

## Pricing wholesale local access services in Geographic Area 3 with a BT Commitment to deploy a fibre network – Clarificatory questions and responses

### Question 1

We think the FTTP premium is treated differently in the Shortfall model and the DCF model.

In the shortfall model the values are as follows:

	years 1-10	years 11 onwards
High	4.00	1.85
Low	1.50	1.50
Central	2.75	1.68

In the DCF model it is £2.75 for both periods.

We were wondering if this is a conscious modelling assumption (something to do with switch off)?

On a related point, absence switch off is it consistent to count the value that arises from avoiding a drop in FTTP prices to the indexation calculation.

### Response

In the DCF model, the FTTP premium is 1.68 for years 11-20 (C20 in 'Fibre shortfall inputs sheet'). We think it is relevant to count the value from avoiding a drop in FTTP prices. This is to reflect our modelling counterfactual where charge controls would apply to all FTTP bandwidths from year 11.

### Question 2

We think the build and take up assumptions in the shortfall and DCF models don't match. Could we understand the thinking behind that please?

### Response

It is correct that build assumptions don't match. In fibre shortfall model, there is a simplification that all build occurs immediately, whilst the DCF model spreads the build over 5 years. Take-up assumptions of 90% by year 8 should be consistent across both models.

### Question 3

In the consultation Ofcom states that the capex assumptions used to calculate the fibre shortfall is based on capex used for building 7m homes (and pro-rated across 3.2m homes). i.e. a capex of £370-£490 per homes passed with a cost of provision of £280.

We think the capex used in the modelling to get to 3.2m homes is closer to £320-£390 per home passed with a cost of provision of £250.

Could Ofcom confirm that is correct?

### Response

We have identified an error in the model whereby the capex used in the fibre shortfall calculation relates to the lowest cost 3.2m premises, as opposed to the capex relating to 7m premises that is then averaged and pro-rated to 3.2m premises. We will correct this in our work for the statement.

### Question 4

I think we are right that you assume no Openreach competitive loss in area 3? We were wondering if we could discuss why this is the case. For example, what about others' roll out plans in area 3 e.g. Gigaclear plans for 500k or public funded build that we don't win.

### Response

Our model does not assume any competitive loss in Area 3. We intend to review evidence and stakeholder responses around this for our statement.

### Question 5

We can't work out why the FTTP premium in the final 10% is counted towards the value of indexation. Logically in a subsidy area, we would separately account the returns in the subsidy area build business case (imagine that should be the same in your assessment of value also). Would be good if you could explain the logic behind the modelling.

### Response

The logic is the same as for Area 3 more generally, the costs of building fibre to 3.2m Area 3 homes is being partly funded by price increases for 8.8m Area 3 homes: this revenue is being counted because the fibre premium is being applied to the last 10% of premises as well.

### Question 6

If we take the CPI 2% and 1.9% assumptions, this doesn't seem to be in line with forecasts post-Covid.

We were wondering why the assumed inflation doesn't more closely match forecast.

We speculated that perhaps Ofcom had run any sensitivities of lower CPI to the model outputs and on that basis not updated? Is that the case?

### Response

The CPI forecasts we have used within our models have been taken from the OBR March 2020 Economic and Fiscal outlook report. The OBR did release a Fiscal sustainability report on 14th July 2020 but we did not update for this. The July report did forecast CPI for 2021 of 1.3% but then back to 1.9% and 2% for the other years of the charge control.

### Question 7

In the CPI-X model, the central case X for FTTC has changed from -9.75% to -2.75%. Please explain the changes to the X from the January 2020 model.

#### Response

RAB Model Headline FTTC area 3 X:	-9.75%
July Discount FTTC area 3 X:	-3.75%
Error in RAB model inputs:	+1.0%
RAB Model Discount FTTC area 3 X:	-2.75%

### Question 8

At paragraph 3.30 Ofcom says: “...we will have the ability to adjust pricing trajectories in future charge controls should it emerge that there will be a material risk of over- or under-recovery”. Could you explain what circumstances would result in Ofcom adjusting future charge controls to increase/reduce the fibre shortfall/subsidy. For example:

- If Openreach passed (say) 2.7m homes rather than 3.2m homes in Area 3 (in the period to 2026)

#### Response

While we would reach any future decision on the basis of the prevailing circumstances, in this instance, we expect that future charge controls would be adjusted as a result of our proposed approach to accelerating depreciation as set out in Section 4.

- If the outturn build or connection costs per home passed were higher/lower than forecast
- If the outturn FTTP uptake was higher/lower than forecast
- If the outturn ‘fibre premium’ revenue (per FTTP customer) was higher or lower than forecast
- If outturn connection revenues (per FTTP connection) were higher than forecast (Ofcom forecast zero)

In relation to the above, we expect future charge controls would be based on forward looking estimates of service costs.

### Question 9

Is Ofcom planning to collect the data needed to assess outturn uptake, revenues and costs in Area 3?

#### Response

Our proposals are set out in Section 5. (see Table 5.2).

### Question 10

At paragraph 4.17 Ofcom explains how accelerating depreciation helps ensure BT meets its commitment. We do not understand how this works and would value an explanation. What incentives does accelerating depreciation provide that standard depreciation would not?

### Response

An explanation is provided in paragraphs 4.10 to 4.18. Our proposals for accelerated depreciation allow us to adjust cost recovery in future charge controls in the event that BT does not meet its commitment to build fibre.

### Question 11

At paragraphs 2.16-2.17 Ofcom explains its assumption for the fibre premium:

- Up to 2026 £1.50-£1.85 for FTTP40/10 and £4 for higher bandwidths
- After 2026 £1.50-£1.85 for all bandwidths

What is the reason for the change in assumption between periods and more specifically why does Ofcom assume no higher premium for bandwidths above FTTP40/10 after 2026?

### Response

We assume a fibre premium of £1.50 - £1.85 from 2031 (not from 2026). For modelling purposes we assume that FTTP services will be charge controlled at that level from 2031.

### Question 12

What assumption has Ofcom made about when in the 2021-2026 period the 3.2m homes will be rolled out by Openreach?

### Response

For modelling purposes, we assume a uniform roll-out across the five-year period.

### Question 13

Ofcom's assumption on efficiency after 2026 (A2.27) is unclear to us. Is Ofcom assuming that there will be no efficiency gains after 2026, or that the rate of efficiency gains after 2026 will be the same as efficiency gains from 2021-26? What is the actual efficiency gain? Is this efficiency gain applied to FTTP only or to FTTP and FTTC?

### Response

The rate of efficiency gains for FTTC post-2026 are assumed to be the same as between 2021-2026. Efficiency assumptions for FTTP are set out in our fibre cost model (and we refer to these in Annex 17 of the January 2020 Consultation).

### Question 14

Why has Ofcom chosen to calculate the average build cost per premise passed of the 3.2m rollout based on the average build cost per premise passed for the lowest cost 7m premises (A2.12) rather than, for example, 5m or 6m?

## Response

This is the set of premises that we have assumed will not be subject to public subsidy.