Ofcom: Promoting Competition and Investment in Fibre Networks (8 January 2020)

Coordinator: Good morning, ladies and gentlemen, and welcome to the Ofcom call to discuss the approaching and promoting competition and investment in fibre networks. The call is hosted by Jonathan Oxley, Ofcom Interim Chief Executive. My name is Joan. I'm your event coordinator. During the presentation, your lines will remain on listen only. [Operator instructions]. I'd like to advise all parties this conference is being recorded for replay purposes, which will be available later on, together with the transcript of the call, on the Ofcom website.

I'd now like to hand over to Jonathan. Please go ahead, Jonathan.

Jonathan Oxley: Thank you, Joan, and good morning to everyone on the call. I think we have a very extensive list of people. We have about 50 people on the call. So, with me this morning, I have David Clarkson, who's a Competition Group Director, and I have Rohit Goel, who many of you will know, our Analyst Relations Manager.

Through the presentation portion of this call, which we'll try to keep reasonably brief so that there's plenty of time for Q&A, we'll be referring to a set of slides, which if you haven't already, you can download from the Analyst Relations section on the Ofcom website. And as I say, once we've completed the presentation, there'll be an opportunity to ask questions.

I'll just give a quick canter around the highlights of what I think we're doing today, and then I'll hand over to David to go through a bit more of the detail behind the proposals we've set out today.

I guess there were two main areas that I think it's important for investors and analysts to focus on. The first is what is a very radical departure from our historic approach of orientating prices to Openreach's costs. For the first time, we are now departing from that. We're trying to encourage competitors to enter the market, and as a result of that, we're setting prices that are more akin to the prices that we think are reasonably efficient competitors to BT, and not just the incumbent's cost base. That means that prices through the regulated products in the areas where we think competition can take place will go up in line with inflation.

We're capping it to CPI but that's a significant departure from the past. If you imagine the past, the counterfactual would have probably been a CPI-X type arrangement. The upshot for that is we're injecting a lot of additional margin and returns for the whole industry in terms of the network builders. So, effectively, this is very pro-infrastructure.

We've also, as you'll see we'll talk about later, included a premium on our anchor price, the 40 megabit price, anchor price, for when the service is provided over full fibre. That reflects the benefit consumers and businesses will get from using a full fibre service and the savings that are made through the value chain from full fibre from, for example, fewer faults.

And the second thing I wanted to highlight, which is particularly relevant to BT and to Openreach, is what we're doing to enable Openreach to close down its increasingly obsolete network of copper cables. It's, obviously, you don't need me to say that it's very expensive and inefficient to run two networks and we want to give them an ability to simplify the business and accelerate full fibre and improve the business cases for doing so.

So, we have proposals here for a two-year transition. Once they have the network built in a particular location, within two years they'll be free of pricing regulation on their copper-based products, which would allow them to price as they see fit. You could speculate that they would have the opportunity therefore to price in a way that would force their wholesale customers to move to their full fibre network, and that will accelerate the returns that they can get on that network.

Those are the two areas I wanted to focus on in terms of substance, but I also just wanted to make the general point that what we've tried to do through this whole process is provide a consistency of our approach that builds on the previous things we've done around ducts and pole to encourage people to come into the infrastructure market. It's also providing certainty and predictability, which is what investors say they want from the sector in the UK. I hope that's your perception of what we're doing.

I'm going to hand over to Dave now to just go into some of the more details.

David Clarkson

Thank you, Jonathan. It's probably worth me just starting off to set out our high-level approach here. So, we talk about promoting investment and competition, and those two things we see going hand in hand. There are some parts of the UK where we actually think there can be competitive investment in these networks. Those areas, by the way, we refer to as Area 2; I'll go into them in more detail. And in those areas, our approach is very much to promote investment by Openreach/BT, and other operators.

We also recognise that there are some areas where competitive investment is less likely. We refer to those areas as Area 3. And in those areas, we don't want to give up on them. We still want to promote commercial investment, and we have looked to build a regulatory approach that we think de-risks the investment and supports that. And again, I will go into that in more detail. So, there's something in this for Openreach, BT, and the other operators.

Moving on to slide 3, Proposals Addressing Regulatory Enablers Identified by Openreach. So this is really Openreach-centric. So, a while back, Openreach identified three regulatory enablers that it felt were important to support its investment case in fibre, and we believe the proposals we set out here today fully address those.

The first one of the enablers is about copper retirement, balanced approach. And Jonathan has already mentioned what we're doing in this area. But, we are fully looking to support the migration from the old copper network to the new fibre network, and the closure of the old copper network and in doing this, actually allowing a higher price for the equivalent fibre products. I'll go into that in a bit more detail on the next slide, just saying that's what we're proposing there.

The next enabler is about the fair treatment of legacy copper investments. Now, this is really about avoiding stranded copper assets and stranded copper investments. Our approach here is subtly different between the Area 2 and the Area 3. So, the Area 2 potentially competitive, what are we doing here? Well, we're proposing, as Jonathan says, to index prices rather than have cost-orientated prices. We believe that this will inject some more margin in to the network layer and that that will actually support investment by both Openreach and indeed other competitors. In terms of Openreach, this extra margin will allow it to accelerate the recovery of its legacy copper investments, thereby avoiding stranded assets.

In the case of Area 3, the non-competitive areas, our proposal there, and again, I'll go into just a bit more detail in one of the later slides, but it's to adopt a regulatory approach which actually underwrites and de-risks the investment. And, we can actually control the depreciation profile of those assets and ensure that they don't become stranded.

The final enabler was the fair bet and our approach to that. It's probably worth just being clear so everyone is on the same page in terms of what the fair bet is. This is where a company faces downside risk, so if the investment fails they potentially lose, that it's actually reasonable that they should enjoy the upside returns in the event that the investment succeeds. So, this is the fair bet and this is a principle that we've always supported and continue to support.

In the past, and with the FTTC investment, Openreach did face significant downside risks on demand and willingness to pay, and in part that was to do with the way that the regulatory construct wrapped around it. Because, we continue to have and regulate the old network, so consumers could have stayed on the old network and not used the new one. And so that was a significant risk. So, therefore, when we did look to regulate that, we obviously factored in those downside risks when we were considering regulation.

For this fibre investment, we're actually proposing to take a slightly different approach to the fair bet. In that actually we're going to focus quite hard on de-risking the downside risk faced. And you can see that we're doing that in the way that we're supporting the migration from the copper networks. So de-risk things like demand. We're not having cost-oriented prices so in terms of willingness to pay, and indeed having higher prices. So, our approach here is very much one of looking to de-risk the risk sides of the fair bet.

In terms of going forwards, well if competition emerges, and we hope in a lot of areas it will do, then in fact our position is that we'll de-regulate that area. So, talk of fair bet in those situations doesn't really come into it. But, there is a chance that regulation is necessary in the future and again, in doing that, we will absolutely look at the upfront downside risks that were faced.

In Area 3, and I'll go into that in a bit more detail in a moment, but the approach there is to de-risk it through the way that we set charge controls for the old and the new services.

Moving on to the next slide, slide 4, Copper Retirement. So clearly we recognise that it'd be inefficient to run both the old and the new fibre networks in parallel for a prolonged period of time. So, we're very keen and what we set out here is a set of proposals which supports the transition in a very rapid way from that old network to the new network and the subsequent closure of the old network.

In terms of the detail, what we're proposing here is on an exchange area by exchange area basis, and there's about 5,500 of those, when the coverage of fibre hits 75%, we will actually start to roll back on regulation. And the first thing we would do at that point is we will actually no longer require Openreach to supply new copper services. So, this is known as stop-sell. What that means is all new orders, moves and upgrades will have to be on fibre. Two years after introducing the stop-sell, and once the rollout is nearer complete, we'd actually proposed to remove all charge controls from the copper network. The idea there, as Jonathan mentioned at the beginning, is that at this point Openreach could use relative pricing to encourage migration from the old to the new network.

Jonathan Oxley

Can I just interject there from my side? It's Jonathan here. I think the stop-sell, which Dave talked about, is hugely important because it's up to Openreach, obviously, but they could make a decision once they build out 75% of a particular exchange area with fibre. We're permitting them to stop selling copper services should they wish to do so. Now, if you look at their customer base, you have potentially quite significant churn on the base. I don't mean competitive churn there; I mean the churn you get where consumers upgrade between services—consumers that go from ADSL to fibre to the curb services, to their GEA network.

That will mean that this change in the regulation gives Openreach the opportunity to move customers quite quickly. So, it's not just the two years' time frame, there is also this stop-sell. And, given the quantity of churn there is, then this is coming, this can potentially come quite soon in terms of people being moved onto their network.

David Clarkson

Thank you very much. Moving on to slide 5, so let's have a look of what's it in for the other potential investors, so the non-BT investors. Well, we think we're actually proposing a number of things, and have done a number of things to support investment by other companies.

In particular, access to BT's ducts and poles looks to lower the upfront costs and the time to deploy networks by these types of providers. We've talked about indexing prices and leaving greater margin in the network layer. Again, that would help the investments in these cases. And, we've also talked about the fact that we will only regulate what we consider to be the entry-level product, which is a 40 Meg product and actually give pricing flexibility above that, again giving more margin and pricing flexibility for those investors.

So, we think that this actually creates an environment where there's actually more incentives for seekers to think about alternatives to Openreach. We are aware that these investors are concerned about actions that could be taken by Openreach in the short-term to undermine them, and we have an ongoing monitoring exercise to make sure that there isn't anti-competitive behaviour. We're happy with competition on the merits but not otherwise.

And, the last point on this slide, which has come up a few times, an area of concern is that Openreach would use localised pricing to try and drive out competition or deter competition in the early days, and this is an area that we're actually looking to prevent doing. But, it would be subject to a case-by-case basis, if there was objective justification to consider otherwise.

Moving on to the next slide, slide 6. So the proposal for the non-competitive area, Area 3, which in this consultation we believe it represents about 30% of the UK, 30% of premises that is. And, what we think here is despite having ducts and pole access that actually competitive investment of a significant level is quite unlikely. So we're not expecting a heavy competitive dynamic here.

So, our approach here is to try and build incentives to incentivise Openreach to build. What we've come up with is what we call the Regulatory Asset Based approach to setting charge controls. And very simply, this is cost-oriented, but the idea is that should Openreach invest in fibre, rather than treat that separate, we would capture those costs, include it in the broader asset base and actually spread it across the whole range of services within these areas. Thus de-risking that investment.

Now, the way we set it out in the document is we've said we'll have a CPI-X control, but if investment takes place then we will increase prices to allow for that, and we called that the +K. So it's a CPI-X+K. We are aware because BT has made comments to us that they're thinking of committing to deployment in this area, and they'd be looking for us to build their commitments into the charge controls and possibly have indexation in these areas at the outset. That is something that we would be keen to pursue. So, if we get commitments to build, we could factor them into the calculation upfront rather than have an after-the-event type approach.

In these areas, of course, there's going to be areas that actually commercial money is just not going to go to and this is very much where any government funding would come in. So, the government has announced the possibility of a £5 billion intervention. That would be in this area and we believe that it can work hand in hand with the approach that we've set out here, so some of this 30% would be commercial under the RAB-type model and some of it could be government funded.

Also, in this area, and the last point on this slide, is for leased lines we think that a better form for access to seeking leased lines have dark fibre rather than Ethernet-type leased lines. And, we're proposing to have a cost-based dark fibre remedy in this area for those purposes.

So that is a quick walk-through what we put into the proposals today. We believe these are very pro-investment, pro-competition. In terms of the competition from the ducts and pole side, in terms of the investment more generally. The fact that we're indexing prices and not having cost-orientation. And actually to support the whole case of fibre, our support for the copper retirement and the transition to the fibre network. So, these regulations we would be looking to bring into place next year in March, and they would be running for five years until 2026, allowing a long period of stability. Thank you very much.

Jonathan Oxley — Thanks, Dave. I mean, just to sort of wrap up, it's easy that you guys are investors and analysts so I won't use hyperbole. But, I actually do think that we, through these proposals, are removing the roadblocks to investment in fibre. And, I do think they transform the economics. It will be interesting to get your views and whether you think that's the case. I think there's a significant change from historically what Ofcom has done, and I think it does get the right balance between ensuring that investors get fair returns but also we protect consumers.

That ends our presentation. Do you want to just take us through the next steps?

Rohit Goel — Sure.

Jonathan Oxley — By the way, I do apologise if you can hear background noise. We do have the builders in so I apologise for all of you on the call if you're getting any background noise. I can tell you it's a lot more background noise in the room.

But, go ahead, Rohit.

Rohit Goel — As Jonathan said earlier, we have quite a number of people on the call so just in case you don't get around to ask a question, do get in touch with myself, Rohit Goel, Analyst Relations Manager here at Ofcom; analyst.relations@ofcom.org.uk.

Operator, we're ready to take questions, please.

Coordinator — Thank you. [Operator instructions]. The first question comes from Michael Bishop (Goldman Sachs). Please go ahead.

Michael Bishop — Yes, thanks very much. I'll just keep it to one given you have a lot of people on the call, and thanks for hosting. I just wanted to follow up. You gave a lot of clarity around how you believe that you're changing the fair bet principle, in effect underpinning less downside risk. But, I think in the past, you've focused on the call in terms of suggesting that after this five-year regulatory period, in all reality, there would probably be a subsequent five-year regulatory period where you wouldn't look to adjust wholesale pricing.

So, I was just wondering whether you have any commentary around the fair bet principle beyond this five-year regulatory cycle. Thanks.

Jonathan Oxley — Yes, we did mention that but I'm happy to reiterate that our intention would be that we wouldn't return to cost orientation in a second cycle, so for the period for the next market review after this one. So ten years of stability and certainty.

Now, if my general counsel was here, she would point out that I can't actually be bound by that because we will have to look at the facts at the end of this current five-year period. But, certainly our intention would be to provide that kind of ten-year certainty.

Michael Bishop — Great. Thanks very much.

Jonathan Oxley — You're welcome.

Coordinator — Thank you. The next question comes from Mandeep Singh (Redburn). Please go ahead.

Mandeep Singh — Hi, thank you for taking the question. It's Mandeep from Redburn. The question is on the 30% of the UK where you said if BT commits to invest then obviously those costs can be included upfront. Can you just give us some parameters of what would be—how would you define the commitment to invest? How many homes are in that area and what would be seen over the five-year period from April 2021 to 2026, what would be a reasonable commitment by BT, like three million lines, four million lines, five million lines? Can you just give us some flavour for what you would see as a commitment? Thank you.

David Clarkson — I will try, and naturally there will be a range on this and there are ranges in the document. In fact, you can probably triangulate some of the numbers. So, Area 3 represents about nine million premises in total. We've looked at some of the numbers, clearly, on producing this condoc, but we would obviously have to go into some more detail at the time to see exactly what the roll-out profile was and which areas. But, I think as a starter, and just to put people in the right place, I think we would be in the area of a few million would have to be the sort of level of commitment in order to get close to index price in these areas.

So, what we're doing there is we're looking at the difference between the charge control absent build and what index prices would be and what that wedge is worth and how much it should buy. But, more work would be needed because we'd need details from BT, but we do think that it would be in the several millions.

Mandeep Singh: Can I just follow up very quickly?

David Clarkson: Ok.

Mandeep Singh: If we were to think of a ballpark number around four million to put in some models, would we be way off the mark or is that a reasonable number to stick in models, for example?

David Clarkson: I would have thought it's a good central base.

Mandeep Singh: Thank you.

Coordinator: Thank you. The next question comes from Paul Sydney (Credit Suisse). Please go ahead.

Paul Sydney: Good morning. Thanks very much, and again, just one question, please. I was just wondering if you could give us of an indication of what level of discussion you've had with Openreach and UK government over the past few months. I mean, clearly, you've been very upfront about the enablers. We've already seen what I think is a pretty encouraging press release from BT already this morning. So, it'd be great to get a feel for just how interactive the discussions have been with BT and the UK government in coming up with this very detailed proposal. Thank you.

Jonathan Oxley: First of all, we're an independent regulator so there's obviously in terms of the decisions we're making, and the proposals we're making, they're our own, not the government. Although we're obviously very conscious of what the government strategy is and we work very closely with them, particularly on the plans that they've announced for the £5 billion potential subsidies in rural areas, which is extremely complementary to what we're doing. We can get into that if that's helpful.

In terms of consultation. The reality of our day jobs is that we spend an awful lot of time with stakeholders so we've obviously had lots of contact and discussions with Openreach and BT, but also with TalkTalk and Sky and with all of the other major stakeholders, CityFibre, Hyperoptic. We meet all of these folk all the time, and

	we're very open to hearing their views, their opinions. This is a consultation after all. That's not just for larger players. We also meet with a lot of the smaller, alternative network operators that are around the country.
Paul Sydney	That's very clear. Thank you.
Coordinator	Thank you. The next one comes from John Karidis (Numis).
John Karidis	Thank you. If I may, two quick ones. First of all, where do you expect do you think there might be a need for further consultations over the next few months? I'm trying to figure out whether these are going to be very substantive issues or not. And secondly, it would be lovely to get an idea of a case where geographic pricing would be allowed, please. Thank you.
David Clarkson	Let's take each one in turn. So, in terms of future consultation, I should start by saying that what we've tried to do here is to cover everything off in one document, which I know is quite a heroic effort, but that's what we've tried to do, and that's why it's quite a heavy document, quite a lot of pages. But realistically, as we go through the year, there's bound to be areas that pop up that we'll need to re-consult on. It's very difficult to know where they might be. The normal areas to give examples would be when we get new cost data that's significantly differently than we anticipated, and therefore, there might be some parts of the charge controls. It doesn't necessarily have to be all of them, it could be something like the ancillary services or something. It's also possible areas like the copper switch-off, and the retirement, that bringing in more detail there is an area that there possibly might need more consultation. But, we're not planning on these. We're planning on trying to go through without further consultations but clearly we accept and we can recognise that there'd be areas that probably will pop up. But, those are the sort of areas. You are searching for an example of where geographic pricing might be allowed to subjectively justified. The obvious ones is if there are identifiable differences in costs. So, we're talking about Area 2 here, so it's the first part of the hockey stick cost curve, so although there's a gradient into it, there isn't wild fluctuations, we believe. But, I mean, clearly, if Openreach identified that there was an area or a big town or city or something where the costs for an identifiable reason were lower and that that was where people were competing against aggressively on price and it wanted to meet those competitive prices, then a cost based justification would be one example, I'd suggest.
John Karidis	Thank you.
Coordinator	Thank you. And, the next one comes from James Ratzer (New Street Research).

James Ratzer — Yes, thank you, good morning. I have two quick questions, please. The first one was just regarding price discounting by Openreach. I mean, you're making it clear that they're not going to be allowed to do any geographically-targeted discounting. But, I mean, Openreach recently has been engaging in quite widespread discounting on its FTTC pricing. Are they going to be allowed to do more widespread discounting on FTTP, which could make life tougher for some of the new entrants going forward?

And secondly, I just wanted to understand the methodology by which you've set the price uplift of £1.50 to £1.85 on the base of 40/10 prices. Thank you.

David Clarkson — I will try and pick up both of those questions. So, on the discounts, other than geo-targeting of discounts, so what we've set out in this document is we recognise that in fact other pricing structures and discount structures could be quite beneficial to the market in terms of encouraging take up and other things. But, equally, they could have downsides in terms of deterring competition.

So, we've looked at this in detail and we were toying, and if you read the document you can see what we were doing, of do we say that these should be by default banned if you like but we would allow them, if they could be justified, or do we go the other way and allow them but potentially be prepared to go in and change them or prevent them if we think that they would have anti-competitive situations? Where we come out and what we propose in this consultation is the second of those two where the default is that discounts are allowable but we actually reserve the position that if we think they have anti-competitive effect that we would look to change them or prevent them. So, that's the position that we've put out there.

And just to complete that, we've actually set out some criteria that we would use when assessing whether or not they would have anti-competitive effects, and so people know in advance how we would make that assessment.

In terms of the fibre price premium, the £1.50 to £1.85, this has been calculated on what we think the extra value that the fibre product, the 40 Meg fibre product, brings over the 40 Meg essentially FTTC product. And, the value comes from two areas. The value comes from the consumer. From the consumer point of view, the first additional value you get is with the fibre products, if you're told it's 40 Megs, it will be 40 Megs, rather than some other speed dependent on your line length. And so, that's one sort of part of the consumer value, and the fact that actually the line is more stable and reliable.

The other part of the value comes from the supply chain, and that's the suppliers actually supplying the retail services to consumers. If they're using a fibre product that's more stable and has lower fault rates, then their supply costs should be lower because they're going to get less customer calls and issues arising. We've tried to quantify those two areas, and those two things make up that £1.50 to £1.85 range.

It's fair to say that at the moment the first one of those for consumer value is the majority of that number.

James Ratzer — And, is it fair to say that that consumer value then, that has a more qualitative aspect in calculating that? Because in the past, your charge controls have always been very quantitative.

David Clarkson — So, I mean, we've tried not to overcomplicate this area, and what we've sort of done in assessing the value to consumers is we've looked at the pricing points of different products, retail pricing points of different products, at different speeds, and what consumers seem to be willing to pay for going from say a 40 Meg product to a 55 Meg product and so on. And, we've taken a number of points and tried to work out what we think the willingness to pay per megabit of guaranteed speed is. And then what we've done is we've said, look, what's the typical speed that you would get on FTTC? It's probably about 36, 37. What's the guaranteed speed you would get on the fibre product? It will be the 40. So, what is the value that we think that that suggests to the consumer? That's where that number comes from.

It's a fairly simple and crude approach but it's a way of just trying to just get a handle on what we think the value to consumers and their willingness to pay is.

James Ratzer — Thank you.

Coordinator — Thank you. The next question comes from Jerry Dellis (Jefferies).

Jerry Dellis — Thank you for taking my question. Just returning to the issue of geographically-targeted pricing, at present, Openreach has a couple of GEA FTTP schemes. It has a localised marketing offer in the Fibre First cities, and then last month they also launched a volume discount offer, also available across Fibre First premises. To what extent would both of those constructions be things that you would be willing to endorse?

My second question is, could you please clarify for us the mechanism for redefining a potentially competitive area to fully competitive. Is that a decision that just gets taken with every five-year cycle in the market review process? Thank you.

David Clarkson — So, let's try and address the first one of those which is going to be quite hard for me, in part because I'm not totally familiar with the pricing schemes that you're talking about, but I'm aware of some of them. I don't think I can sit here and say that I think they're bad or that we would endorse them. They are not something that is being brought to our attention in a negative way at the moment[1]. If they were to, we would look at them. We would need to look at them in the round and on a case-by-case basis. We don't have a position on them.

In terms of your second question, what we've not done here is we've not pre-set out criteria that would say if this is met then this area would be reclassified as competitive, i.e. moving from Area 2 to Area 1, I guess is the proposal. So, our default position is that actually we would need to look at it and normally that would be done on the market review cycle. However, we are conscious that this is a five-year review and a lot can happen in that period of time. So, we are open to the notion that areas could become more competitive and that we should and indeed could open up and do a look at certain areas to see whether or not we think that the competitive landscape changed to a point that we need to change our regulations.

Jerry Dellis: Thank you.

Coordinator: Thank you. The next one comes from Carl Murdock-Smith (Berenberg).

Carl Murdock-Smith: Hi, thanks very much. Two questions from me, please. Firstly, I was just wondering, in your view, what would you say has changed most since the consultation you put out in March last year? I'd say most of this looks incredibly consistent with that, so I'd be interested in what you think has changed in terms of direction rather than just detail.

And then secondly, following up on Jerry's question, in terms of when you're thinking about Area 1 and Area 2, just how you think about cable within that. In particular, what counts as multiple networks, does two count as multiple, and also how would you consider cable, either in the case where it's not opened to wholesale and also in the case if it were open to wholesale. Would you take into consideration cable? Thank you.

Jonathan Oxley: Just on the first, it's Jonathan here, I'll let Dave add to it and then deal with your second issue. My perspective on it, something I think is really important for the people on this call to understand is on the transition from copper to fibre. And, one of the things there were submissions from Openreach around was that we've set the trigger for when we would start to transfer and allow them freedom on the copper to price up to copper was that they had to build to 100% of a particular exchange area. Now, we've reduced that to 75%. I think that is actually quite a significant change, and that does, I think, remove any sort of roadblock to start that process of closing down the copper network and in particular moving and migrating the providers onto the new fibre network. I think that's a very significant one.

[1] Please note, we are in fact aware of concerns from some stakeholders. Our new proposals provide an ongoing basis for discussion

I don't know if there's one obviously you want to highlight, Dave.

David Clarkson	Yes, so I think that is one of the significant changes. But, of course, that earlier document was us trying to elicit views from industry and others about the direction. And, it lacked quite a lot of detail. So, I think what we've done here is we've actually put quite a lot of detail in the areas in particular around the fibre premium. We didn't have numbers in the March document; we now do have numbers. And, we've actually worked up a lot about the regulatory asset base approach in Area 3, and exactly how we would do that, and actually have set out the calculations. So, I think those are the big differences. In terms of our treatment of cable. Effectively, we do count the cable networks. It always features in our assessment of the competitive landscape, and in fact, always has done. And, we haven't actually made a difference, really, about whether or not it wholesales or not. The fact that it's there and the fact is it has customers on it and it's able to serve a certain level of service means that it's in the calculation and in the assessment.
Carl Murdock-Smith	That's great. So, is that a confirmation that the half of the country where there is cable would be classified as a competitive area in that case?
David Clarkson	So, at the moment, what we've done is our Area 2 are potentially competitive areas, and it's broadly those areas where there is some existing network competition and the prospects of more investment from competitors, and in fact cable features there because it's an existing network. So, in fact, the Virgin Media cable network plays a big part in our definition of Area 2 as being potentially competitive.
Carl Murdock-Smith	That's great. Thank you.
Coordinator	Thank you. [Operator instructions]. We do have another question. That one comes from Steven Howard (HSBC). Go ahead, Steven.
Steven Howard	Hi there. It's Steven Howard from HSBC. So my question is why is the dark fibre regulation, as well as DPA regulation, in the Area 3? Why do you need both? It seems to me that's unnecessary duplication and complexity. I think this plugs into some of the earlier questions about under what circumstances would an area be deemed to move into the first area category? It's going to be quite hard to convince investors that you're serious about de-regulation when the terms under which something would shift into Area 1, aren't set out in detail, and when you've actually got multiple, potentially redundant, layers of regulation in Area 3, i.e. dark fibre as well as DPA.
David Clarkson	Hi, Steven. Let's try and pick that up, both those points. So, your first point about Area 3 and dark fibre, effectively our position here really is that we're not really putting a lot of weight on DPA being

effective in Area 3. And, that's in large part because of the information that we've gathered from the various network operators and what their plans are and where they would tend to use it, which is a function of density of customers and so on.

So, in truth, in Area 3, we're not really expecting DPA to be that successful. What we're then saying is if people aren't using DPA to build their own fibre networks, what should the regulatory access products be? And in the case of leased lines, what we're saying is we think dark fibre should be the regulatory access products as opposed to the Ethernet products that we previously regulated. So, that's how that fits into that space.

In terms of Area 1 and the criteria. We actually do in the document set out how we would assess the competitive conditions for Area 1, and in broad terms what we actually think needs to happen. And, it is fairly obvious, we just need a certain level of competition, perhaps more than one player, who has a reasonable scale and has a reasonable track record that we think that they're going to be about for a few years. I'm simplifying it. It's in the document, but please read it.

That's our position there. Yes, we've been basically looking for three reasonably stable operators, would be our criteria.

Steven Howard — Forgive me, if the DPA is something you're not expecting to be used in Area 3, why don't you withdraw it?

David Clarkson — So, I mean, it's a fair point, Steven. If you knew precisely where the boundaries are, between Area 2 and 3, then I think that would be a reasonable challenge. At this stage, precisely where that boundary is, there is uncertainty. So, withdrawing and trying to burn that boundary doesn't seem like a necessary thing to do and probably not even really an ideal thing to do. It's the sort of thing that will naturally find its own position and we think that's a better way of doing it because it puts less stress on how we define that boundary today.

Steven Howard — Thanks for that answer. May I just make one observation? Which is, I do think that the geo-pricing topic that's come up is extremely important. I'm very interested in your answer to that, but I do think other investors regard that as very important some flexibility on costs.

David Clarkson — Noted. Thank you.

Coordinator — Thank you. The next one comes from Nick Lyall (Societe Generale).

Nick Lyall — I actually find it difficult to hear you because of the background noise. It's a very, very simple one on the timing. I think John there mentioned that possibility of further consultations in his question. But, are you under pressure here to speed up the timing? You've heard a lot of this, even government and your enablers. But, how much pressure are you under just to get on with this thing and what's the earliest the process could be finished in your view? Would those extra consultations add a great deal of time? Could you give us a bit of an idea of the timescale, please?

Jonathan Oxley — Hello, Nick. I'm not sure how familiar you are with the way do market reviews in the past. I mean, it's not uncommon for us to do some and narrower consultations for the reasons Dave gave earlier. Why do we do it? I mean, just to stand back from this, actually it's investors that typically tell us all the time that we should take a careful and considered approach to this with certainty, providing certainty at the forefront of what we're doing.

I'm looking around at the team actually to see whether we're getting lots of pressure. We're not actually getting lots of pressure from any stakeholders to speed up as you say. I think stakeholders, typically, are more interested in that we get the right answer, and that they have adequate opportunity to talk to us about concerns they have with the regulation that we do, a lot of the things we're doing today. So, no, I'm not hearing any concerns.

I suppose the only concerns would come from BT. I think they have occasionally said there's some uncertainty about when things are happening. To be honest, BT ought to know this game. They've been in this game for 20 years. But, we don't hear it from other stakeholders particularly.

Do you want to add anything?

David Clarkson — The only thing I would add is that we're not sitting here today in a vacuum of regulation. We do have regulations for leased lines and for broadband services. That all plays out until March 2021, and the approach we're taking here is to just sort of build the next regulatory environment that goes beyond that. So, we have a position that everyone knows and understands, and we actually think that allowing that to run its course and then just picking up from that point going forwards is the sensible thing to do.

Jonathan Oxley — We've been kind of doing a program of stuff, Nick. You'll have seen in the past we did the business connectivity. We also did duct and pole. So, we've done a number of things over the last few years as part of this program of encouraging full fibre investment and infrastructure.

Nick Lyall — Yes, understood on that. It's just, I suppose, the problem from a BT point of view is just waiting to give guidance. And as a bit of feedback, that's the investor concern from the pure equity market investors is they want to see this guidance on capex, cash flows and dividends and of course that doesn't happen till potentially you get full clarity and that's dependent on you.

Thank you very much for the answer. That's great.

Jonathan Oxley	Well, I'm going to come back to you because I think it's really important because that is a concern. These things can be appealed as well. So, now BT is in this game. They know how this process works. I know they've been saying that. I have to say, I also hear from within BT that other people within BT say to us just get this right and take the time that you're taking. So, it's not exactly the same message that we receive that we have to speed up.
Nick Lyall	Interesting. Thank you.
Coordinator	Thank you. [Operator instructions]. We do have the next question. That one comes from Steve Malcolm (Redburn).
Steve Malcolm	Good morning. I have one question with three parts. Just coming back to geographic de-averaging of pricing, I mean, on the current construct, do you expect wholesale prices to be different in Area 2 from Area 3 in the absence of government funding? And then following on from that, are you hopeful or confident that the £5 billion referenced in the press release this morning will somehow level out the prices between the two areas? Then finally, when do you expect to get clarity [from the Government] on exactly how that money one is going to flow into fibre networks? Thank you.
Jonathan Oxley	On the last point, I don't think we know at this stage. Dave, do you want to pick up on the other points?
David Clarkson	Yes, I was going to say while I can probably try and answer the first two, the last one probably not. So, in terms of the wholesale pricing Area 2, Area 3, so there is a potential for it to be different. And in fact, if you actually looked and saw—if you think, we're proposing indexation and price in Area 2, and we are saying one form of the RAB could be a CPI-X+K in Area 3. Now if we went with that, actually initially we would actually end up with lower wholesale price in Area 3, compared to Area 2. And then of course if roll out of fibre in Area 3 took place, then those prices would move back up. That's one of the reasons, and in fact, we're quite attracted to in fact accepting commitments to deployment in Area 3 and indexing prices. We don't have those price movements. It keeps it a much more constant and of course we get the certainty of the fact we know the consumer is going to benefit from the build. So, there could be differences but also there are ways to mitigate that or there are alternative options that we're looking at in terms of commitments. In terms of the £5 billion, we haven't done the detailed numbers but I mean, we've looked at the shape of the cost curves and looked at what the £5 billion buys, and it does appear to us that in our first walk through this that that £5 billion could in fact pay for that hockey stick

part of the cost curve and actually level out the pricing in Area 3 to something which is more analogous to the Area 2 type prices.

Steve Malcolm — Okay. You have no real visibility as to when we will know how that £5 billion is going to be allocated.

Jonathan Oxley — It's a matter of the government. They need a bit of time, I'm sure. I'm not sure even when the budgets—if the budget has been set. I think March, isn't it? I'm sure that will come out shortly but I think it's a little bit early days that the government is to do that.

Steve Malcom — Okay, thank you.

Coordinator — Thank you. The next one comes from Karen Egan (Enders Analysis).

Karen Egan — Good morning. I have a question about the charge control in Area 3, and essentially wondering whether the charge control in Area 3 should be higher because it is presumably more expensive to serve on average, and therefore then why is the base the national average.

David Clarkson — Let me try and answer that. So, when we set charge controls, we're very much concerned about cost recovery. We currently have national data from BT and Openreach. We made the assessment that in fact setting charges in this way would ensure cost recovery and was actually the most simple and straightforward thing to do in terms of data availability and monitoring. So, we've taken that approach.

In terms of are costs higher in these areas than elsewhere, maybe, but it always appears to us that it's not quite as straightforward as you think. Because I think if you're comparing like for like, then it probably is the case. But, remember, these areas, there is no competition, which means that actually you have much higher market shares so you actually get higher utilisation. That can balance the factors. So the difference often isn't as much as you might think.

Karen Egan — Okay, yes, makes sense. Thank you.

Coordinator — Thank you. The next one comes from James Britton (HSBC).

Rohit Goel — Operator, I think we'll take two more questions before we end the call. So, go ahead, James.

James Britton — Good morning. Thanks. So my question is linked to the views around the business market, and I think this is the first document the way you're integrating the approach on residential and business. But, I just wanted to understand whether there's any real differentiation of your objectives as you look to incentivise investments across the market. Do you also want to inject more margin into build programs to business premises around the UK and draw new competition into that market as well? If you could just comment on the business side.

David Clarkson Okay. I'll start with a short answer and then explain it in a bit more detail. I think the short answer is yes. Injecting margin and having more competition and networks there is part of what we're doing. But it's not really as straightforward as that. What we sort of see here is when you start thinking about people building new fibre networks, it's very difficult to de-link the two. People will invariably just roll out fibre in an area and serve whoever they can with it, whether that be businesses or whether that be residential customers.

So, really, we come at it from the other way and we sort of think that it is non-sensical for us to try and separate the two and treat them differently because we'll end up creating tensions between them. If we are trying to embark on a strategy of promoting investment and deployment of fibre, our view is that we have to really treat them together and just promote that fibre investment. What people do with it and exactly where they put it, well that's up to them as we go forwards.

James Britton Okay. Thanks.

Coordinator Thank you. So, your last question then will be from David Wright (Bank of America Merrill Lynch). Please go ahead.

David Wright Thank you very much, guys, David from Bank of America. Thanks for taking the call. Could you just talk a little more on the fair bet? It seems like it focuses, as very clearly said, on maybe trying to reduce the downside risks, which would probably by implication reduce the kind of return on capital, return on invested capital feeling. Does that make sense? You're looking to probably maybe cap returns at a slightly lower level than before because your argument is you're reducing the risk. Is that right?

David Clarkson I think so but it's worth thinking about how this plays out. So, with the fair bet, what we're talking about is we're talking about what we take into account at future points in time when we're thinking of regulating these types of investments. And, what we did with FTTC is we looked at all of those downside risks that existed at the front, at the early part of the project, and we asked ourselves whether or not it was reasonable for us to intervene at this point in time with this type of regulation. Had Openreach and BT been sufficiently rewarded with the upside?

Now, the point is, is that we do exactly the same here. We're not proposing any difference. It's just that when we go back and look at what the risks were, if they genuinely were less because they were mitigated, then that would factor into our decision and the structure of the regulation we were proposing to do. So, that's how it works.

I mean, at one level, I guess you're right that with FTTC, we saw a 15% return and we sort of said that we felt that that had more than compensated for the investment. It has to be true that if we think that those initial downside risks were less that we would potentially take the same decision at a slightly lower number.

David Wright — Yes, I think that makes sense. Thank you very much for the call today.

Jonathan Oxley — Thank you.

Coordinator — Thank you very much. Okay, Jonathan.

Rohit Goel — Thank you very much to everyone who joined the call. If you do have any follow-on questions, please do get in touch with me, analyst.relations@ofcom.org.uk. I'd like to apologise again for the background noise. We will have a replay and a transcript available on the website as soon as we can so hopefully that can help clarify for anyone who was struggling a little bit with the noise.

Jonathan Oxley — Thanks from my side, too. Thank you very much.

David Clarkson — Thanks very much.

Coordinator — Thank you, Jonathan and David. Ladies and gentlemen that concludes your conference for today. You may all now disconnect. Thanks for joining and enjoy the rest of your day.

[END OF CALL]