Executive summary of the BT response to Ofcom’s consultation on promoting competition and investment in fibre networks - Wholesale Fixed Telecoms Market Review 2021-26

13 May 2020

Non-confidential version

1. Executive Summary

1.1. BT is committed to upgrading the UK's digital infrastructure to help deliver faster and more reliable broadband widely across the UK to homes and businesses. The COVID-19 crisis provides a reminder of the importance of this. BT and Openreach will play a critical part in delivering these benefits to make sure that nobody is left behind. At our recent annual results, we announced a new target to pass 20m premises with full fibre by the mid- to late-2020s, conditional on critical regulatory and policy enablers (including those set out below). We have already made significant progress: Openreach has passed almost 2.6m premises and is on target to reach 4.5m by the end of March 2021.

1.2. The Government has set out the changes to markets and policy needed to help deliver world-class digital infrastructure in the UK. It envisages the promotion of competition and commercial investment, and intervention only where necessary. Where intervention is needed, the Government calls for stable and long-term regulation that incentivises network investment and ensures fair competition between operators.

1.3. Ofcom's proposals represent a significant step forward in creating the right conditions for competitive investment. We welcome proposals to support the retirement of our copper network so we can avoid the costs of operating two networks. Capping wholesale prices at inflation (with a modest premium for full fibre services) will help everyone's ultrafast business case and help us invest widely, including in harder to reach areas. But more is needed to unlock fully the scale and pace of investment needed to deliver the Government's ambition of gigabit-capable networks everywhere by 2025, and to enable our 20m contribution to this target.

- **Ofcom should reconsider its market power finding** as Openreach does not have market power in ultrafast, or in certain areas for business circuits, when the competitive dynamics characterising markets today are properly considered.
- **Ofcom should confirm that its pro-investment regulatory policy will endure as the market transitions from copper to fibre** and that the fair bet will be honoured by committing not to impose additional price regulation for at least 15 years, and by indicating (in advance and for each investment tranche) the level of risk-adjusted returns that BT will have the opportunity to earn.
- **Consistent with the Government's strategic priorities, Ofcom should facilitate commercial arrangements that will deliver real benefits to customers** such as supporting investment in gigabit-capable networks at competitive prices, rather than putting in place undue obstacles that put these benefits in jeopardy.
- **Ofcom should apply the same regulatory approach in non-competitive areas as elsewhere in the country to support investment by BT**. We intend to build in the more costly parts of the country and stand ready to make a commitment with the right regulatory pricing and long-term signals to help us get going quickly.
- **Duct and pole access (DPA) will make it easier for others to build full fibre in competition with Openreach; we need a fair pricing regime to support this**.

Ofcom should set regulated prices which reflect the investment we have made, and will make, in our underground ducts and telegraph poles, and rivals should make a fair contribution reflecting their usage.

- **As markets become more competitive, our Commitments and regulation will need to evolve.** BT has no advantages from its control of Openreach in competitive markets so our downstream businesses should be on a par with rivals in being able to use Openreach inputs flexibly and competitively.

1.4. Full fibre investment is already accelerating and making telecoms markets more competitive than Ofcom has found. We address this first as it underpins what we think Ofcom could do differently to really put the UK in the fibre 'fast lane'.

Competitive forces are shaping outcomes to the benefit of customers making prescriptive regulation unnecessary

1.5. The key facts below illustrate how vibrant competition is in fixed telecoms markets. Virgin Media, the ultrafast leader (by a factor of 7x), has agreed a consolidation with O2 potentially creating a range of synergies and convergence opportunities;[1] it is also expanding as a fixed network operator and considering wholesaling and co-investment. Altnets are consolidating and scaling up their plans (enabled by DPA); and telecoms providers are shopping around and partnering with established *and* new networks to deliver competitive fibre services to homes and businesses.

Key facts

1. Ultrafast broadband speeds (at 300Mbps or above) are available to 53% of UK homes, of which c.10% is supplied by full fibre
2. Virgin Media has an ultrafast capable footprint in excess of 15m households; the latest cable technology, providing gigabit broadband, will be deployed across this footprint by 2021
3. Liberty Global (Virgin Media's parent) has applied to Ofcom for the necessary approval to start building networks and is willing to provide network access on commercial terms; Sky may participate as an investor and a customer
4. This, and Project Lightning, may increase Virgin Media's footprint by 7-10m (taking its coverage from half the country to c.80%)
5. CityFibre acquired FibreNation, the fibre network business of TalkTalk, in January 2020 and increased its roll-out plans from 5m to 8m premises
6. The planned coverage of other alternative network operators by 2025 amounts to 9m premises (5m - Hyperoptic; 0.3m - Gigaclear; 3.5m - other); Hyperoptic secured additional funding in October 2019 to support its plans
7. 80 companies are now looking to use Openreach's telegraph poles and underground ducts to lay new fibre; they are planning to use over 40,000 poles and 5,000km of duct, up from around 12,000 and 2,500km in May 2019
8. Sky (the second largest broadband provider) contacted several fibre providers in March 2019 to explore network access options in specific local areas
9. TalkTalk has made strategic long-term 'anchor tenant' commitments to use CityFibre's existing and future network rollout for residential and business fibre services
10. Vodafone has partnered with both Openreach and CityFibre to deliver gigabit broadband
11. The government has committed £5bn to help the final 20% of premises get gigabit broadband; this is expected to be via competitive tender

[1] ISP Review, 7 May 2020. Virgin Media and O2 Agree UK Broadband and Mobile Merger.

1.6. Similar dynamics exist in business markets where there is material existing and planned competitive leased line infrastructure in UK towns and cities. New networks are entering quickly, funding build through long-term tenders and using access to Openreach's physical infrastructure to reduce build costs, just as Ofcom intended. Competition from Virgin Media has stepped up in recent months with large contract wins (for services to Three and Vodafone). The consolidation with O2 will also create 'self-serve' opportunities for O2's mobile backhaul requirements.

1.7. These are game-changing developments. Retail telecoms markets have been competitive for many years. Now we are seeing a more intense infrastructure competition which looks more like the mobile sector where network operators compete to supply commercial network access to retailers under long-term agreements.

1.8. Communication providers (CPs), like Sky, have leverage in these negotiations as they have strong brands and sizeable customer bases that can be upsold full fibre services. Full fibre builders must, therefore, offer competitive prices to secure this demand and are entering partnerships to align interests (particularly to share the risks and gains of fibre investment). Vodafone considers 'strong partnerships' to be the only way to achieve the UK's digital ambition.

1.9. Other factors support competitive fibre build by lowering barriers. DPA helps operators deliver full fibre coverage at lower build cost; the Government is stepping up barrier busting; and innovative techniques are lowering the cost of infrastructure self-build. Government will also invest £5bn of public money to help reach the most challenging areas (and we expect these funds to be competed for). Private financing is also available; Hyperoptic, Gigaclear and CityFibre are owned by investment groups with vast infrastructure experience and access to funding.[2]

1.10. Liberty Global has funds from the sale of its cable assets in Europe (reportedly €11bn) leaving Virgin Media as its most important remaining European asset. Additional cash from the UK transaction with O2 of £1.4bn has been reported. Fibre build in cable areas will erode Virgin Media's competitive advantage. Liberty Global's response is to expand the Virgin Media footprint (supported by partnerships and DPA) and potentially enter the wholesale market (which would represent the most extensive ultrafast wholesale offering in the UK).

1.11. Openreach is responding to these pressures by building an ultrafast broadband capability (currently at close to 2.6m homes passed, compared to Virgin Media's 15m); preparing to switch off its copper network, and negotiating with telecoms providers to offer competitive prices, and other terms, for its enhanced services (to encourage take-up).

1.12. It does so with very little incumbency advantage. DPA removes Openreach's cost, coverage and speed of provision advantage. Geographic ubiquity is not a differentiator for Openreach when all operators have access to Openreach's national network of physical assets. Having BT Consumer as an anchor tenant helps but would not, on its own, allow Openreach to build at scale. Nor is BT Consumer the only anchor tenant in the market: Sky has been called the 'kingmaker', Virgin Media has its own retail arm (and potential scope to cross-sell to O2's customers), and TalkTalk and Vodafone have agreed to be anchor tenants for CityFibre.

[2] KKR, Infracapital and Goldman Sachs/Antin Infrastructure Partners, respectively.

1.13. A full analysis of these factors would likely show that Openreach does not have market power in ultrafast (now or during the review period) and does not have market power in leased line markets with a high density of rival infrastructure, known as high network reach (HNR) areas. As part of its analysis, Ofcom will wish to consider the implications of the Virgin Media / O2 deal for the competitive dynamic in the industry and its regulation of Openreach wholesale fixed services.

1.14. Ofcom should not regulate at all where competitive pressures are shaping market outcomes in a way that delivers clear benefits for customers. To do so risks stifling the very competition that Ofcom wishes to encourage as well as the associated customer benefits of lower prices and the widespread and competitive deployment of fibre. If Ofcom persists with its SMP finding it must, at least, avoid regulation (such as pricing restrictions) which unduly limits the realisation of these benefits.

Ofcom should confirm to investors that its pro-investment pricing policy is intended to last beyond 2026

1.15. Where Ofcom does need to regulate, it must be mindful of the vast and risky investment needed (and taking place) to deliver world class connectivity, and the critical importance of a long-term regulatory framework in this context. The Government has identified 'stable and long-term regulation' as a strategic priority, and the National Infrastructure Commission (NIC) says that investors in 'major transformational projects' need certainty that regulators' views on prices will not change 'half-way through'.

1.16. We agree with Ofcom's proposed 'pricing continuity' policy to keep prices for a set of baseline wholesale services the same in real terms (with a modest premium for full fibre services). This policy strikes the right balance between promoting competitive investment and protecting customers during a transformative period (spanning decades) as the UK transitions away from copper and towards fibre. Ofcom should clarify that this policy is intended to endure for the entirety of this transformative period, consistent with the Government's call for stable and long-term regulation.

1.17. Ofcom should *also* be more explicit about how it intends to treat the commercial 'bets' we are taking, should it decide to impose price caps on higher speed bandwidth products in the future. Downsides exist, even after allowing for the support provided by Ofcom's proposals. Investors (reasonably) want to know what opportunity they have to keep upside to compensate for these risks, before Ofcom would step in to cap returns. The downsides they see relate to take-up risk, cost risk, technology risk and exposure to macro-economic impacts.

1.18. Ofcom has said orally that it expects its framework to endure for two control periods, i.e. until 2031. This is helpful. But we think that Ofcom should confirm that no additional regulation of higher speed products is intended for 15 years, because this would be consistent with investment horizons which will exceed 15, and possibly 20 years.

1.19. Ofcom should also indicate a level of upside returns which BT would have the opportunity to retain (but with no guarantee of earning) if the investment turns out to be successful, and if BT is not otherwise constrained by competition. This can be set upfront for different tranches of fibre to the premise (FTTP) investment at the time the investment decision is made, allowing the fair bet assessment to reflect the risk conditions applicable at that time.

1.20. There is enormous benefit in identifying risks upfront (tranche by tranche) rather than many years later when outcomes can give a bias to how these initial risks are perceived. Waiting does not reveal relevant new information on the risks at the outset of the investment tranche, and memories can be short and/or rose tinted.

1.21. Regulation further down the line may or may not be needed - this depends on how competition plays out. But if we can agree with Ofcom what risks we are bearing now, then we can proceed with more comfort that, should price regulation be imposed, our investors will be fairly treated for the bets they took. All firms who are investing private capital into enhanced broadband services care about this, because any regulation of BT in the future affects the returns of every operator.

Ofcom should facilitate commercial wholesale deals that will deliver real benefits to customers

1.22. Telecoms regulation has traditionally focussed more on protecting customers from high or discriminatory prices charged by operators with market power where such conduct might harm *retail* competition. At this market review, Ofcom wants to promote more *infrastructure* competition. Therefore, it is also now particularly concerned about low wholesale prices targeted at areas with new networks; or other commercial terms which might discourage CPs' use of new network entrants.

1.23. This poses a much trickier regulatory challenge because Ofcom's efforts to limit competition (i.e. through restrictions on how Openreach can price its services) may inadvertently limit pro-competitive and pro-investment pricing and commercial arrangements which deliver benefits to customers through lower, more stable prices and/or accelerated investment.

1.24. Commercial deals and partnerships that share the risks and gains of network investment are being struck (or negotiated) widely, following the lead of fibre-rich countries like Spain and Portugal. The UK Government has said that firms should have flexibility to manage risks in this way, and it expects Ofcom to facilitate such arrangements 'where appropriate'. Openreach's ability to compete fairly and negotiate agreements with CPs is critical to manage the substantial risks of investing in full fibre at scale and at pace, particularly given Virgin Media's extensive, established (and sunk) ultrafast broadband network.

1.25. For Ofcom's regulation to do more good than harm, it should:

- Enable competition with established networks to the benefit of customers (for example, Virgin Media's cable network and other established leased line operators)
- Enable operators to reach commercial deals with CPs where the deals are important to support investment in new or expanded networks and/or facilitate lower long-term prices or other benefits to consumers
- Limit restrictions on prices to protect new entrants to only what is proportionate and consistent with promoting efficient competition, with entrants being required to compete on their merits over the medium-to-long run

1.26. Consistent with these principles, we think that customers would gain more through investment and keener prices (and smaller players still be protected) if FTTP and leased lines were excluded from Ofcom's proposed restrictions. In both cases, there is more reason to expect benefits than harms to arise from allowing Openreach the flexibility to compete, as it does not have market power in ultrafast and leased line competition is fierce in many parts of the country.

1.27. Further, there is no evidence of unfair pricing practices (or the risk of them) on Openreach's part. Openreach's pricing will be shaped by powerful customers who have no interest in harming infrastructure competition. Prescriptive regulation is not, therefore, objectively necessary nor is it proportionate.

1.28. If Ofcom nevertheless decides to proceed, it needs to be clearer on its analytical framework for deciding whether to grant consent or to intervene following a review. The criteria applied must be proportionate to Ofcom's goal of promoting network competition. Otherwise there is a risk that regulation itself unduly stifles competitive responses by Openreach – and possibly investment - through the application of excessively cautious, and unpassable, thresholds.

1.29. Ofcom should confirm that the principles established in competition law will form the basis of its assessment as these have been designed to assess (or reliably predict) competition effects. It is not appropriate to limit Openreach's conduct unless Ofcom can show that Openreach's pricing has (or will be likely to) materially harm end customers.

1.30. Equally, Ofcom should indicate how long its proposed restriction will last so that rivals can appropriately reflect fair competition with Openreach in their business cases. This would help avoid protracted regulatory disputes in which rivals rely on general statements from Ofcom which are mis-interpreted as a guarantee of their business case or particular market share outcomes.

Ofcom should apply the same pricing remedies in non-competitive areas as elsewhere in the country to support investment by BT

1.31. We agree with Ofcom that the benefits of fibre investment should be available to people and businesses everywhere. We welcome Ofcom's willingness to flex its regulation in the harder to reach areas, specifically, the proposal to allow BT to recover fibre build costs across a wider range of services. We plan to build significantly in rural locations and stand ready to make a commitment to build full fibre commercially in these areas with the right regulatory conditions to help us get going quickly. We also welcome the announcement in this year's budget that £5bn will be earmarked to fund ultrafast rollout in the hardest-to-reach areas.

1.32. Ofcom's preferred option is to allow fibre build costs to be spread across wholesale copper services from the outset of the review period (rather than ex post once the fibre investment is delivered). If regulated prices are set in line with Area 2, then this approach will allow us to get going quickly and has the added advantage of a consistent pricing approach across geographies.

1.33. The commitment we make will appropriately reflect the benefit of being able to recover costs in the way Ofcom suggests. But the model is not (as Ofcom suggests) similar to a regulatory asset base. A RAB exposes infrastructure providers to an efficiency challenge but not (usually) volume risk. We remain exposed to this risk even in those areas where Ofcom does not envisage effective fibre infrastructure competition. For example, take up of higher speed tiers may be less than expected, government intervention may be higher than expected, there is still some competition risk (which is exacerbated by the availability of DPA and mandated dark fibre) and there is also a risk of competition from new technologies. The scale of a committed build will need to reflect these uncertainties. More can be committed if Ofcom signals that fibre build costs can be spread across copper services in subsequent review periods and indicates the 'uplift' that will be allowed on copper prices in the future to support the recovery of fibre build costs.

1.34. Ofcom's alternative approach for encouraging investment by BT (the 'post build' option) is unlikely to be effective as proposed. This is because the proposed uplifts to copper prices are insufficient to support the necessary investment given the costs and risks involved. It could also result in significant price differentials between different parts of the country for fibre and copper.

DPA will make it easier for others to build fibre in competition with Openreach, but we need fair prices to support this

1.35. Openreach already provides access to its physical infrastructure nationwide (and without restriction) to support competitive investment in fibre networks. Over the review period, Openreach will be investing to upgrade its duct and pole infrastructure, so that it, and other CPs, can rollout full fibre. In setting prices for the period until 2026, Ofcom recognises that Openreach must have the opportunity to recover efficiently incurred costs and that a level playing field is needed between Openreach and rivals that use DPA to compete downstream. We agree with Ofcom that these objectives are important to create conditions supportive of investment.

1.36. But to ensure DPA pricing is sustainable and can continue to achieve Ofcom's goals some adjustments are needed. Prices must be set using the latest estimate of costs including future investment we expect to make in the physical assets over the review period. Further, the method for allocating costs between Openreach and other providers (including Virgin Media and alternative operators) should be amended for some product components to better reflect their use of the physical infrastructure and their opportunity to earn revenues related to that usage.

The BT Commitments and regulation will need to evolve as markets become competitive

1.37. As markets become competitive (reflecting technology developments, as well as evolving dynamics of competition), BT's downstream businesses will be able to use de-regulated assets in different ways. Our Commitments will evolve to allow BT's downstream businesses to compete and differentiate in circumstances where rivals no longer rely on the de-regulated assets (hence the lifting of regulation).

1.38. Where Ofcom still finds Openreach to have market power, we expect that access regulation will not be imposed on BT's downstream business units where they use Openreach passive infrastructure (ducts, poles and dark fibre) or where they self-build to complement existing Openreach passives.