within the WLA market, irrespective of whether they relate to the fibre or copper networks. Therefore, in the WLA market network adjustment costs incurred to support any of BT's downstream services should also be recovered in the same way as network adjustments requested by other telecoms providers, unless BT can demonstrate that a different approach can be justified.

<sup>62</sup> 2018 BT RFR Consultation, paragraph 4.7.

<sup>63</sup> Were BT to demonstrate that a different treatment for some network adjustments is justified (in either the WLA or physical infrastructure markets), the reporting requirements would need to reflect this.

<sup>64</sup> BT response to the 2018 BT RFR Consultation, paragraph 4.8.

<sup>65</sup> UKTA response to the 2018 RFR Consultation, page 4.

## Our reasoning and decisions

- 4.11 We have decided that it is both appropriate and proportionate to adopt the proposals with respect to the scope of network adjustments reporting set out in our consultation with a minor amendment to the requirement to report on internal network adjustments.
- 4.12 We disagree with BT's comment that that regulatory financial reporting for internal network adjustments should only apply to its FTTP network rollout. This would make regulatory financial reporting for network adjustments inconsistent with how they are regulated. As set out in the 2019 PIMR and BCMR Statement, the no-undue discrimination requirement applies to all network adjustments that are carried out to support BT's own downstream services, irrespective of whether they relate to the fibre or copper networks. We also said that "while the Fibre First programme processes may in many cases be one useful benchmark when considering process alignment, the scope of the no undue discrimination covers Openreach's full product range, including those on the copper and leased lines networks."<sup>66</sup>
- 4.13 In terms of regulatory financial reporting, in the 2019 PIMR and BCMR Statement we said that "if Openreach undertakes network adjustments to support BT's own deployments, it should charge itself internal transfer charges which are consistent with the charges for network adjustments faced by competing telecoms providers using PIA (to the extent that a different approach cannot be justified). This means that costs of network adjustments above the financial limit which are incurred to support BT's own deployments should be attributed entirely to Openreach's downstream products, and not spread across all users of the physical infrastructure".<sup>67</sup> Therefore, we consider that BT's regulatory financial reporting must be consistent with the pricing approach which is applicable to all technologies.
- 4.14 We do however recognise that there may be practical issues for BT setting up processes for reporting internal network adjustments that are identical to those for external network adjustments. According to BT, these include:
- a) how to re-engineer process and supplier arrangements to record the numbers and types of network adjustments;
  - b) how to separate the costs between network adjustments from other costs; and
  - c) how to define the geographical area for financial limit in order to calculate the average costs per kilometre, required to assess whether network adjustments are above or below the financial limit.<sup>68</sup>
- 4.15 In relation to FTTP, BT noted that "[it is] working to ensure [its] processes for the Fibre Cities / FTTP programme are equivalent with the relevant DPA activities".<sup>69</sup> Therefore, we expect BT to report its internal network adjustments made for the purposes of FTTP rollout

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<sup>66</sup> 2019 PIMR and BCMR Statement, Volume 1, paragraph 4.87.

<sup>67</sup> 2019 PIMR and BCMR Statement, Volume 1, paragraph 4.88.

<sup>68</sup> BT response to the 2018 BT RFR Consultation, paragraph 4.11.

<sup>69</sup> BT response to the 2018 BT RFR Consultation, paragraph 4.10.

in the same way as the reporting of external network adjustments. We will work with BT to help them develop appropriate methods for this purpose.

- 4.16 In relation to other (non-FTTP) technologies, BT noted that “[it] would need to develop additional methods to extend these measures to cover all of Openreach’s systems, processes and operations across all its different technologies”.<sup>70</sup> We acknowledge that in this case setting up identical reporting of internal and external network adjustments may involve significant re-engineering of BT’s legacy processes. Nevertheless, as noted above, the no undue discrimination requirement and the network adjustment requirement imposed on BT in the 2019 PIMR and BCMR Statement cover all technologies including non-FTTP. Therefore, BT should use its best endeavours to report these internal network adjustments in the same way as it reports external network adjustments, unless there are objectively justifiable reasons why this is not possible. We have amended the relevant directions<sup>71</sup> to reflect this.
- 4.17 In response to UKCTA, we note that when setting prices, including the maximum charges for PIA services, we rely not only on BT’s RFS, but on a range of sources, such as data collected through our information gathering powers. Also, as explained in paragraph 2.15, 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).<sup>72</sup>

## Network adjustments above the financial limit

### 2018 BT RFR Consultation

- 4.18 In the 2018 BT RFR Consultation, we proposed that all costs relating to network adjustments above the financial limit should be identified and recorded separately from other infrastructure costs and treated as an operating expense within the PI market. We proposed that this also applies to the costs of network adjustments undertaken to support BT’s own downstream services.<sup>73</sup>
- 4.19 In terms of the accounting treatment for network adjustments above the limit for BT’s downstream services, i.e. the internal sales from the PI market to regulated and unregulated services, we proposed that, so long as the treatment was transparent and in accordance with the RAP, BT could choose to separately capitalise the transfer charges within the relevant markets and attribute to services.<sup>74</sup>

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<sup>70</sup> BT response to the 2018 BT RFR Consultation, paragraph 4.12.

<sup>71</sup> Direction 3, Schedule C, Part 2, paragraphs 2, 4 and 6.

<sup>72</sup> In any case, BT’s passive assets are now all valued on an indexed historic basis (with varying indexes) rather than an absolute valuation. Any changes to the valuation basis would need to go through the CCN process.

<sup>73</sup> 2018 BT RFR Consultation, paragraph 4.9.

<sup>74</sup> 2018 BT RFR Consultation, footnote 95.

## Stakeholder responses

- 4.20 Stakeholders generally agreed with our proposals.
- 4.21 TalkTalk did not raise any concerns with our proposed accounting treatment in respect of external network adjustments. However, it suggested an alternative approach where the network adjustments above the financial limit are capitalised as an asset which would then be excluded from the regulated cost base, rather than be expensed.<sup>75</sup>
- 4.22 Vodafone was concerned that BT was recognising costs and revenues differently between the RFS and the BT Group statutory financial statements and that BT was not complying with the International Financial Reporting Standards 15 (IFRS 15<sup>76</sup>).<sup>77</sup>
- 4.23 In respect of our proposal to allow BT to capitalise the transfer charges for internal network adjustments within the downstream markets, BT proposed discussing with us an appropriate capitalisation policy and potential differences in accounting treatment between BT's RFS and the BT Group statutory financial statements.<sup>78</sup>

## Our reasoning and decisions

- 4.24 We have decided that it is both appropriate and proportionate to adopt the proposals set out in our consultation in relation to network adjustments above the financial limit with minor clarification.
- 4.25 The purpose of our decision to require BT to expense network adjustment charges above the financial limit is to prevent potential double recovery in relation to external charges and ensure that the internal charges are accounted for on a consistent basis.
- 4.26 Our decision is designed to ensure that network adjustment costs above the financial limit paid for by other telecoms providers are not recovered again through SMP network access services in future; and that network adjustment costs above the financial limit incurred to support BT's own downstream services are not recovered through PIA infrastructure services in future.<sup>79</sup>
- 4.27 We agree with TalkTalk that capitalising the costs of external network adjustments above the financial limit and excluding them from the cost base would be an alternative way to prevent double recovery. We also agree that this approach would bring an additional benefit in that the asset base within the RFS would reflect the full extent and value of Openreach's network.<sup>80</sup> However, we think that this information can be provided more effectively by changing the requirements relating to public information in the RFS.

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<sup>75</sup> TalkTalk response to the 2018 BT RFR Consultation, paragraph 14.

<sup>76</sup> See IFRS 15 Revenue from Contracts with Customers, <https://www.ifrs.org/issued-standards/list-of-standards/ifrs-15-revenue-from-contracts-with-customers/>. This impacts services where the contractual agreements are typically longer than 12 months.

<sup>77</sup> Vodafone response to the 2018 BT RFR Consultation, paragraphs 75-78.

<sup>78</sup> BT response to the 2018 BT RFR Consultation, paragraph 4.15.

<sup>79</sup> BT may recover these costs from any SMP network access service that the network adjustment was undertaken to support.

<sup>80</sup> TalkTalk response to the 2018 BT RFR Consultation, paragraph 14.

Accordingly, as set out in paragraph 4.61 below, we have decided to amend the Preparation, Delivery, Publication, Form and Content of the RFS Direction to require BT to publish in an appendix to the RFS the costs it has expended, restated as accumulated MCE, in relation to network adjustments above the financial limit (both internal and external). This additional disclosure will allow stakeholders to restate BT's MCE by including all expensed network adjustment costs above the financial limit. We have therefore decided to maintain the requirement that costs relating to network adjustments above the financial limit should be treated as an operating expense in the PI market.

- 4.28 In response to Vodafone, we do not necessarily consider divergent accounting treatments, such as where the RFS does not comply with IFRS standards, to be a concern. As we set out in the 2018 BT RFS Consultation, the RAP is applied in order of priority, and the principle of ensuring the RFS is consistent with our regulatory decisions has a priority over the principle that the RFS are consistent with statutory reporting requirements.<sup>81</sup> For example, where we direct BT to change its accounting treatment in the RFS to reflect how we set prices, the resulting RFS treatment could be inconsistent with IFRS standards. In addition, as set out in paragraph 4.48e below, we have directed BT to disclose information in the RFS that will reconcile the RFS revenue to the IFRS 15 revenue in BT Group statutory financial statements.
- 4.29 We welcome BT's request for a discussion of its capitalisation policies as part of our ongoing dialogue on the RFS. We expect that this discussion will be wider than network adjustments above the limit and will cover all assets paid for in advance by third parties, such as grant funded assets, and potentially the disclosures required in the downstream markets in the RFS. In order to ensure the reporting of internal network adjustments above the financial limit that are capitalised within downstream markets is consistent with the charging principle, we consider that a new network component is required to identify if these costs are being attributed to downstream regulated services. We discuss this below in paragraphs 4.113 to 4.116.

## Network adjustments below the financial limit

### 2018 BT RFR Consultation

- 4.30 In the 2018 BT RFS Consultation, we proposed that network adjustments below the financial limit should be identified and recorded in the RFS separately from other infrastructure costs. We considered that these costs should be appropriately capitalised and recovered over the network services (including those in relation to supporting BT's own downstream services) which use BT's physical infrastructure.<sup>82</sup>

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<sup>81</sup> 2018 BT RFR Consultation, paragraph 4.11.

<sup>82</sup> 2018 BT RFR Consultation, paragraphs 4.13-4.15.

### Stakeholder responses

- 4.31 Stakeholders generally agreed with our proposals.
- 4.32 Whilst BT agreed with our proposals, they had specific concerns about certain disclosure proposals.<sup>83</sup> We consider it is more appropriate to respond to these concerns in paragraph 4.62 below because the relevant disclosure proposals were included in the Preparation, Delivery, Publication, Form and Content of the RFS Direction.

### Our reasoning and decisions

- 4.33 We have decided that it is both appropriate and proportionate to adopt the proposals set out in our consultation in relation to network adjustments below the financial limit without any modification.
- 4.34 Consistent with our decisions in the 2018 WLA Statement, we have decided that network adjustments below the financial limit should be identified and recorded in BT's RFS separately from other infrastructure costs. BT should ensure that the network adjustment costs below the financial limit are appropriately capitalised within the PI market and recovered over network services (including those in relation to supporting BT's own downstream services) which use BT's physical infrastructure.
- 4.35 While we appreciate that network adjustment costs in total are unlikely to be significant in 2019/20, our assumption is that they will grow to £[<]m in capital terms in the next two years. We consider that it is therefore proportionate for BT to separately record these costs on an FAC basis in advance of them becoming material.

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<sup>83</sup> BT response to the 2018 BT RFR Consultation, paragraphs 4.17 and 4.18.



**Table 4.1: Summary of decisions in relation to the Consistency with Regulatory Decisions and Regulatory Asset Value Direction**

	Requirements on treatment in the RFS
Network adjustment costs above the financial limit	<ul style="list-style-type: none"> <li>• BT will identify and record network adjustment costs above the financial limit separately from other infrastructure costs.</li> <li>• BT will ensure that network adjustments above the financial limit are treated as an operating cost in the PI market.</li> <li>• The costs will be recovered from the telecoms provider (including BT) requesting the network adjustment.</li> </ul>
Network adjustment costs below the financial limit	<ul style="list-style-type: none"> <li>• BT will identify and record network adjustment costs below the financial limit separately from other infrastructure costs.</li> <li>• BT will ensure any costs incurred for network adjustments below the financial limit are appropriately capitalised in the PI market and attributed to all network access services that use the physical infrastructure.</li> </ul>

Source: Ofcom

## Adjusted Financial Performance Direction

- 4.36 We have imposed the Adjusted Financial Performance Direction in the March 2019 BT RFR Statement, in relation to the wholesale local access market and in Section 5 of this Statement, in relation to the business connectivity markets. In both decisions this direction includes a requirement for BT to disclose the impact of smoothing restructuring charges and property provision costs in both the wholesale local access market and business connectivity markets.
- 4.37 In the 2018 BT RFR Consultation, whilst we proposed applying the Adjusted Financial Performance Direction to the physical infrastructure markets, we did not set out details of any adjustments to be included. This was because we did not impose a cost-based charge control in relation to services within the physical infrastructure markets that would have given rise to specific adjustments in relation to PIA services.
- 4.38 As set out in paragraphs 4.72 to 4.73 below, we have decided to require BT to report PIA services, including the new service “Physical Infrastructure for Active Services” from 2019/20.<sup>84</sup> This service will be an input from the physical infrastructure markets into WLA and BCMR active services in their respective markets.<sup>85</sup> When setting charge controls in the wholesale local access and business connectivity market reviews, the passive infrastructure costs within these network components form part of our analysis.
- 4.39 In respect of the smoothing restructuring charges and property provision cost, we directed in the WLA and are doing so in the BCMR, that BT should calculate the adjustment with

<sup>84</sup> And to disaggregate this into the services ‘Spine Duct’, ‘Lead in Duct’, ‘Poles’, ‘Manholes’ and ‘Junction Boxes’ from 2020/21 once service volumes exceed £5m.

<sup>85</sup> Currently the costs of these passive input services are reported within network components such as ‘D Side Copper and Duct’ and ‘Ethernet Access Direct Fibre’ disclosed in the relevant WLA and BCMR services.

reference to costs included within our charge control analysis. These include passive infrastructure costs within network cost components within WLA and BCMR services, that will be reported within the PI market from 2019/20. It is our opinion therefore that if BT is not required to calculate and disclose the impact of the adjustment in respect of the PI market, the integrity of the RFS will be undermined as only a partial impact of the adjustment (as it relates to the active elements of WLA and BCMR services) will be calculated and disclosed in the RFS.

- 4.40 We have therefore decided that adjustment e) in Table 5.2 should be included in BT’s Adjusted Financial Performance schedule for the PI market. We set out in Table 4.2 below how BT should reflect the adjustment in the Adjusted Financial Performance schedule.

**Table 4.2: Adjustments to be made in BT’s Adjusted Financial Performance schedule**

Adjustment	Required treatment in the Adjusted Financial Performance schedule
Restructuring charges and property provision costs	Show the impact of removing the actual movement on Restructuring costs and the Property Rationalisation provision and replacing it with one calculated based on a three-year average.

## Preparation, Delivery, Publication, Form and Content of the RFS Direction

- 4.41 In this section we set out our decisions on the Preparation, Delivery, Publication, Form and Content of the RFS Direction with respect to the physical infrastructure markets. We first set out our decision in relation to public reporting, which is included in the published RFS, and then private reporting, which is provided to Ofcom only.

### Requirements relating to public information in the RFS

- 4.42 This is information that we consider should be published in BT’s RFS on the basis that it would give stakeholders reasonable confidence that BT has complied with its SMP conditions, allow them to contribute to the regulatory regime and is consistent with the other remedies imposed. For example, if the remedy is in the form of a charge control on individual services or baskets of services, information should be published relating to those services or baskets of services.<sup>86</sup>

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<sup>86</sup> In certain circumstances, we may decide that BT needs to publish regulatory financial data that goes beyond the level of the remedy to give stakeholders reasonable confidence that BT has complied with its SMP conditions and allow them to contribute to the regulatory regime. For example, in the 2016 BCMR Statement, given the broad baskets used in that charge control, we decided that BT must publish financial information on certain individual services (see paragraphs 16.44 - 16.46 and 16.52 – 16.61).

4.43 In the published RFS, financial information on regulated markets broadly falls into four categories: BT level information; market level information; service level information; and cost components for reported services. We discuss these in turn below.

#### **BT level information**

4.44 BT level information shows how regulated markets fit within the BT business and reconciliations to the statutory accounts and Openreach information.

#### 2018 BT RFR Consultation

4.45 In the 2018 BT RFR Consultation we proposed several changes to the BT level information published in the RFS which were originally requested by BT in a letter to Ofcom:<sup>87</sup>

- a) a formatting change to the “Performance Summary by Market”, “Attribution of Wholesale Current Costs” and “Attribution of Wholesale Current Cost Mean Capital Employed” schedules;
- b) combining certain cost categories in the “Attribution of Wholesale Current Costs” and “Attribution of Wholesale Current Cost Mean Capital Employed” schedules;
- c) the removal of inter-market revenues and costs from the “BT Reconciliation Statement – Consolidated Profit and Loss Account” and inclusion within the “Summary of Market Performance” schedule;
- d) changes to the schedules that reconcile the RFS to BT’s plc financial statements; and
- e) how to reflect IFRS 15 within the RFS.

#### Stakeholder comments

4.46 Stakeholders provided a number of comments on the substance of the above proposals which we summarise and address in Section 3 of the March 2019 BT RFR Statement.

4.47 No stakeholder raised any concerns in relation to how these requirements would specifically apply to the physical infrastructure markets.

#### Our reasoning and decisions

4.48 As set out in the March 2019 BT RFS Statement,<sup>88</sup> we have decided to impose changes to some of the schedules that BT is required to produce on a BT wide basis. These changes are:

- a) Formatting changes to the “Performance Summary by Market”, “Attribution of Wholesale Current Costs” and “Attribution of Wholesale Current Cost Mean Capital Employed” schedules. These formatting changes were required in order to increase the prominence of Openreach information in these schedules.

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<sup>87</sup> Letter from [redacted] (BT) to [redacted] (Ofcom), dated 28 September 2018, entitled ‘BT Regulatory Financial Statement simplification proposals’.

<sup>88</sup> March 2019 BT RFR Statement, paragraphs 3.45-3.81.

- b) Combining certain cost categories in the “Attribution of Wholesale Current Costs” and “Attribution of Wholesale Current Cost Mean Capital Employed” schedules. These changes were required to remove some non-material cost headings and improve the cost heading descriptions.
  - c) Removing inter-market revenues and costs from the “BT Reconciliation Statement – Consolidated Profit and Loss Account” schedule. These changes were made to remove reconciling items that were no longer required.
  - d) Changes to the schedules that reconcile the RFS to BT’s plc financial statements. We decided that combining the BT and Openreach profit and loss reconciliations within one schedule is consistent with the new market performance and cost attribution schedules.
  - e) Disclosure of IFRS 15. As a result of BT’s adoption of IFRS 15 in its statutory financial statements, we decided that in regulated markets where this would create revenue reconciling items, BT must disclose an additional ‘IFRS 15 deferred revenue’ line within the relevant market summary schedules to reconcile RFS revenue back to the revenue in BT’s statutory accounts, recorded on an IFRS 15 basis. We also decided that any SLG payments should be disclosed as a credit to revenue rather than an operating cost at the relevant market level, i.e. SLG costs must still appear in the total FAC costs for each relevant service.
- 4.49 Consistent with our decision in the March 2019 BT RFS Statement, we have decided to extend the above requirements to the physical infrastructure markets. This extension will ensure the integrity and consistency of the RFS.

### Market level information

- 4.50 Market level information includes information on the revenues, operating costs, capital employed and returns on MCE for a specific market. It is presented in the sections “Summary of Market Performance” and “Attribution of Wholesale Current Costs and Mean Capital Employed” of the RFS.
- 4.51 We set out our market definitions and our rationale behind them in Volume 1, Section 3 of the 2019 PIMR and BCMR Statement. We identified one product market – the supply of wholesale access to telecoms physical infrastructure for deploying a telecoms network – and four geographic markets:
- a) BT only areas;<sup>89</sup>

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<sup>89</sup> Areas where there is no or limited alternative to BT.

- b) areas with alternative telecoms physical infrastructure that has been deployed to support multi-service networks, but excluding High Network Reach areas;<sup>90</sup>
- c) High Network Reach areas excluding the Central London Area (“HNRs”);<sup>91</sup> and
- d) the Central London Area (“CLA”).<sup>92</sup>

#### 2018 BT RFR Consultation

- 4.52 In the 2018 BT RFS Consultation we proposed that BT must publish the revenue, operating costs, mean capital employed and returns for the physical infrastructure markets on a national basis. In practice, this would mean that the physical infrastructure markets would be included in the sections “Summary of Market Performance” and “Attribution of Wholesale Current Costs and Mean Capital Employed” in the RFS.
- 4.53 In respect of network adjustments below the financial limit, we proposed that BT must disclose the MCE attributed to each downstream market as an appendix to the RFS. We proposed the appendix would disclose internal and external MCE (where this is over £5m) and total network adjustments below the financial limit attributed to each downstream market.

#### Stakeholder responses

- 4.54 Stakeholders generally agreed with our proposals.
- 4.55 IIG said that reporting for the physical infrastructure markets should be done separately for each geographic market, as this information is likely to be useful for Ofcom as well as other operators in the analysis of BT’s costs by market.<sup>93</sup>
- 4.56 BT disagreed with our proposal to disclose the MCE attributed to each downstream market in respect of network adjustments below the financial limit in the appendix to the RFS. It said that “a more relevant disclosure for stakeholders would be the total value of MCE in the PI market relating to network adjustments under the financial limit and the split of this into those adjustments made at the request of external PI customers and those made for internal purposes”.<sup>94</sup>

#### Our reasoning and decision

- 4.57 We have decided that it is both appropriate and proportionate to adopt the proposals set out in our consultation for market level reporting with the exception of the appendix for the PI market that sets out the MCE of network adjustments below the limit attributed to each downstream market.

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<sup>90</sup> In Volume 1 of the 2019 PIMR and BCMR, for shorthand, we refer to these areas as ‘**Alternative Multi-service Network**’ areas. In practice, Virgin Media is expected to be the only significant operator of such infrastructure over this review period.

<sup>91</sup> Areas outside the Central London area with a high presence of rival telecoms physical infrastructure deployed to support leased lines networks.

<sup>92</sup> An area in central London with a uniquely high presence of rival telecoms physical infrastructure deployed to support leased lines networks.

<sup>93</sup> IIG response to the 2018 PIMR, BCMR and BT RFR Consultations, paragraph 15.2.4.

<sup>94</sup> BT response to the 2018 BT RFR Consultation, paragraph 4.18.

- 4.58 We have decided to require BT to publish in the RFS the revenue, operating costs, mean capital employed and returns for the physical infrastructure markets on a national basis. Trends in market level financial performance are informative in the context of considering the impact and effectiveness of the remedies imposed in the physical infrastructure markets. Market level cost information also provides transparency regarding how BT has allocated costs between regulated markets (and between regulated and unregulated markets). We see this as facilitating stakeholder confidence that such costs have been allocated consistently and appropriately. It also mitigates the risk that costs might be unreasonably loaded onto particular services or markets.
- 4.59 In response to IIG, we acknowledge that market level information split by geographic market may generally be useful for Ofcom and stakeholders. However, since we did not set PIA prices on a geographic basis, we consider market level information split by geographic market would have limited value in the physical infrastructure markets. As noted in the 2019 PIMR and BCMR Statement, whilst we have identified four geographic physical infrastructure markets, we have imposed a national PIA remedy and we continue to expect low take up of the PIA product in this review period.<sup>95</sup> In view of this, we consider that reporting split by geographic market would not be beneficial to stakeholders during this review period, and therefore it would not be proportionate at this stage to require BT to report PIA services on a geographic basis.
- 4.60 In respect of network adjustments below and above the financial limit, in view of stakeholder responses, we have decided to make certain changes to the disclosure requirements in the appendix for the PI market.
- 4.61 First, we have decided that BT should extend the appendix for the PI market to include the accumulated MCE of network adjustments above the limit both external and internal. We note that this is a departure from the 2018 BT RFR Consultation where we proposed that this information is provided to Ofcom privately. However, in light of TalkTalk's response mentioned above,<sup>96</sup> we consider that stakeholders should be able to compare both network adjustments below and above the financial limit, as well as external and internal network adjustments in order to have reasonable confidence that BT has complied with the relevant SMP conditions.
- 4.62 Second, in relation to all network adjustments, we have decided that BT does not need to show the amount of MCE attributed to downstream markets in respect of network adjustments. We agree with BT that the destination market of the MCE is less important for readers of the RFS than its internal/external split. This is consistent with our intention to provide stakeholders with information on the relative internal and external distribution of network adjustments.
- 4.63 As a result of the above decisions, the appendix for the PI market will set out:

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<sup>95</sup> See, for example, Volume 1, 2019 PIMR and BCMR Statement, paragraph 7.27.

<sup>96</sup> See paragraph 4.21 above.

- a) all network adjustments on the same accumulated MCE basis;<sup>97</sup>
- b) the total MCE split between above and below the financial limit. This is then split between internal and external;
- c) network adjustments above the financial limit that have been capitalised and that have been expensed;
- d) in respect of network adjustments that have been expensed in the PI market and not capitalised in downstream markets (namely external network adjustments), BT must record, calculate and disclose what the MCE would have been had the cost been capitalised.

4.64 We set out the form and content of the appendix for the PI market in Annex 1.

### Service level information

#### 2018 BT RFR Consultation

- 4.65 In the 2018 BT RFS Consultation, we proposed that BT publish a separate section called “Review of Physical Infrastructure Markets”. We proposed this would incorporate information in relation to PIA services in the physical infrastructure markets and be consistent with BT’s reporting requirements on all other regulated markets.
- 4.66 We also proposed that WLA PIA service information is reported in the physical infrastructure markets rather than the WLA market. We considered this to be appropriate because the PIA remedies in both markets are almost identical and we expect relatively low take up compared to other services in the review period. Consequently, we proposed to remove the 2018 WLA Statement requirement for WLA PIA service information to be included in the WLA market.
- 4.67 We proposed to require BT to include revenue, volume, average price and FAC for all PIA services, split between internal and external customers, at the level that they are regulated.
- 4.68 Consistent with the 2018 WLA Statement,<sup>98</sup> we did not expect BT to be able to account for duct and pole services on an FAC basis until 2020/21 and therefore proposed disaggregated service level information for 2020/21 only.
- 4.69 We proposed that prices and volumes for disaggregated individual services where revenues were less than £5m but exceeded £1m were not published but instead provided privately as part of the additional financial information.

#### Stakeholder responses

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<sup>97</sup> Whilst the accounting treatment within the PI market is the same for internal and external network adjustments above the financial limit, in that they should be expensed in the PI market, BT is allowed (but not required) to capitalise internal network adjustments within the downstream markets. In contrast, external network adjustments must be expensed.

<sup>98</sup> 2018 WLA Statement, Annex 8 Paragraph 291.

- 4.70 BT agreed in principle with the proposals. However, it said that this market review period is unusually short, and that Ofcom has already commenced a new market review that would cover a longer review period and potentially lead to very different reporting. BT saw no merit in publishing detailed service and component information for a single year and recommended that reporting of FAC at a service level should be deferred until 2021/22.<sup>99</sup>
- 4.71 IIG agreed with our proposals. It pointed to an inconsistency between the proposed requirement for BT to publish information on internal usage of PIA, which implies that Openreach will be a consumer of PIA, and the 2019 PIMR, which suggested that Openreach will not consume PIA.<sup>100</sup>

#### Our reasoning and decisions

- 4.72 We have decided that it is both appropriate and proportionate to adopt the proposals regarding service level reporting set out in our consultation in relation to PIA services, disaggregated where revenues exceed £5m, with a minor modification to remove Openreach / Rest of BT disclosures.
- 4.73 Publishing service level information can demonstrate the impact and effectiveness of the remedies we have imposed in the physical infrastructure markets and provides transparency about the relative usage of the services in the market by BT and external telecoms providers.
- 4.74 We disagree with BT's comment that there is no merit in publishing detailed service and component information for a single year. The purpose of service level proposals is to provide reasonable confidence to stakeholders that the SMP provider has complied with its SMP conditions and add credibility to the Regulatory Financial Reporting Regime. In our view, this benefit is not outweighed by the possibility that this information may become less relevant following a future market review. If our next 2021 physical infrastructure market review establishes a different market structure and the information currently supplied becomes irrelevant, then we would consider what information would need to be provided to stakeholders at that point. This means BT should provide information in relation to decisions made in the current market review, such as defining a new PI market and reporting on the remedies in relation to individual services supplied from that market.
- 4.75 In response to IIG, as set out in the 2019 PIMR and BCMR Statement,<sup>101</sup> Openreach has made the argument that its use of its own physical infrastructure is different to PIA and not subject to an EOI obligation. While Openreach does not consume PIA, it is possible that downstream divisions of BT may decide to do so. Therefore, we have decided that BT should disclose internal and external PIA consumption as proposed but have removed the proposed disaggregated Openreach / Rest of BT disclosures.
- 4.76 We set out the full list of services that BT is required to publish information for in Table 4.3 below.

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<sup>99</sup> BT response to the 2018 BT RFR Consultation, paragraphs 4.20-4.30.

<sup>100</sup> IIG response to the 2018 PIMR, BCMR and BT RFR Consultations, paragraph 15.2.5.

<sup>101</sup> 2019 PIMR and BCMR Statement, Volume 1, paragraph 4.128.



## Requirements for private information to be provided to Ofcom

- 4.77 This is information that we consider BT should provide to Ofcom in private. We require this information in order to, for example, 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.
- 4.78 BT currently provides private information to Ofcom in the form of Additional Financial Information (AFI) schedules, including a 'Data File'.<sup>102</sup> The Data File provides detailed information on all the revenues, volumes, costs and cost categories that support the published RFS.
- 4.79 In this sub-section we set out our decisions in relation to private reporting set out in three proposed AFIs in relation to services in the physical infrastructure markets:
- Additional Detailed Service Reporting for PI market Services;
  - Updated Inputs for Calculation of the Maximum PIA Rental Charges; and
  - Network adjustments.

### Removal of duplicate information

- 4.80 As set out in the March 2019 BT RFS Statement,<sup>103</sup> we decided to remove the requirement to provide a number of AFIs on a confidential basis as the information was duplicated in the Data File. The AFIs removed are:
- a) Analysis, by asset category and network activities, of the depreciation charge for the year and impact of CCA valuation adjustments on costs for the year (for example HCA depreciation, CCA supplementary depreciation and Other CCA adjustments);
  - b) Total mean capital employed and detailed activity analysis for all network components;
  - c) Detailed network activity analysis of mean capital employed for all network components;
  - d) Total operating costs and mean capital employed costs (and associated volumes) for each plant group and their individual exhaustion, including the disclosure of relevant usage factors, onto each network activity and/or (sub) component;
  - e) BT Network Services Reconciliation; and
  - f) Comprehensive analysis of transfer charges.

### Additional Detailed Service Reporting for PI market Services schedule

#### 2018 BT RFR Consultation

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<sup>102</sup> BT provides the Data File as part of AFI 12.

<sup>103</sup> March 2019 BT RFR Statement, paragraphs 3.82-3.94.

4.81 In the 2018 BT RFR Consultation we proposed that BT provide an AFI named “Additional Detailed Service Reporting for PI market Services”. We proposed that this schedule include individual internal and external revenue and volume information for every disaggregated service within each specified PI market group of services where the annual revenues for that service exceeds £1m. We proposed the AFI should include two elements.

- a) **Detailed physical infrastructure markets service information:** We proposed this should set out the revenues, volumes and FAC on a CCA<sup>104</sup> basis of any physical infrastructure market service not publicly disclosed in the RFS where the revenue from this service is above £1m. We proposed the revenues and costs, in total, be reconciled to the revenues and costs included within the publicly reported totals for the physical infrastructure markets in the RFS. We proposed that BT only provide this information as separate AFI where it cannot demonstrate this information meets the Data File requirements.
- b) **Detailed physical infrastructure markets service FAC disaggregated costs information:** We proposed this should set out the calculation of FAC and usage factors on a service by service level reported under the first requirement. We proposed the totals should reconcile to the first requirement in a) above. We proposed that BT only provide this information as separate AFI where it cannot demonstrate this information meets the Data File requirements.

4.82 Consistent with the proposed service level information, we proposed that BT provide this AFI from 2020/21.

#### Stakeholder comments

4.83 Most respondents agreed with our proposals.

4.84 BT disagreed with the proposed £1m threshold for the provision of the above information. It considered that a more appropriate threshold would be £5m which it said is consistent with its reporting obligations in the wholesale local access and business connectivity markets.<sup>105</sup>

#### Our reasoning and decisions

4.85 We have decided that it is both appropriate and proportionate to adopt the proposals set out in our consultation in relation to the private reporting of the schedule “Additional Detailed Service Reporting for PI market Services” without any modification. This information will ensure that we have sufficient information to identify services that account for a considerable proportion of revenues and costs in the PI market.

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<sup>104</sup> Current Cost Accounting (CCA): An accounting convention, where assets are valued and depreciated according to their current replacement cost whilst maintaining the operating or financial capital of the business entity.

<sup>105</sup> BT response to the 2018 BT RFR Consultation, paragraphs 4.31-4.32.

- 4.86 We disagree with BT's suggestion to increase the threshold for this private reporting from £1m to £5m. Whilst we can see the merit in having consistent reporting across markets, the PI market is a new regulatory structure and it contains a number of nascent services. Also, BT has in the past been slow to implement systems to accurately record volumes of low but fast-growing services.<sup>106</sup> We believe requiring BT to provide reporting to us at a relatively low level, will encourage BT to develop its cost accounting and accounting separation system to robustly report PIA services in advance of their uptake at scale.

### Updated Inputs for Calculation of the Maximum PIA Rental Charges schedule

#### 2018 BT RFR Consultation

- 4.87 In the 2018 BT RFR Consultation we proposed that BT provide an AFI named "Updated Inputs for Calculation of the Maximum PIA Rental Charges". We proposed that this AFI include updated information relating to the inputs we use to populate our PIA pricing model.

#### Stakeholder comments

- 4.88 Most respondents agreed with our proposals.
- 4.89 BT disagreed with our proposal. In its view, given that the PIA pricing structure may change significantly from 2020/21, the proposed schedule would not help Ofcom design any future PIA price controls. BT proposed instead to share new information with Ofcom as the new pricing structure evolves.<sup>107</sup>

#### Our reasoning and decisions

- 4.90 We have decided that it is both appropriate and proportionate to adopt the proposals set out in our consultation in relation to the private reporting of the schedule "Updated Inputs for Calculation of the Maximum PIA Rental Charges" without any modification.
- 4.91 We disagree with BT's proposal to instead share information as the pricing structure evolves. Whilst we would need some additional information to inform our next market review, this schedule would provide valuable inputs in respect to the design of any future PIA price controls. In addition, the information contained in this schedule will allow us to better monitor the effectiveness of the current PIA remedies.

### Network Adjustments schedule

#### 2018 BT RFR Consultation

- 4.92 In the 2018 BT RFR Consultation we proposed that BT provides an AFI named "Network Adjustments". We proposed that this AFI should set out, on an accumulated MCE basis, internal and external network adjustments below and above the limit across all downstream markets.

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<sup>106</sup> For example, BT was slow in implementing systems to attribute GEA costs to its new FTTP services.

<sup>107</sup> BT response to the 2018 BT RFR Consultation, paragraph 4.34.

- a) **Network adjustment costs below the financial limit:** we proposed these should be disaggregated on a service basis, where the accumulated MCE is greater than £1m. We said that this information should reconcile to the appendix for the PI market published in the RFS.
- b) **Network adjustments above the financial limit:** we proposed that, for each downstream market, both internally and externally, BT should set out the costs they have appropriately capitalised within the downstream markets.

#### Stakeholder comments

- 4.93 Most respondents agreed with our proposals.
- 4.94 As discussed above, BT disagreed with the proposal because in its view “a more relevant disclosure for stakeholders would be the total value of MCE in the PI market relating to network adjustments under the financial limit and the split of this into those adjustments made at the request of external PI customers and those made for internal purposes”.<sup>108</sup>

#### Our reasoning and decisions

- 4.95 As noted above, we have decided that BT should publish an appendix for the PI market which includes the accumulated MCE of network adjustments above and below the financial limit, external and internal, where the cost is £5m or more. Consistent with this, we have decided that BT must provide in private to Ofcom the AFI named “Network Adjustment” setting out all network adjustments (above or below the financial limit) that are less than £5m in the same format as the appendix for the PI market. This AFI will provide us with full comparability of all network adjustments on the same accounting basis, where they are at a relatively low level. This will allow us to monitor BT’s compliance with its non-discrimination obligation in relation to such network adjustments.

### **LRIC information**

#### 2018 BT RFR Consultation

- 4.96 In the 2018 BT RFR Consultation<sup>109</sup> we proposed to remove the requirement for BT to provide LRIC service information, and DLRIC and DSAC cost component information in 2019/20 and 2020/21. This was because the proposed new physical infrastructure market would have meant BT carrying out considerable redevelopment and restructuring of its LRIC model. We proposed that BT instead provides us with LRIC and FAC cost component information that excludes any cost components that have been attributed to the physical infrastructure markets as this could be provided with little extra development.

#### Stakeholder comments

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<sup>108</sup> BT response to the 2018 BT RFR Consultation, paragraph 4.18.

<sup>109</sup> (3.49 – 3.53),

4.97 UKCTA and Vodafone disagreed with our proposal. They noted that in the past the LRIC model has been extensively used by Ofcom to set charge controls and calculate cost floors and ceilings. Both telecoms providers also considered that our proposal to no longer require BT to provide outputs from its LRIC model was pre-emptive of changes in the market structure.<sup>110</sup>

#### Our reasoning and decision

4.98 We have decided that it is both appropriate and proportionate to adopt the proposals set out in our consultation in relation to the private reporting of information on incremental costs without any modification.

4.99 As a result of the new physical infrastructure markets, BT will no longer be able to report LRIC, DLRIC and DSAC data to us in the same format as it has done historically without considerable redevelopment and restructuring of its LRIC model. The production of LRIC, DSAC and DLRIC data by service in particular would require significant development, as the duct and other physical infrastructure costs (manholes, junction boxes and poles) will now form their own single increment rather than being part of the incremental costs of components and hence of services.

4.100 UKCTA and Vodafone are correct that we have used data from BT's LRIC model in the past. However, in our latest round of market reviews (Narrowband 2017, WLA 2018, WBA 2018, PIMR 2019 and BCMR 2019) we have not relied on outputs from BT's LRIC model but have instead focussed on developing our own view on incremental costs. Given our proposals in the 2019 FTTP Modelling Consultation,<sup>111</sup> this approach is likely to be adopted in market reviews going forward. It would therefore be disproportionate to require BT to update or rebuild its LRIC model if we are not yet sure whether the outputs will be relevant to us.

4.101 We disagree with UKCTA and Vodafone that reducing BT's reporting obligations in relation to its LRIC model is pre-emptive of changes in the market structure. The introduction of the new PI market has already changed the market structure, which as we explained in the 2018 BT RFS Consultation, will result in the LRIC model as currently constructed no longer providing reliable outputs from 2019/20 onwards.

4.102 At a stakeholder workshop we held on 8 October 2018 on the future of BT regulatory financial reporting we noted that we were reviewing the requirement for BT to continue to provide us with LRIC data post 2020/21. We will consider the requirement for BT to continue to provide us with LRIC data post 2020/21 as part of our Fixed Telecoms Market Review.

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<sup>110</sup> UKCTA response to the 2018 BT RFR Consultation, page 5; Vodafone response to the 2018 BT RFR Consultation, paragraphs 67-68.

<sup>111</sup> Ofcom, *Promoting competition and investment in fibre networks Initial consultation on the approach to modelling the costs of a fibre network*, 21 June 2019, [https://www.ofcom.org.uk/data/assets/pdf\\_file/0021/153255/consultation-modelling-fibre-network.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0021/153255/consultation-modelling-fibre-network.pdf)

## Other stakeholder comments

- 4.103 Vodafone said Ofcom’s proposals for the Preparation Delivery, Publication, Form and Content Direction in the physical infrastructure markets seem reasonable if considered in isolation because PIA products are in their very early stages, current use is extremely low, operators have stated that on-boarding the product and setting up systems and processes will take some time, and long-term use and adoption is unknown. However, Vodafone considered that, since PIA would have little effect in the business connectivity markets, it would not be appropriate to reduce the reporting for business connectivity services at this point. Vodafone said this reporting should only be reduced when “PIA product use has demonstrated that other operators rolling out network can provide a competitive constraint on BT”.<sup>112</sup>
- 4.104 We consider that the proposed reduction in reporting for business connectivity services is appropriate for the reasons set out in Section 5. For example, while BT’s obligations for basket level reporting in the business connectivity markets have led to reduced public reporting, this is a result of consistently applying our philosophy of ensuring that regulatory financial reporting is relevant to the regulatory remedy. We also note that, as set out in Section 5, we have accepted some of the arguments raised by stakeholders and have decided to increase the reporting requirements on BT in respect of business connectivity services from our proposals in the 2018 BT RFR Consultation. For example, we have decided to require BT to report for each basket or sub-basket, a separate disclosure for the EAD and EAD LA rentals and EAD Main Link in the CI Access Services markets and the non-dark fibre intra exchange technical area (see paragraph 5.77 and following).

## Summary

- 4.105 We summarise our decisions in relation to the Preparation, Delivery, Publication, Form and Content of the RFS Direction in Table 4.3 Table 4.4 and Table 4.5 below.

**Table 4.3: Summary of decisions in relation to the Preparation, Delivery, Publication, Form and Content of the RFS Direction**

	Requirements to be included in BT’s RFS	Implementation
<b>Public information</b>	BT must publish revenue, volume, average price and cost information for the following services: <ul style="list-style-type: none"> <li>• Physical Infrastructure for Active Services;<sup>113</sup></li> <li>• PIA rentals;<sup>114</sup></li> <li>• PIA ancillary charges;<sup>115</sup></li> </ul>	For 2019/20 RFS, BT to report more aggregated information.

<sup>112</sup> Vodafone response to the 2018 BT RFR Consultation, paragraph 80.

<sup>113</sup> These will be imputed figures, the costs being the physical infrastructure consumed by active services based on current attributions methods, the revenue being the FAC plus the Openreach WACC. Average prices and volumes will not be applicable.

<sup>114</sup> Costs, average prices and volumes will not be applicable until disaggregated.

<sup>115</sup> Average prices and volumes will not be applicable until disaggregated.

	<ul style="list-style-type: none"> <li>network adjustments above the financial limit of £4,750 per km of Spine Duct;</li> <li>other PIA charges;<sup>116</sup> and</li> <li>an appendix to the RFS disclosing (where they are above £5m) the MCE of network adjustments above the limit (internal and external) and below the limit (internal and external). In respect of internal network adjustments above the limit, BT must separately identify those that have been capitalised and those that have been expensed within the downstream market.</li> </ul>	
<b>Private information</b>	<p>BT must report privately to Ofcom three AFIs in relation to the physical infrastructure market:</p> <ul style="list-style-type: none"> <li>Additional Detailed Service Reporting for PI market Services;</li> <li>Updated Inputs for Calculation of the Maximum PIA Rental Charges; and</li> <li>Network adjustments</li> </ul>	<ul style="list-style-type: none"> <li>Not provided for 2019/20.</li> <li>Provided both years.</li> <li>Provided both years where Network Adjustments are below £5m.</li> </ul>

Source: Ofcom

**Table 4.4 Removal of requirement to provide information under both a separate AFI and the Data File**

Additional Financial Information	Summary Description
Provision of FAC, LRIC, DLRIC and DSAC data per service.	Provide FAC, LRIC, DLIC, and DSAC information for each regulated service.

Source: Ofcom.

<sup>116</sup> Costs, average prices and volumes will not be applicable until disaggregated.

Table 4.5: Information<sup>117</sup> provided under a separate AFI and as part of the Data File

Reference	Additional Financial Information	Summary Description
5(a)(i)	<p>Cost category (as used within regulatory LRIC model) analysis for network components, increments and relevant layers of common cost, <u>for all costs that are not part of the physical infrastructure markets</u> (LRIC, <del>DLRIC</del> and DSAC basis)</p>	<ol style="list-style-type: none"> <li>1. ensure the LRIC model reconciles to BT Group's total cost and asset and liability base <u>excluding the fully allocated costs of the physical infrastructure markets</u>;</li> <li>2. review the outputs of BT's LRIC model for the whole BT Group by cost category and components, increments and layers of common costs;</li> <li>3. identify all relevant layers of common costs separately within BT Group;</li> <li>4. enable trend analysis of this breakdown to be undertaken;</li> <li>5. enable assessment of cost-volume relationships;</li> <li>6. provide input into network price control reviews.</li> </ol>
5(a)(ii)	<p>Summarised activity analysis for network components and increments <u>for all costs that are not part of the Physical Infrastructure Market</u> (LRIC, <del>DLRIC</del> and DSAC basis)</p>	<ol style="list-style-type: none"> <li>1. review the outputs of BT's LRIC model by activity analysis for network components, increments and the layers of common costs;</li> <li>2. identify all relevant layers of common costs separately for network activities;</li> <li>3. enable trend analysis of this breakdown to be undertaken;</li> <li>4. provide input into network price control reviews;</li> <li>5. ensure LRIC model reconciles to the total cost and asset and liability base for BT's network activities <u>excluding the fully allocated costs of the PIMR market</u>.</li> </ol>

Source: Ofcom

<sup>117</sup> The underlined and deleted text highlights how this direction is different to the one previously imposed in the 2016 BCMR.



## The Network Components Direction

### 2018 BT RFR Consultation

- 4.106 In the 2018 BT RFR Consultation, we proposed that in this review period BT should use a single network component named “PI cost” in order to capture all capital and maintenance costs of ducts and poles within its physical infrastructure, including those costs related to WLA PIA services.
- 4.107 This proposal was significantly different from our decision in relation to network components for PIA services in the 2018 WLA Statement (which we proposed to revoke) where we specified ten network components.<sup>118</sup> We provided the following reasons for this change:
- a) The proposal that BT provides cost reporting on an aggregate level in relation to Physical Infrastructure for Active Services from 2019/20 which was not envisaged in the 2018 WLA Statement. The proposed cost reporting required any new physical infrastructure components to be in place a year earlier than BT had expected. We felt it would not be proportionate to expect BT to have ten new network components in place in 2019/20.
  - b) The proposed reporting of Physical Infrastructure for Active Services would provide additional information on no undue discrimination which was not envisaged at the time of the 2018 WLA Statement.

### Stakeholder responses

- 4.108 BT agreed with our proposals.<sup>119</sup>
- 4.109 IIG disagreed. It considered that the aggregated information would not allow a distinction to be made between underground and overhead costs, nor between access and long-distance costs. IIG said the ten components from the 2018 WLA Statement will allow competitive operators to understand BT’s costs. It believed the reporting of the ten components would not impose an undue burden on BT to make this information available as a part of the published RFS, given that BT will be required to provide this information to Ofcom in the AFIs.<sup>120</sup>

### Our reasoning and decisions

- 4.110 We have decided that it is both appropriate and proportionate to adopt the proposals set out in our consultation for reporting against the “PI cost” network component, with one

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<sup>118</sup> The ten network components were: 1) Duct Spine capital; 2) Duct Spine maintenance; 3) Junction Boxes Capital; 4) Junction Boxes maintenance; 5) Manhole capital costs; 6) Manhole maintenance costs; 7) Pole capital costs; 8) Pole maintenance costs; 9) Lead-in duct capital costs; and 10) Lead-in maintenance costs.

<sup>119</sup> BT response to the 2018 BT RFR Consultation, paragraph 4.38.

<sup>120</sup> IIG response to the 2018 PIMR, BCMR and BT RFR Consultations, paragraph 15.3.3.

modification - the addition of a new network component named “PIMR Costs – Downstream Asset”.

- 4.111 First, we continue to believe that BT should use a network component named “PI cost” in order to capture all capital and maintenance costs of ducts and poles within its physical infrastructure, including those costs related to WLA PIA services. This information will allow stakeholders to see the aggregate level of physical infrastructure costs within active services and make comparisons between different types of active services and the PIA services themselves.<sup>121</sup> This component will also allow BT to start to report physical infrastructure costs in 2019/20.
- 4.112 Second, as noted above, we are concerned that internal network adjustments above the financial limit that are capitalised in downstream markets may be identified in downstream regulated services.
- 4.113 The purpose of expensing network adjustment charges above the financial limit is to prevent potential double recovery in relation to external charges, and we believe the internal equivalent should be treated on a consistent basis.
- 4.114 We have therefore decided to create a new network component called “PIMR Cost – Downstream Asset” that BT must use where it depreciates internal network adjustments costs above the financial limit that it capitalises in downstream markets. This network cost information will allow us and stakeholders to see if and where BT is recovering its own network adjustment costs above the financial limit in downstream markets.
- 4.115 To preserve the integrity and consistency of BT’s RFS it is important that there is a single list of network components used to attribute costs to services in regulated markets. We have therefore decided that the new network components below are added to the list imposed on BT by the March 2019 BT RFS Statement<sup>122</sup> and that apply to all services in regulated markets in the RFS from 2019/20.
- i) “PIMR Cost”
  - ii) “PIMR Costs – Downstream Asset”

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<sup>121</sup> In particular, the service level reporting for 2020/21 will allow a distinction to be made between underground (duct, manhole and junction boxes) and overhead costs (poles) as well as ‘access duct’ (lead ins) and long-distance costs (spine), where the combined internal (Openreach and Rest of BT) and external revenues exceed £5m in any given financial year for the individual services.

<sup>122</sup> See March 2019 PIMR and BCMR Statement, paragraphs 3.104-3.111. As noted above, the addition of these network components was within the scope of our 2018 BT RFR Consultation. We proposed a list of network components which included components which were specific to physical infrastructure markets and proposed that this direction would apply in all markets (see Annex 5, Draft Direction 5, paras 2 and 4). We also said in our March 2019 BT RFR Statement that “We will make our decision relating to [network components which are specific to business connectivity and physical infrastructure markets] in the upcoming statements on these market reviews” (paragraph 3.96).

## 5. Regulatory financial reporting specific to the business connectivity markets

- 5.1 As noted in Section 3, in the 2018 BT RFR Consultation we proposed a set of eight regulatory financial reporting directions that would apply to BT in all regulated markets<sup>123</sup> (including new markets we proposed to identify under the physical infrastructure market review and the business connectivity market review). In the March 2019 BT RFR Statement we imposed these directions across the wholesale local access, narrowband and wholesale broadband access markets.
- 5.2 In Section 3, we set out our decision to impose on BT five regulatory financial reporting directions in relation to the physical infrastructure<sup>124</sup> and business connectivity markets which are unchanged from our decision in the March 2019 BT RFR Statement.
- 5.3 In this section we set out our decisions in relation to the remaining three regulatory financial reporting directions that contain obligations that are specific to the business connectivity markets. These directions are:
- the Consistency with Regulatory Decisions and Regulatory Asset Value Direction and Adjusted Financial Performance schedule;
  - the Preparation, Delivery, Publication, Form and Content of the RFS Direction; and
  - the Network Components Direction.

### Consistency with Regulatory Decisions and Regulatory Asset Value Direction, and Adjusted Financial Performance Directions

#### 2018 BT RFR Consultation

- 5.4 In the 2018 BT RFR Consultation, we proposed specific requirements related to the Consistency with Regulatory Decisions and Regulatory Asset Value Direction and the Adjusted Financial Performance schedule for the business connectivity markets. Our analysis was structured as follows:
- we set out the adjustments to BT's cost information that we made to inform our price control proposals contained in the 2018 BCMR Consultation;<sup>125</sup>
  - we set out the criteria we use to determine whether a cost adjustment made by Ofcom should be reflected in the RFS or the Adjusted Financial Performance schedule; and, if so,
  - we set out how (if at all) the adjustments should be reflected in the RFS or the Adjusted Financial Performance schedule.

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<sup>123</sup> The adjusted financial performance direction was not imposed in either the Narrowband, WBA markets or physical infrastructure markets.

<sup>124</sup> Excluding the adjusted financial performance direction.

<sup>125</sup> These adjustments were described in detail in Annex 19 of the 2018 BCMR Consultation.

5.5 Table 5.1 below summarises our proposed treatment for each adjustment.

**Table 5.1: List of all adjustments made within the 2018 BCMR Consultation to BT's cost information**

Adjustment	Description	Proposed treatment
a) Fibre indexation	<p>Within the 2017/18 RFS BT calculated the CCA valuation of the Access Fibre Cable using the CPI index.</p> <p>Based on the analysis we have undertaken, we believe that a CCA valuation using flat nominal indexation provides a more appropriate measure of the CCA valuation. We have adjusted the valuation on the fibre assets to reflect this.</p>	Reflected in RFS
b) EE integration costs	Integration costs in relation to acquisition of EE have been removed.	Reflected in RFS
c) Excess Construction Charges (ECC)	We have removed historical and in-year capitalised ECC costs together with any associated in-year depreciation and replaced them with an operating expense equal to the actual in-year capital expenditure.	Reflected in RFS
d) Openreach Repayment Works	The revenue for Openreach repayment works is recognised within its residual markets. However, repayment work assets are capitalised within regulated markets. We have removed the capitalised repayment costs and associated depreciation.	Reflected in RFS
e) Restructuring charges and property provision costs	Consistent with our approach in the 2018 WLA Statement, we have smoothed these volatile costs.	Reflect in AFP schedule
f) Cumulo costs	Consistent with the approach in the 2018 WLA Statement, we forecast cumulo costs separately to reflect the significant increases in these costs.	Not reflected in the RFS or the AFP schedule <sup>126</sup>
g) Pensions service costs	We have adjusted the pensions costs to take account of the new pension agreements in place from 2018.	Not reflected in the RFS or the AFP schedule
h) SLG Payments	We forecast SLG costs separately to reflect the significant increases in these costs in recent years.	Not reflected in the RFS or the AFP schedule
i) BT CCN adjustments	BT proposed several changes in its 2018 Change Control Notification. <sup>127</sup> These changes were subsequently made in the 2017/18 RFS and will be present in our base data when we update our analysis for the forthcoming BCMR statement.	Not reflected in the RFS or the AFP schedule

<sup>126</sup> This reflect the adjustments we made with respect to cumulo for the purposes of setting business connectivity charge controls and separate from our decision with respect to cumulo set out in paragraphs 3.37-3.45.

<sup>127</sup> <https://www.btplc.com/Thegroup/Policyandregulation/Governance/Financialstatements/2018/ChangeControlNotification2017-18.pdf>

## Stakeholder responses

- 5.6 In relation to our proposals for this direction in general, Vodafone responded that the proposed adjustments are ‘necessary’ and that ‘Ofcom’s work in analysing them at a low level of detail and requesting that BT make these adjustments does ensure that BT’s RFS better reflects the regulated costs of them providing these regulated services’.<sup>128</sup>
- 5.7 In relation to the fibre valuation adjustment (adjustment a) below), BT recognised that our proposal is consistent with the treatment of our modelling in the 2018 BCMR Consultation. BT therefore agreed with the proposal that it should adopt the flat nominal indexation approach to compute the current cost of fibre assets in the RFS.<sup>129</sup>
- 5.8 In relation to the EE integration costs adjustment (adjustment b) below), BT stated that there will be no material impact to the unit FAC of regulated products and services from making this adjustment in the RFS and thus there will be no benefit to stakeholders from making this adjustment.<sup>130</sup>
- 5.9 TalkTalk agreed that the EE integration costs should not be attributed to SMP services. It said that it did not understand why it should remain necessary for Ofcom to specify that EE integration costs should not be allocated to SMP services since it is “obvious that these costs are not relevant to or caused by SMP services. The general rules for preparation of the regulatory financial statements (e.g. regulatory accounting principles) should be sufficient to make plain that these type of costs must not be attributed to SMP services”.<sup>131</sup>
- 5.10 Regarding the Excess Construction Charge (ECC) adjustment (adjustment c) below), BT agreed that it is useful for Ofcom and other stakeholders to see the costs and revenues of the ECC services presented together in the same financial period, and therefore supported our proposal to show such costs as expensed, not capitalised. However, BT considered that it is useful for stakeholders to view the financial results by market, and for Openreach in total, using measures which correspond as closely as possible to those that BT uses in preparing its Annual Report. Following on from this, BT proposed an additional line is added to the “Detailed Service Analysis” schedule showing the difference between ECC costs as expensed and the cost had they been capitalised under IFRS 15.<sup>132</sup>
- 5.11 Vodafone agreed with Ofcom’s proposed treatment of Excess Construction Charges. It presumed that under IFRS 15 all external ECCs over the threshold of £2,800 have to be expensed given that the revenue from them has been recognised when telecoms providers paid.<sup>133</sup>

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<sup>128</sup> Vodafone response to the 2018 BT RFR Consultation, paragraph 95.

<sup>129</sup> BT response to the 2018 BT RFR Consultation, paragraphs 5.18.

<sup>130</sup> BT response to the 2018 BT RFR Consultation, paragraphs 5.24.

<sup>131</sup> TalkTalk response to the 2018 BT RFR Consultation, paragraph 16.

<sup>132</sup> BT response to the 2018 BT RFR Consultation, paragraphs 5.27-5.29.

<sup>133</sup> Vodafone response to the 2018 BT RFR Consultation, paragraph 78.

5.12 In relation to the Openreach repayment works adjustment (adjustment d) below), BT agreed with the proposal and suggested that, for the years where it does not have actual data (pre-2009/10 information), it uses an average of the cost of repayment works by using information from the years where there is available data.<sup>134</sup>

## Our reasoning and decisions

- 5.13 In our analysis below, we follow the same analytical steps as in our 2018 BT RFR Consultation, namely:
- a) we set out the adjustments to BT’s cost information that we made to inform our price control decisions contained in the 2019 PIMR and BCMR Statement;<sup>135</sup>
  - b) we set out the criteria we use to determine whether a cost adjustment made by Ofcom should be reflected in the RFS or the Adjusted Financial Performance schedule; and, if so,
  - c) we set out how (if at all) the adjustments should be reflected in the RFS or the Adjusted Financial Performance schedule.

### Adjustments made to BT’s cost information when setting prices

5.14 To inform our decisions on the charge controls in Volume 3 of the 2019 PIMR and BCMR Statement we made various adjustments to the cost information reported in BT’s 2017/18 RFS<sup>136</sup>, which we used as our base year. We also made several other adjustments in respect of costs calculations that do not strictly reflect BT’s actual costs. These adjustments are summarised in Table 5.2 below. We note that we consulted on adjustments BT put through in the 2017/18 Change Control Notice. These adjustments are no longer required because the Leased Lines Charge Control modelling used updated 2017/18 RFS base which already incorporates the 2017/18 Change Control Notice adjustments.

**Table 5.2: List of all adjustments made within the 2019 PIMR and BCMR Statement to BT’s cost information**

Adjustment	Description
a) Fibre indexation	<p>Within the 2017/18 RFS BT calculated the CCA valuation of the Access Fibre Cable using the CPI index.</p> <p>Based on the analysis we have undertaken, we believe that a CCA valuation using flat nominal indexation provides a more appropriate measure of the CCA valuation. We have adjusted the valuation on the fibre assets to reflect this.</p>

<sup>134</sup> BT response to the 2018 BT RFR Consultation, paragraphs 5.33.

<sup>135</sup> These adjustments were described in detail in Annex 19 of the 2019 PIMR and BCMR Statement.

<sup>136</sup> *Ibid.*

Adjustment	Description
b) EE integration costs	Integration costs in relation to acquisition of EE have been removed.
c) Excess Construction Charges (ECC)	We have removed historical and in-year capitalised ECC costs together with any associated in-year depreciation and replaced them with an operating expense equal to the actual in-year capital expenditure.
d) Openreach Repayment Works	The revenue for Openreach repayment works is recognised within its residual markets. However, repayment work assets are capitalised within regulated markets. We have removed the capitalised repayment costs and associated depreciation.
e) Restructuring charges and property provision costs	Consistent with our approach in the 2018 WLA Statement, we have smoothed these volatile costs.
f) Cumulo costs	Consistent with the approach in the 2018 WLA Statement, we forecast cumulo costs separately to reflect the significant increases in these costs.
g) Pensions service costs	We have adjusted the pensions costs to take account of the new pension agreements in place from 2018.
h) SLG Payments	We forecast SLG costs separately to reflect the significant increases in these costs in recent years

### Characteristics of adjustments

- 5.15 We explained in the 2015 Directions Statement that the identification of adjustments that should or should not be reflected within either BT's regulatory financial reporting or the Adjusted Financial Performance schedules is a matter for our judgement and should be considered on a case by case basis.
- 5.16 We explained that the starting point for our analysis is that we would expect to see a cost adjustment made by us in our regulatory decisions to be reflected in the RFS if it relates to the way BT's actual or incurred costs should be treated.
- 5.17 We also said that we would not expect to see an adjustment arising from a regulatory decision reflected in the RFS if:

- the adjustment has the effect of replacing BT’s incurred costs with an alternative estimate of cost (type a); or
- the adjustment has the effect of replacing BT’s incurred costs with a value that is not based on BT’s network whether actual or estimated (type b).<sup>137</sup>

5.18 If the adjustment has the effect of replacing BT’s incurred costs with an alternative estimate of cost (type a), we would expect to see the adjustment reflected in the Adjusted Financial Performance schedules. If the adjustment has the effect of replacing BT’s incurred costs with a value that is not based on BT’s network whether actual or estimated (type b), we would not expect such an adjustment to be reflected in the Adjusted Financial Performance schedules.

5.19 Consistent with the 2018 BT RFS Consultation, 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. We present our analysis in Table 5.3 below where:

- If type a) = no and type b) = no: we would require the adjustment to be reflected in the RFS;
- If type a) = yes and type b) = no: we would require the adjustment to be reflected in the Adjusted Financial Performance schedule but not the RFS; and
- If type a) = no and type b) = yes: we would not require the adjustment to be reflected in the RFS or the Adjusted Financial Performance schedule.

**Table 5.3: Analysis of all adjustments**

Adjustment	(a) Does the adjustment have the effect of replacing BT’s incurred costs with an alternative estimate of cost?	(b) Does the adjustment have the effect of replacing BT’s incurred costs with a value that is not based on BT’s network?
a) Fibre valuation		
b) EE integration costs	No	No
c) Excess Construction Charges		
d) Openreach repayment works		
e) Restructuring charges and property provision costs	Yes	No

<sup>137</sup> 2015 Directions Statement, paragraph 3.35.



Adjustment	(a) Does the adjustment have the effect of replacing BT's incurred costs with an alternative estimate of cost?	(b) Does the adjustment have the effect of replacing BT's incurred costs with a value that is not based on BT's network?
f) Remove cumulo costs		
g) Pensions services costs	No	Yes
h) SLG Payments		

### Adjustments to be reflected within the Consistency with Regulatory Decisions and Regulatory Asset Value Direction

5.20 In line with the approach set out above, we require that adjustments a) to d) in Table 5.3 must be reflected within the 2019/20 RFS as set out in Table 5.4.

**Table 5.4: Adjustments to be reflected in the RFS**

Adjustment	Required treatment in the RFS
a) Fibre valuation	In Annex 19, Volume 3 of the PIMR and BCMR Statement we explain that the CCA valuation of the fibre asset in the RFS using CPI must be revised to flat nominal indexation, which our analysis has shown to be the current best measure of the CCA valuation. Fibre assets should be indexed forward at a flat nominal rate. <sup>138</sup>
b) EE integration costs	Any costs relating to the EE acquisition must not be attributed to regulated markets. We require that BT reflect this adjustment within the RFS on the same basis.
c) Excess Construction Charges	ECC costs must be treated as an operating expense in the year they are incurred rather than capitalised.
d) Openreach Repayment Works	In Annex 19, Volume 3 of the PIMR and BCMR Statement, we set out how we calculated the adjustments we made to BT's 2016/17 RFS base year data to correct the Openreach repayment works cost error. BT must reflect these adjustments in its RFS on a similar basis. However, where we made an assumption for pre-2009/10 costs, BT should use post 2009/10 data that is available to them to estimate a pre-2009/10 average and calculate the full impact.

<sup>138</sup> Resulting in the same valuation as HCA.

- 5.21 In relation to the EE integration costs, we agree with BT that this adjustment will not have a material impact on the FAC of products or services.<sup>139</sup> However, we require BT to make this adjustment within the RFS to ensure these costs are not allocated to regulated services.
- 5.22 We also agree with TalkTalk that the general rules for preparation of the RFS should be sufficient to guide BT that this type of costs must not be attributed to SMP services. However, we also acknowledge that in certain cases it may be appropriate to additionally direct BT in order to address any potential ambiguities.
- 5.23 Regarding the Excess Construction Charge adjustment, we agree with BT's proposal to include an additional line within the 'Market/Technical Area Summary' schedule in the RFS which reconciles the difference between the treatment of ECCs if they were expensed or capitalised. This line will provide additional information to stakeholders above what is currently available in the RFS and is also consistent with our decision on how network adjustments will be reported in the RFS.
- 5.24 Regarding the Openreach Repayment Works adjustment, we agree with BT that if actual data is not available pre-2009/10, their proposed approach of using the average of the cost of repayment works derived from information for the years where there is available data is a suitable methodology.

#### **Adjustments to be reflected within the Adjusted Financial Performance Direction**

- 5.25 In the 2015 Directions Statement, we noted that if we did not reflect all regulatory decisions in the RFS, differences could arise between the reported view of BT's financial performance and the view we took when making regulatory decisions.<sup>140</sup> We therefore decided that BT must prepare the Adjusted Financial Performance schedules as part of its regulatory financial reporting to show the impact of certain regulatory decisions not reflected in the RFS.<sup>141</sup>
- 5.26 In line with the approach set out above, we consider that adjustment e) in Table 5.3 should be included in BT's Adjusted Financial Performance schedule. We set out in Table 5.5 below how BT should reflect the adjustment in the Adjusted Financial Performance schedules.

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<sup>139</sup> To reach this conclusion we analysed Openreach response dated 12 December 2018 to question 6 of 11<sup>th</sup> s.135 notice.

<sup>140</sup> 2015 Directions Statement, paragraph 3.36.

<sup>141</sup> Each market review level is composed of individual SMP markets. The market review levels and the component SMP markets for which BT has regulatory financial reporting requirements are set out each year in Section 1 of BT's RFS.

**Table 5.5: Adjustments to be made in BT's Adjusted Financial Performance schedule**

Adjustment	Required treatment in the Adjusted Financial Performance schedule
e) Restructuring charges and property provision costs	Show the impact of removing the actual movement on Restructuring costs and the Property Rationalisation provision and replacing it with one calculated based on a three-year average.

**Adjustments not reflected within the RFS or the Adjusted Financial Performance schedule**

- 5.27 We would not expect to see a cost adjustment to be reflected in the RFS or the Adjusted Financial Performance schedules if the adjustment has the effect of replacing BT's incurred costs with a value that is not based on BT's network.
- 5.28 In line with our approach set out above, the adjustments f) to g) in Table 5.3 should not be reflected in either the RFS or the Adjusted Financial Performance schedules. We set out our reasons in Table 5.6 below.

**Table 5.6 Adjustments not to be made in BT's RFS or the Adjusted Financial Performance schedules**

Adjustment	Justification for non-inclusion
f) Remove Cumulo costs	This adjustment is based on our forecasts of these costs. This adjustment does not reflect BT's actual costs and should not be reflected in the RFS. Going forward, BT's actual costs will be reflected in the RFS rather than the costs we have modelled. It is therefore not appropriate for BT to prepare and include adjustments in respect of Cumulo.
g) Pensions service costs	BT's RFS will reflect the actual increase in pension service costs.
h) SLG Payments	This adjustment in our model reflects our view of what these costs will be going forward. This adjustment does not reflect BT's actual costs and should not be reflected in the RFS. Going forward, BT's actual costs will be reflected in the RFS rather than the costs we have modelled. It is therefore not appropriate for BT to prepare and include adjustments in respect of SLG payments.

## Preparation, Delivery, Publication, Form and Content of the RFS Direction

5.29 In this section we set out our decisions on BT's reporting requirements in relation to the Preparation, Delivery, Publication, Form and Content of the RFS Direction in the business connectivity markets. We first set out our decision in relation to public reporting, which is included in the published RFS, and then private reporting, which is provided to Ofcom only.

### Requirements relating to public information in the RFS

5.30 The published RFS financial information on regulated markets broadly falls into four categories: BT level information, market level information, service level information and cost components for reported services. In this section we set out proposals, stakeholder responses and our decisions in relation to these categories of financial information.

#### BT level information

5.31 We summarised our proposals and decisions for BT level information in Section 4 (paragraph 4.49). No stakeholder raised any concerns in relation to how these requirements would specifically apply to the business connectivity markets. We have therefore decided to extend the requirements we set in the March 2019 BT RFS Statement into business connectivity markets to ensure the integrity and consistency of the RFS.

#### Market Level Information

5.32 Market level information includes information on the revenues, operating costs, capital employed and returns on MCE for a specific market. It is presented in the sections "Summary of Market Performance" and "Attribution of Wholesale Current Costs and Mean Capital Employed" of the RFS. In the 2017/18 RFS, this information is set out in the schedules on pages 22, 88 and 91 for the 2017/18 financial year. For example, in 2017/18, these schedules show that revenue in the BCMR markets was £766m and the return on MCE was 10.3%. The schedules also show a breakdown of operating costs and capital employed.<sup>142</sup>

5.33 We set out our market definitions and our rationale behind them in Volume 2 Sections 4, 5 and 7 of the 2019 PIMR and BCMR Statement. We identified two product markets: CI Access services at all bandwidths and CI Inter-exchange connectivity services.

#### CI Access markets

5.34 In the CI Access services market we identified the following geographic markets:

- BT Only areas;

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<sup>142</sup> Operating cost and capital employed are broken down by what BT calls 'sectors' on pages 88 and 91 of the 2017/18 RFS. These sectors provide a high-level view of the types of operating costs and assets associated with the relevant market.

- BT+1 areas;
- the Central London Area<sup>143</sup>;
- High Network Reach (HNR) areas of each of Birmingham, Bristol, Edinburgh, Glasgow, Leeds and Manchester (Metro Areas); and
- all other HNR areas.<sup>144</sup>

5.35 In the 2018 BT RFR Consultation, we proposed that BT should report separately on BT Only areas, BT+1 Areas, and all High Network Reach areas combined. For the remainder of this section we refer to these as the “CI Access reporting markets”.

#### CI Inter-exchange markets

5.36 In the CI Inter-exchange connectivity services market, we decided that each BT exchange is in its own geographic market. All BT exchanges fall into one of three categories, based on the number of Principal Core Operators (PCOs) present:

- BT Only;
- BT+1; and
- BT+2 or more.

5.37 In the 2019 PIMR and BCMR Statement we said that in our legal instrument we defined the following two broad markets for the purpose of imposing regulation:

- a) The market for CI Inter-exchange connectivity between BT+2 or more exchanges (in which we do not find SMP). In our legal instrument we refer to this as the “Wholesale market for CI Inter-exchange Connectivity Services along Competitive IEC Routes”; and
- b) The market for CI Inter-exchange connectivity in the rest of the UK (in which we find SMP). In our legal instrument we refer to this as the “Wholesale market for CI Inter-exchange Connectivity Services along Non-competitive IEC Routes”.<sup>145</sup>

5.38 In the 2018 BCMR Consultation we proposed to require BT to provide dark fibre access on routes from BT only exchanges. Therefore, in our 2018 BT RFR Consultation, we proposed that reporting for the Wholesale market for CI Inter-exchange Connectivity Services along Non-competitive IEC Routes is split into two technical areas:

- a) Technical Area – Inter-exchange Connectivity (Dark Fibre Circuits); and
- b) Technical Area – Inter-exchange Connectivity (Non-Dark Fibre Circuits).

#### 2018 BT RFR Consultation

5.39 We proposed that BT must publish the revenue, operating costs, capital employed and returns for each of the CI Access reporting markets and technical areas. In practice this

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<sup>143</sup> In the 2019 PIMR and BCMR Statement we found that BT has no SMP in this market.

<sup>144</sup> We also impose that the Hull Area constitutes a geographic market.

<sup>145</sup> Within this, we decided in our 2019 PIMR and BCMR Statement to impose a dark remedy which is limited to routes from BT Only exchanges with no rival networks within 100m (see Section 12). Therefore, for the purposes of regulatory financial reporting, we have decided to split this into two ‘technical areas’ reflecting dark fibre circuits and non-dark fibre circuits.

meant that the CI Access reporting markets and technical areas will be included in the “Summary of Market Performance” the “Attribution of Wholesale Current Costs and Mean Capital Employed” sections in the RFS.<sup>146</sup>

#### Stakeholder comments

- 5.40 Only BT responded to our market level proposals. It argued that if Ofcom’s price controls are the same across two geographic markets (such as CI Access BT+1 and BT only) the reporting should combine these geographic markets. According to BT, stakeholder interest is best served when there is a clear link between any pricing remedy imposed and information which BT is required to publish and combining the two markets for publication would provide this link. BT stated that external stakeholders do not require information broken down below basket level as the baskets that would be published provide reasonable confidence to stakeholders that the SMP provider has complied with its SMP conditions and, therefore, BT does not believe that the separate public reporting of the two markets would provide them with any additional useful information.<sup>147</sup>
- 5.41 BT also suggested an additional line within the ‘Detailed Service Analysis’ schedule in the RFS which reconciles the difference between the treatment of ECCs if they were expensed or capitalised.<sup>148</sup>

#### Our reasoning and decisions

- 5.42 We have decided that it is both appropriate and proportionate to adopt the proposals set out in our consultation for market level reporting.
- 5.43 Trends in market level financial performance are informative in the context of considering the impact and effectiveness of the remedies we imposed in Volume 2 of the 2019 PIMR and BCMR Statement. Market level cost information also provides transparency regarding how BT has allocated costs between regulated markets (and between regulated and unregulated markets).
- 5.44 We see this as facilitating stakeholder confidence that such costs have been allocated consistently and appropriately. It also mitigates against the risk of double recovery of costs or that costs might be unreasonably loaded onto services or markets. We consider it is proportionate to require BT to publish this information to understand and demonstrate the overall reliability and robustness of the RFS.
- 5.45 We do not agree with BT’s suggestion that the BT+1 and BT only geographic areas for CI Access should be combined. Although the same price control remedies apply for both markets, the market definition and SMP designation are based on our finding that these are separate markets with different levels of competition. This is consistent with how we have reported BCMR markets previously.<sup>149</sup> We consider it would be of interest of

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<sup>146</sup> See pages 22, 88 and 91 of the 2017/18 RFS.

<sup>147</sup> BT response to the 2018 BT RFR Consultation, paragraphs 5.7- 5.11.

<sup>148</sup> BT response to the 2018 BT RFR Consultation, paragraphs 5.27-5.29.

<sup>149</sup> In the 2016 BCMR Statement we imposed the same charge control for Ethernet services across the CISBO (rest of UK) and CISBO (London Periphery) geographic markets however the two geographic markets were required to be reported separately.

stakeholders to see revenues and costs for each market separately to be able to assess the effectiveness of the remedies. We have therefore decided to require BT to publish market-level information for each geographic CI access market.

5.46 In respect of the Technical Areas we have decided, in line with our consultation proposals, that reporting for the Wholesale market for CI Inter-exchange Connectivity Services along Non-competitive IEC Routes (in which BT has SMP) shall be split into two technical areas:

- a) Technical Area – Inter-exchange Connectivity (Dark Fibre Circuits)<sup>150</sup>; and
- b) Technical Area – Inter-exchange Connectivity (Non-Dark Fibre Circuits).

5.47 We have also decided to require BT to include an additional line within the ‘Detailed Service Analysis’ schedule in the RFS which reconciles the difference between the treatment of ECCs if they were expensed or capitalised.

### Service level information

#### 2018 BT RFR Consultation

5.48 In the 2018 BT RFR Consultation, we proposed a reduction in BT’s service level reporting within each business connectivity market. We proposed this because in the 2018 BCMR Consultation we did not propose any pure cost-based charge controls on individual services, apart from dark fibre services.

5.49 Instead, in the 2018 BT RFR Consultation we proposed that:

- a) within each of the CI Access reporting markets BT should disclose aggregate rentals, connections and ‘Other’ for each basket and sub basket;
- b) within “Technical Area – Inter-exchange Connectivity (Dark Fibre Circuits)”, for each new dark fibre service<sup>151</sup> BT should disclose:
  - i) the revenue, volume, average price and FAC; and
  - ii) the calculation of FAC based on network component costs and usage factors; and
- c) within “Technical Area – Inter-exchange Connectivity (non-Dark Fibre Circuits)” for the dark fibre reference services<sup>152</sup> BT should disclose:
  - i) the revenue, volume, average price and FAC; and
  - ii) the calculation of FAC based on network component costs and usage factors.

#### Stakeholder responses

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<sup>150</sup> We note that the scope of the dark fibre remedy was modified as between the 2018 BCMR Consultation and the 2019 PIMR and BCMR Statement (see Volume 2, paras 12.158-12.177). The “Technical Area – Inter-exchange Connectivity (Dark Fibre Circuits)” shall reflect the scope of the remedy imposed in the 2019 PIMR and BCMR Statement.

<sup>151</sup> These are: dark fibre connection, dark fibre rental, dark fibre main link, dark fibre cessation charges, dark fibre right when tested charge and dark fibre TRCs. See Section 4 of Volume 2 of the 2018 BCMR Consultation.

<sup>152</sup> EAD 1GB Connections, EAD 1GB Rentals and EAD Main Link rentals.

- 5.50 With the exception of BT, stakeholders opposed the proposed reduction in service level information.
- 5.51 BT agreed that it should not be required to publicly disclose service level information where a cost-based charge control has not been applied. It stated that stakeholder interest is best served when there is a clear link between any pricing remedy imposed and information which it is required to publish.<sup>153</sup>
- 5.52 IIG and UKCTA said that the reduction in service level reporting is likely to materially affect the ability of stakeholders to engage in meaningful dialogue with Ofcom, and hence the quality of decisions made. According to IIG, as a minimum, Ofcom should require BT to publish internal and external revenues, volumes, average prices and FAC for EAD, EAD LA, Main Link, EBD and WDM services, broken down by speed and rental/connection.<sup>154</sup>
- 5.53 TalkTalk also argued that the publication of more detailed service level information will not be disproportionate because other services are already regulated above Openreach's cost and have such information published. According to TalkTalk this is the case with the price cap for MPF and the ISDN charge control which, it said, are well in excess of actual costs due to Ofcom's HON adjustment. TalkTalk also said that since this data is provided to Ofcom privately there is no additional cost to BT in providing it publicly.<sup>155</sup>
- 5.54 TalkTalk and UKCTA said that detailed service level reporting is required to:
- a) monitor for discriminatory behaviour such as increasing margins on services used externally, or squeezing the margin between EAD and EAD LA services to deter network-based operators;
  - b) to identify the consumer harm from excessive prices and thereby develop and substantiate arguments as to why prices should be regulated at cost;
  - c) to identify where BT is engaging in predatory pricing;
  - d) to assess fair and reasonable pricing in the context of Openreach's costs;
  - e) to provide assurance and promote stakeholder confidence that costs have been allocated consistently, appropriately and without double recovery.<sup>156</sup>
- 5.55 Vodafone argued generally that the RFS need to be detailed, in-depth, and comprehensive to ensure BT is held to account by Ofcom and other telecoms providers and does not recover non-regulated costs from regulated markets and distort markets where it has SMP.<sup>157</sup> Vodafone also argued that if Ofcom is relaxing the regulatory reporting on BT in regard to its active products then Ofcom need to prove that the market has changed, that

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<sup>153</sup> BT response to the 2018 BT RFR Consultation, paragraphs 5.2-5.6

<sup>154</sup> IIG response to the 2018 PIMR, BCMR and BT RFR Consultations, paragraph 15.2.3; UKCTA response to the 2018 BT RFR Consultation, page 2.

<sup>155</sup> TalkTalk response to the 2018 BT RFR Consultation, paragraph 6.

<sup>156</sup> TalkTalk response to the 2018 BT RFR Consultation, paragraph 5; UKCTA response to the 2018 BT RFR Consultation, page 3.

<sup>157</sup> Vodafone response to the 2018 BT RFR Consultation, paragraph 41b.



BT's SMP has diminished, or that BT's SMP is effectively being controlled by another product or competitive constraint which, according to Vodafone, Ofcom has not done.<sup>158</sup>

- 5.56 Specifically, Vodafone argued (like TalkTalk and UKCTA) that detailed service level information is needed to monitor for discriminatory behaviour:
- a) Detailed service level information is particularly useful where BT lines of business purchase a different mix of services compared to other telecoms providers (for example, WES services are not being purchased by BT at all).<sup>159</sup>
  - b) Internal and external volumes split at an individual service level allow stakeholders to compare if BT's volumes over time change significantly for a particular product and this is not matched by external changes in demand.<sup>160</sup>
- 5.57 Vodafone also argued (like TalkTalk and UKCTA) that detailed service level information is needed to provide assurance and promote stakeholder confidence that costs have been allocated consistently, appropriately and without double recovery:
- a) The large number and the significance of the adjustments made by Ofcom to the base data for its modelling show that the regulated accounts still require a high level of scrutiny and external (to BT) intervention.<sup>161</sup>
  - b) Over the past ten years there has been a significant number of disputes that have arisen or been influenced by the RFS, including disputes on PPC, Ethernet, and TRC over-charging.<sup>162</sup>
- 5.58 Vodafone made a number of additional points which relate to the purpose of the RFS. In particular, Vodafone said the current service level reporting allows them to:
- a) make decisions regarding what BCMR products to procure;<sup>163</sup>
  - b) gain insights into how BT has manipulated purchasing behaviour of CPs;<sup>164</sup>
  - c) understand how BT's prices differ from its costs which helps competing CPs' plan investments and purchasing plans;<sup>165</sup>
  - d) invalidate a claim made by BT.<sup>166</sup>

### Our reasoning and decisions

- 5.59 For the reasons set out below, most of the arguments against our proposals failed to establish a link between the removal of service information and the purpose that

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<sup>158</sup> Vodafone response paragraph 83

<sup>159</sup> Vodafone response to the 2018 BT RFR Consultation, paragraph 41f.

<sup>160</sup> Vodafone response to the 2018 BT RFR Consultation, paragraph 34.

<sup>161</sup> Vodafone response to the 2018 BT RFR Consultation, paragraph 95.

<sup>162</sup> Vodafone response to the 2018 BT RFR Consultation, paragraphs 42-43.

<sup>163</sup> Vodafone response to the 2018 BT RFR Consultation, paragraph 41e.

<sup>164</sup> Vodafone response to the 2018 BT RFR Consultation, paragraph 41e.

<sup>165</sup> Vodafone response to the 2018 BT RFR Consultation, paragraph 41c.

<sup>166</sup> Vodafone response to the 2018 BT RFR Consultation, paragraph 41d.

information served. We have grouped the stakeholder comments into similar themes set out by UKCTA and considered them in turn below.

*General comments on service level reporting*

- 5.60 We disagree with IIG, UKCTA and Vodafone that more detailed service level reporting is required for stakeholders to engage in in the regulatory process. As we said in the 2014 Regulatory Financial Reporting Statement, stakeholders have a legitimate interest in seeing information that will be taken into account in regulatory decisions, such as charge controls, although we noted that it did not follow that this should necessarily be provided within the RFS.<sup>167</sup> Indeed, as part of our market reviews, we publish (typically in consultations) information we consider necessary for stakeholder to make meaningful contributions. This information may provide a greater level of detail than that disclosed in the RFS.
- 5.61 We disagree with TalkTalk that information at a service level is currently published for other services, such as ISDN or MPF, which are regulated above cost. Our reasoning for requiring service level reporting on MPF was that, whilst not cost based, the remedy imposed was based on the service<sup>168</sup> and so service level reporting was required to assess the effectiveness of the remedy. The imposed remedies in the business connectivity markets are based on baskets, so we consider basket level reporting is sufficient. In relation to ISDN services, we no longer require publication to this level of detail due to the remedy on these services no longer being based on costs. Our decision to reduce service level reporting on the business connectivity services is consistent with this.
- 5.62 We agree with TalkTalk that the detailed service level information is provided to Ofcom in private and so there would not be a material additional administrative burden on BT from publishing the information. However, the decision on what level of information should be published is not made based solely on the administrative burden to BT.

*Monitoring for discriminatory behaviour (including predatory pricing)*

- 5.63 TalkTalk and UKCTA, raised concerns that telecoms providers will not be able to monitor discriminatory behaviour which could occur when BT lines of business purchase a different mix of services from external CPs. UKCTA and TalkTalk gave EAD and EAD LA (where BT purchase a significantly larger portion of EAD LA compared to CPs) as examples of where this could occur.<sup>169</sup>
- 5.64 We agree that there would be benefit to stakeholders if service level information was further split between EAD and EAD LA variants<sup>170</sup> to reassure stakeholders that they were not subject to undue discrimination.<sup>171</sup> In particular, this would allow CPs to identify cost and margin differentials between the variants. We have therefore decided to require

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<sup>167</sup> 2014 Regulatory Financial Reporting Statement, paragraph 2.45.

<sup>168</sup> MPF (SML1).

<sup>169</sup> IIG also ask for separate reporting for EAD, Main Link, EBD and WDM services at all speeds but do not provide any justification for requiring this information.

<sup>170</sup> Which make up the vast majority of the basket for active services at 1Gbit/s and below.

<sup>171</sup> Both price and non-price discrimination in relation to BT favouring its downstream retail markets is a competition concern we highlight in Volume 2 section 10 of the 2019 PIMR and BCMR Statement.

information on EAD, EAD LA and EAD Main Link to be separately published. This decision is explained in more detail below.

- 5.65 In relation to Vodafone's comment regarding WES services, it is worth noting that internal and external rentals are broadly similar in total (revenue of £14.7m int. vs £14.1m ext.) and across the bandwidths so there would seem to be little incentive for BT to load costs from other BCMR services onto these legacy WES services in order to unduly discriminate external WES purchasers.<sup>172</sup> Even if it were to do so via changes in cost attribution, these would be set out in the Change Control Notice which BT publishes at the end of March prior to the RFS being published. As with all services, the Openreach price list sets out whether there is a difference in internal and external prices. Unlike EAD and EAD LA, we do not think the separate reporting of WES is justified.

*Excessive prices and fair and reasonable pricing in the context of Openreach's costs*

- 5.66 TalkTalk and UKCTA raised concerns that telecoms providers will not be able to assess excessive pricing and fair and reasonable pricing.
- 5.67 As set out in Volume 2, Section 10 of the 2019 PIMR and BCMR Statement, in light of our finding that BT has SMP in certain business connectivity markets, we are concerned that, amongst other things, in the absence of appropriate ex ante regulation:
- a) BT would have the incentive and ability to fix and maintain some or all of its prices at an excessively high level or engage in a price squeeze; and
  - b) BT would have the incentive to increase prices in areas with limited or no competition, to subsidise price reductions in more competitive areas (or where it considers rivals may build).<sup>173</sup>
- 5.68 In respect of excessive pricing, as set out in volumes 2 and 3 of the 2019 PIMR and BCMR Statement, the pricing remedy has been designed to provide a long-term solution to our competition concerns by giving investors in new networks confidence in the investments they have made and planned. As a result, we have set a CPI-CPI price control with a sub cap of CPI+5% on each and every service. In any event, our analysis showed that prices are broadly aligned with costs.
- 5.69 If there are changes in cost attributions between services, information in the Change Control Notification and Reconciliation Report section of the RFS will also provide stakeholders with information on how these cost attributions will or have changed. Therefore, unless there are significant changes in volumes over the next two years, we do not expect large shifts in costs between services and basket / sub-basket level reporting will be sufficient to reassure stakeholders.

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<sup>172</sup> As WES is contained within a basket, subject to service cap requirements and basket level requirements, BT is entitled, for example to increase prices on legacy services to encourage migration to newer technologies.

<sup>173</sup> 2019 PIMR and BCMR Statement, Volume 2, paragraph 10.5. We said that we would assess fair and reasonable using an ex post margin squeeze framework. We also imposed within the CI Access BT+2 or more market outside of the CLA that a fair and reasonable charges requirement is sufficient to address our competition concerns.

5.70 In respect of fair and reasonable pricing in the CI Access BT+2 or more (HNR) areas, we said in our statement that we would adopt an approach consistent with the margin squeeze test. Therefore, detailed wholesale service level reporting will not provide any relevant information. A more appropriate tool to identify divergence in prices between the HNR areas and the other price controlled markets is the Openreach price list. Therefore, we consider that the reduction in the service level reporting (with the addition of an EAD / EAD LA split) will not hinder either Ofcom's or other stakeholders' ability to identify if any of these competition concerns are realised.

*Assurance and stakeholder confidence that costs have been allocated consistently, appropriately and without double recovery*

- 5.71 TalkTalk, UKCTA and Vodafone raised concerns that the reduction in the service level reporting will harm stakeholder confidence that costs have been allocated consistently, appropriately and without double recovery.
- 5.72 We do not agree that the overall reduction in service level reporting will hinder stakeholders' ability to assess these concerns. Firstly, as explained in paragraphs 5.43 and 5.44, market level reporting (supplemented by basket level reporting) gives stakeholders sufficient information as to whether costs have been consistently attributed. The Change Control Notification and Reconciliation Report section of the RFS will also provide stakeholders with information on how cost attributions change over time. Where there is a specific concern, as with EAD vs. EAD LA and WES, we have considered additional reporting.
- 5.73 Second, it is not clear how stakeholders can use service level reporting in the RFS to assess the appropriate attribution of costs (as opposed to consistent attribution). Stakeholders' concerns over appropriate attribution of costs are usually raised during Ofcom's charge control consultations. As noted above, as part of our market reviews, we publish information we consider necessary for stakeholders to make meaningful contributions. Outside of a market review, concerns over the appropriate attribution of costs are addressed by market level reports, supplemented by a combination of the Change Control Notice, the Reconciliation Report and the Accounting Methodology Document.
- 5.74 Finally, avoiding double recovery is a function of how prices are set rather than how costs are reported although it is linked to an understanding of what costs are attributed to each market review. As explained in paragraph 5.44, market level reporting mitigates against this risk. Double recovery is something that we will assess the risk of at each market review, and once again we do not see how detailed service reporting can provide reasonable assurance to stakeholders on double recovery.
- 5.75 Vodafone noted that there have been a number of disputes over the last 10 years which could only have been raised because certain details were included in the RFS, citing the PPC, Ethernet and TRC disputes. All three of these disputes were in relation to cost orientation obligations which are not being imposed in this market review. Given the remedy imposed is one of stable prices and not linked to costs, we do not agree that this is a relevant justification for detailed service level reporting within the RFS.

*Other uses of the RFS by Vodafone*

5.76 Vodafone made a number of additional points which relate to the purpose of the RFS. These primarily related to CPs' use of the RFS to make purchasing and investment decisions. However, as set out in the 2014 Regulatory Financial Reporting Statement, providing information to inform stakeholders' make or buy decisions should not be an objective of the RFS.<sup>174</sup> Nor do we consider that the objectives of the RFS include enabling stakeholders to invalidate BT's public statements.

*Conclusion*

5.77 In relation to the CI Access reporting markets and the Technical Area – Inter-exchange Connectivity (non-Dark Fibre Circuits), taking stakeholder responses into consideration, we acknowledge that some of the information we proposed removing did serve a regulatory purpose, namely reassurance on price discrimination between EAD and EAD LA. We have therefore decided to modify our proposals so that for each separate service, basket or sub-basket, BT is required to report separately on EAD, EAD LA and EAD Main Link (as EAD LA does not consume Main Link, this information is required to enable a useful like-for-like comparison).

5.78 This means that for the CI Access reporting markets, given prices are not strictly set on costs, BT is required to disclose revenue, volume, average price and total FAC information at the basket/sub-basket<sup>175</sup> level but with EAD, EAD LA and EAD Main Link separately reported. Please see Annex A within Direction 8 at Annex 1.

5.79 Specifically, in relation to the technical areas, we have decided that it is both appropriate and proportionate to adopt the proposals set out in our consultation for service level with one clarification around Cablelink (see next paragraph). In particular, for each new dark fibre service<sup>176</sup> required within the "Technical Area – Inter-exchange Connectivity (Dark Fibre Circuits)" and the dark fibre reference services<sup>177</sup> required within the "Technical Area – Inter-exchange Connectivity (non-Dark Fibre Circuits)", we require that BT discloses:

- the revenue, volume, average price and FAC; and
- the calculation of FAC based on network component costs and usage factors.

5.80 In connection with Cablelink services, as noted in the 2019 BCMR and PIMR Statement,<sup>178</sup> Openreach said "we do not think the RFS is currently a robust source of financial data to assess the costs of Cablelink. We have identified a number of potential issues with the RFS treatment of Cablelink and there are a number of methodology changes being investigated that might lead to a more accurate costing of Cablelink in the RFS going forward". We noted that this was consistent with our own analysis which suggested Cablelink costs in the

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<sup>174</sup> 2014 Regulatory Financial Reporting Statement, paragraph 2.61.

<sup>175</sup> Excluding cable link which is not to be reported in the technical areas.

<sup>176</sup> These are: dark fibre connection, dark fibre rental, dark fibre main link, dark fibre cessation charges, dark fibre right when tested charge and dark fibre TRCs. See Section 4 of Volume 2 of the 2018 BCMR Consultation.

<sup>177</sup> EAD 1GB Connections, EAD 1GB Rentals and EAD Main Link rentals.

<sup>178</sup> 2019 BCMR and PIMR Statement, Volume 3, footnote 66.

RFS currently do not include the key costs of providing Cablelink services but include costs that should not be attributed to Cablelink.<sup>179</sup> In view of this and the relatively small size of the Cablelink services (c £1-2m revenue) we think it would be disproportionate to require BT to separately identify volumes in the technical areas. We have therefore decided that BT must report the Cablelink sub-basket within the basket for active services at 1Gbit/s and below only in the CI Access reporting markets.

- 5.81 We set our charge control for dark fibre services (i.e. in the “Technical Area - Inter-exchange Connectivity (Dark Fibre Circuits)”) with reference to 2017/18 financial information from the RFS for the Low Bandwidth CISBO rest of UK market as information in relation to BT Only exchanges was not available. This information also closely aligns to the “Technical Area – Inter-exchange Connectivity (Non-Dark Fibre Circuits)”. Therefore, to allow stakeholders to assess the effectiveness of our dark fibre services charge control against both the dark fibre costs and the reference service costs, we require service level information for the dark fibre reference service costs to disclosed in the “Technical Area – Inter-exchange Connectivity (Non-Dark Fibre Circuits)”.
- 5.82 Consistent with our approach in the 2016 BCMR Statement, we consider that it is important that telecoms providers and Ofcom are provided with this additional information to ensure transparency of the pricing of regulated dark fibre services in the CI Inter-exchange connectivity services markets

### **Cost components for reported services**

- 5.83 In BT’s cost attribution system, costs are ultimately attributed to cost components, which in turn are attributed to services. BT publishes a list of how the service level FAC information is broken down by cost component.<sup>180</sup>

#### 2018 BT RFR Consultation

- 5.84 We proposed that FAC component cost information at the service level, for business connectivity services, was to be no longer published in the RFS except for dark fibre services and dark fibre reference services in the technical areas.

#### Stakeholder comments

- 5.85 Stakeholders did not raise any concerns with our proposals.

#### Our reasoning and decisions

- 5.86 We have decided to require reported costs on components for dark fibre services within the “Technical Area – Inter-exchange Connectivity (Dark Fibre Circuits)” and dark fibre reference services within the “Technical Area – Inter-exchange Connectivity (non-Dark Fibre Circuits)”. This is consistent with our decision not to impose a FAC-based charge control on BT in the business connectivity markets. However, as explained below, we have

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<sup>179</sup> 2019 BCMR and PIMR Statement, Volume 3, footnote 66.

<sup>180</sup> For example, in relation to the CISBO Rest of UK market, page 48-52 of the 2016/17 RFS shows which cost components are used by each reported CISBO Rest of UK service.

decided that additional cost component information for all principle business connectivity services be provided to Ofcom as part of the private information contained in the RFS.

## Requirements for private information to be provided to Ofcom

### Removal of AFI information

#### 2018 BT RFR Consultation

5.87 We proposed that the AFI “Analysis for the markets covered by the replicability review to explain the differences between ledgered revenue and calculated service revenue” is no longer required.

#### Stakeholder comments

5.88 We received no stakeholder comments on our proposals.

#### Our reasoning and decisions

5.89 We have decided to remove the requirement for BT to provide the AFI “Analysis for the markets covered by the replicability review to explain the differences between ledgered revenue and calculated service revenue”. In the 2019 PIMR and BCMR Statement we decided to no longer regulate the Low bandwidth TISBO market and this schedule relates solely to TISBO services.

### Additional AFI information

#### 2018 BT RFR Consultation

5.90 We proposed that BT provides additional information privately in relation to detailed business connectivity service information, business connectivity service component FACs, and dark fibre revenues and costs.

5.91 The first proposed requirement was for detailed business connectivity service information pursuant to which BT would set out the revenues, volumes and total FAC on a CCA basis of any business connectivity service provided. The revenues and costs should, in total, be reconciled to the revenues and costs included within the publicly reported totals for each of the disclosed business connectivity markets and technical areas.

5.92 The second proposed requirement was for detailed business connectivity service network component FACs pursuant to which BT would set out the calculation of FAC based on component costs and usage factors for all services reported in the Detailed BCMR Service information schedule. The FAC service unit costs should reconcile to those given in the first requirement.

5.93 We proposed that BT provided this information as part of the ‘Data File’.

5.94 The third proposed requirement was to introduce a new AFI schedule entitled ‘Dark Fibre Services Revenues and Costs’ which must set out how the charge for inter-exchange dark fibre services connectivity has been calculated.

#### Stakeholder responses

5.95 BT did not object to our proposals.<sup>181</sup> We did not receive any other stakeholder comments.

Our reasoning and decisions

- 5.96 As explained in the service level and cost component level reporting sections above, we have decided to require reporting at a level that is more detailed than consulted on but less detailed than currently within the 2017/18 RFS. Given this, we remain of the view that it is important that we receive more granular information for our own internal purposes, as we still need it in order to monitor the effectiveness of our remedies and understand the individual volume and pricing trends in the business connectivity markets. We have therefore decided that BT provides this information privately to enable us to do this.
- 5.97 The first requirement, consistent with our proposals, is for detailed business connectivity service information pursuant to which BT would set out the revenues, volumes and total FAC on a CCA basis of any business connectivity service provided. The revenues and costs should, in total, be reconciled to the revenues and costs included within the publicly reported totals for each of the disclosed business connectivity markets and technical areas. This information will ensure that we have sufficient data to identify services that account for a significant proportion of business connectivity revenues and costs which will allow us to monitor the effectiveness of our regulation and to enable our timely intervention to ensure that the SMP obligations within the business connectivity markets address the underlying competitions concerns identified in our market analysis.
- 5.98 The second requirement, again consistent with our proposals, is for detailed business connectivity service network component FACs pursuant to which BT would set out the calculation of FAC based on component costs and usage factors for all services reported in the Detailed BCMR Service information schedule. The FAC service unit costs should reconcile to those given in the first requirement. As with the Detailed BCMR Service information, this schedule will ensure that we have sufficient cost component information for the services that account for a significant proportion of costs in the business connectivity markets.
- 5.99 As with schedules provided publicly, these schedules will ensure Ofcom has sufficient information to monitor movements of revenues and costs within the market and conduct initial analysis where there appear to be unusual movements.
- 5.100 Where it cannot provide this information as part of the 'Data File', we require BT to provide this information as a separate AFI.
- 5.101 Lastly, we are introducing a new AFI schedule entitled 'Dark Fibre Services Revenues and Costs' which must set out how the charge for inter-exchange dark fibre services connectivity has been calculated.

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<sup>181</sup> BT response to the 2018 BT RFR Consultation, paragraph 5.13-15.



## The Network Components Direction

### 2018 BT RFR Consultation

5.102 In the 2018 BT RFR Consultation we proposed to include two new dark fibre components in the 2019/20 RFS to reflect the proposed dark fibre access remedy from the 2018 BCMR Consultation.

### Stakeholder comments

5.103 Respondents to the consultation did not raise any concerns with our proposal.

### Our reasoning and decision

5.104 We have decided that it is both appropriate and proportionate to adopt the proposals set out in our consultation for reporting against the two dark fibre network components below with no modification. The inclusion of these new dark fibre components below from 2019/20 RFS will allow the costs specific to dark fibre services to be appropriately captured. It will also ensure that we and stakeholders can monitor how BT attributes costs to these new services in a transparent way.

5.105 To preserve the integrity and consistency of BT's RFS it is important that there is a single list of network components used to attribute costs to services in regulated markets. We have therefore decided that the new network components below are added to the list imposed on BT by the March 2019 BT RFS Statement<sup>182</sup> and that apply to all services in regulated markets in the RFS from 2019/20.

- Dark fibre Specific Connection costs;<sup>183</sup> and
- Dark fibre specific rental costs.<sup>184</sup>

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<sup>182</sup> See March 2019 BT RFS Statement, paragraphs 3.104-3.111. As noted above, the addition of these network components was within the scope of our 2018 BT RFR Consultation. We proposed a list of network components which included components which were specific to business connectivity markets and proposed that this direction would apply in all markets (see Annex 5, Draft Direction 5, paragraphs 2 and 4). We also said in our March 2019 BT RFR Statement that "We will make our decision relating to [network components which are specific to business connectivity and physical infrastructure markets] in the upcoming statements on these market reviews" (paragraph 3.96).

<sup>183</sup> To cover "birth certificate" process costs. The dark fibre "birth certificate" will be provided by Openreach when handing the circuit over to the access seeker and will display the actual performance characteristics of the dark fibre circuit.

<sup>184</sup> To cover the costs of the patch panel.

## 6. Legal tests

- 6.1 Under the “Regulatory Financial Reporting” SMP condition we have imposed on BT in each regulated market, Ofcom may from time to time make such directions as they consider appropriate in relation to BT’s reporting obligations.<sup>185</sup>
- 6.2 For the reasons set out below we consider that, for each direction discussed in this document, the relevant legal tests set out in the Act are satisfied.
- 6.3 In each case we consider that the new directions would fulfil our general duties under section 3 of the Act and meet the Community requirements set out in section 4 of the Act by promoting competition because:
- they ensure that the RFS is aligned with Ofcom’s regulatory decisions; and that the presentation and usability of the RFS is improved, thereby increasing transparency;
  - they 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;
  - they ensure that BT cannot leverage its market power in a way which could distort or restrict competition.
- 6.4 In giving the directions, 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.<sup>186</sup>
- 6.5 Section 49(2) of the Act further requires that Ofcom must be satisfied that any direction is objectively justifiable, non-discriminatory, proportionate and transparent.

### Stakeholder comments on whether Ofcom’s proposals satisfy the relevant legal tests

- 6.6 Vodafone commented that Ofcom’s proposals did not satisfy the legal tests for withdrawing or modifying a direction set out in 49(2).<sup>187</sup> In our 2019 BT RFR Statement we set out Vodafone’s comments in detail and our response to them.<sup>188</sup>

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<sup>185</sup> See Condition 9.4 in the 2017 NMR Statement legal instruments, [https://www.ofcom.org.uk/\\_data/assets/pdf\\_file/0022/108355/final-statement-narrowband-market-review-annexes-9-10.pdf](https://www.ofcom.org.uk/_data/assets/pdf_file/0022/108355/final-statement-narrowband-market-review-annexes-9-10.pdf); Condition 12.4 in the 2018 WLA Statement legal instruments, [https://www.ofcom.org.uk/\\_data/assets/pdf\\_file/0024/112488/wla-statement-annex-33.pdf](https://www.ofcom.org.uk/_data/assets/pdf_file/0024/112488/wla-statement-annex-33.pdf); Condition 7.4 in the 2018 WBA Statement legal instruments, [https://www.ofcom.org.uk/\\_data/assets/pdf\\_file/0032/116996/wba-annex-1.pdf](https://www.ofcom.org.uk/_data/assets/pdf_file/0032/116996/wba-annex-1.pdf); Condition 11.4 in the 2018 PIMR Consultation legal instruments, [https://www.ofcom.org.uk/\\_data/assets/pdf\\_file/0014/125420/PIMR-consultation.pdf](https://www.ofcom.org.uk/_data/assets/pdf_file/0014/125420/PIMR-consultation.pdf);

<sup>186</sup> European Commission, *Commission Recommendation of 19 September 2005 on accounting separation and cost accounting systems under the regulatory framework for electronic communications*, <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32005H0698&from=EN>

<sup>187</sup> Vodafone response to the 2018 BT RFR consultation, section 8.

<sup>188</sup> See paragraphs 4.6-4.7.

## Consistency with Regulatory Decisions and Regulatory Asset Value Direction

- 6.7 We consider that the Consistency with Regulatory Decisions and Regulatory Asset Value Direction meets the tests set out in section 49(2) of the Act in that it is:
- a) objectively justifiable because it is necessary for us to give a direction which specifies the accounting treatment of various costs across all markets, including the physical infrastructure and business connectivity markets. For example, in the physical infrastructure markets we need to specify the accounting treatment of the physical infrastructure costs so that the RFS is consistent with our regulatory decision to set maximum charges on PIA; and in the business connectivity markets we need to specify the accounting treatment of dark fibre costs so that the RFS is consistent with our regulatory decision to set prices for dark fibre at cost. Furthermore, the direction is objectively justifiable in that the requirements specifying the RAV methodology establish further detail and provide BT with clarity as to the requirements which BT will need to follow to ensure that the RFS are prepared on the RAV basis;
  - b) not unduly discriminatory because it reflects BT's market position in the UK excluding the Hull Area;
  - c) 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
  - d) transparent because it is clear that the intention of our proposal is to ensure that BT's RFS are consistent with our decisions in relation to the price controls imposed in the physical infrastructure and business connectivity markets.

## Audit of the RFS Direction

- 6.8 We consider that the Audit of the RFS Direction meets the tests set out in section 49(2) of the Act in that it is:
- a) objectively justifiable because it is important for both stakeholders and Ofcom that an appropriate level of assurance is provided on the RFS, both in newly identified markets and existing ones;
  - b) not unduly discriminatory because it reflects BT's market position in the UK excluding the Hull Area;
  - c) proportionate because the audit requirements are no more than is necessary to ensure that an appropriate level of assurance is provided on the RFS. In particular, we have only directed BT to provide PPIA opinions on the RFS, reflecting the introduction of ISA 800; and
  - d) transparent because the intention of our changes (i.e. to ensure that an appropriate level of assurance is provided on the RFS) is clear.

## Reconciliation Report Direction

- 6.9 We consider that the Reconciliation Reporting Direction meets the tests set out in section 49(2) of the Act in that it is:
- a) objectively justifiable because in all markets it is necessary that there is visibility in relation to errors methodology changes 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;
  - b) not unduly discriminatory because it reflects BT's market position in the UK excluding the Hull Area;
  - c) 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. We are also reducing the burden on BT by removing the requirement to publish certain schedules; and
  - d) transparent because 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.

## Preparation, Delivery, Publication, Form and Content of the RFS Direction

- 6.10 We consider that the Preparation, Delivery, Publication, Form and Content of the RFS Direction meets the tests set out in section 49(2) of the Act in that it is:
- a) objectively justifiable because the information to be provided, both in public and in private, seeks 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. This direction will also ensure visibility of newly-identified physical infrastructure markets and the dark fibre remedy in the context of business connectivity markets;
  - b) not unduly discriminatory because it reflects BT's market position in the UK excluding the Hull Area. We have explained in this document the reasons for requiring relevant additional information from BT both publicly and privately;
  - c) proportionate because the direction will be no more than is required to ensure the effectiveness of our decisions in recent market reviews and will ensure that Ofcom and stakeholders are provided with a sufficient level of information, and does not extend beyond these. In particular, in the business connectivity markets, we have explained in Section 5 why we consider it is necessary to require a slightly higher level of reporting than that consulted upon; and

- d) transparent because the intention of the direction is to make sure that the RFS remain fit for purpose and that Ofcom and stakeholders are provided with a sufficient level of information.

### **Network Components Direction**

6.11 We consider that the Network Components Direction meets the tests set out in section 49(2) of the Act in that it is:

- a) objectively justifiable because it is necessary to specify network components for BT so that it can attribute costs consistently across all markets;
- b) not unduly discriminatory because it reflects BT's market position in the UK excluding the Hull Area;
- c) proportionate because our proposal is no more than is required to specify network components relevant to the charge controls that we have decided to impose and to resolve inconsistencies between our requirements and BT's RFS; and
- d) transparent because it is clear that our decision seeks to specify relevant network components in the light of our charge controls and to ensure that these network components remain fit for purpose.

### **Regulatory Accounting Principles Direction**

6.12 We consider that the Regulatory Accounting Principles Direction meets the tests set out in section 49(2) of the Act in that it is:

- a) objectively justifiable because by specifying the RAP we will establish the attributes for BT's regulatory financial reporting;
- b) not unduly discriminatory because it reflects BT's market position in the UK excluding the Hull area;
- c) proportionate because our direction requires is no more than is required to ensure an absence of bias and consistency with regulatory decisions. While we have established the Regulatory Accounting Principles, BT retains an important role in determining the basis of preparation of the RFS, and can continue to put through methodology changes where this is in line with the RAP and such changes have been notified to Ofcom;
- d) transparent because the intention of our direction is to ensure we take a greater role in the basis of preparation of the RFS to ensure an absence of bias and consistency with regulatory decisions.

### **Adjusted Financial Performance Direction**

6.13 We consider that the Adjusted Financial Performance Direction meets the tests set out in section 49(2) of the Act in that it is:

- a) objectively justifiable because some disclosure of BT's financial performance from a regulatory perspective is appropriate and necessary to disclose the impact of our regulatory decisions on BT's financial performance. The decision in relation to the calculation of the impact of the smoothing restructuring and property provision costs, residual copper proceeds and the steady state adjustments specifies the detail which will enable BT to produce the additional statement. Our decision that the Adjusted Financial Performance schedules be provided in private seeks to enable us to understand the way in which BT has calculated the impact of the smoothing restructuring and property provision costs, residual copper proceeds and the steady state adjustments in the published Adjusted Financial Performance schedule;
- b) not unduly discriminatory because it reflects BT's market position in the UK excluding the Hull Area;
- c) proportionate because our decision in relation to the Adjusted Financial Performance schedules is no more than is required to provide stakeholders with a better understanding of BT's financial performance from a regulatory perspective and to enable us to understand the way in which BT has prepared the published Adjusted Financial Performance schedule;
- d) transparent because the intention of our decision is to ensure that stakeholders can gain a better understanding of BT's financial performance from a regulatory perspective and that we can understand the way in which BT has prepared the published Adjusted Financial Performance schedule.

## Transparency Direction

- 6.14 We consider that the Transparency direction meets the tests set out in section 49(2) of the Act in that it is:
- a) objectively justifiable because: the Accounting Methodology Documents prepared by BT on this basis will provide clarity on BT's accounting methodologies; we are identifying new markets for physical infrastructure and therefore it is important to ensure visibility of BT's behaviour; and in business connectivity markets we are relaxing regulation in some markets and imposing a dark fibre remedy for inter-exchange connectivity;
  - b) Not unduly discriminatory because it reflects BT's market position in the UK excluding the Hull Area;
  - c) Proportionate because the changes are no more than is required to ensure that presentation of the basis of preparation is clear for users;
  - d) Transparent because the intention of our changes is to ensure that presentation of the basis of preparation is clear for users.

## A1. Directions

The [directions](#) are available separately

([https://www.ofcom.org.uk/\\_\\_data/assets/pdf\\_file/0020/156143/bt-rfr-directions-jul.pdf](https://www.ofcom.org.uk/__data/assets/pdf_file/0020/156143/bt-rfr-directions-jul.pdf)).