Ofcom: Promoting Competition & Investment in Fibre Networks (18 March 2021)

Coordinator: Good morning, ladies and gentlemen. Welcome to the Ofcom call to discuss Promoting Competition & Investment in Fibre Networks. The call is being hosted by Melanie Dawes, Ofcom Chief Executive. My name is Ben and I'm your event manager. I would like to advise all parties that 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.

Now, I would like to hand over to Rohit Goel, Ofcom's Analyst and Investor Relations Manager.

Rohit Goel: Great. Thank you, Ben. Good morning to you all. With me this morning are Melanie Dawes, Ofcom Chief Executive; Lindsey Fussell, Group Director, Networks & Communications; and David Clarkson, Director, Networks & Communications.

Through the presentation portion of this call we will be referring to the accompanying slides, which you can download, if you've not already done so, from the Analyst Presentations section of the Ofcom website. There will be an opportunity to ask questions once we've completed the presentation.

With that, I'd like to hand over to Melanie.

Melanie Dawes: Thank you very much, Rohit. Welcome, everybody, to this morning's call. Thank you very much for joining us.

It's an important day for Ofcom today. We've announced our final decisions on how we're going to be regulating wholesale fixed telecoms in the year ahead. And in a moment, I'll pass over first to Lindsey Fussell who's our Group Director for Communications & Networks, and then to David Clarkson who is our Director for Fixed Telecoms and who has led our work on the Access Review.

So just to give you a bit of an introduction, and I'm now looking at slide two of the slides for those of you who are using the slides. Just to say a little bit about what we're aiming for and what we're trying to achieve from Ofcom. So the important thing to say is that we know now that broadband services are ever more important, not just for the economy and for businesses, but actually to how we live our home lives as well, and we've really had that brought home to all of us I think in the past year and it's not going away any time soon. So, the need for really high-quality broadband is actually essential to every part of UK life. So, what our approach is aiming to achieve is to encourage investments in the new fibre networks that, as you know, we will need into the future.

And we know that this is not just another upgrade; it's a long-term investment, which will take a decade or more to pay back and we understand that, and we've built that into our approach. And it is in the end about replacing the decades old copper network that we've relied on for so long and that actually we've sweated as assets to give us Superfast broadband across 96% of the country, but we know that's not good enough in the future. We need fibre optic cable to reach right into the home in order to give us not just the speed but also the reliability.

And as you know, central to our approach is to incentivize investments of course from BT, and I think as you hear the final decisions in a moment, we're aiming to make sure that they have a fair bet, that we honour the fair bet and allow them the opportunity earn a fair return above their normal cost of capital over the duration of this investment.

But it's also about incentivizing others into the market, too. Ultimately what we're aiming for is for consumers to have a choice of networks so that they have choices on pricing, but also so we can really get competition for quality and for service levels as well. And if we do see that market growing, then we will be able to step back from regulating much more in the future, which I think is what everybody would ideally like to see.

So, on that note, I'm going to pass over now to Lindsey who will take you through the next bit of the presentation.

Lindsey Fussell Thank you, Melanie. I'm going to outline the key decisions that we're announcing today.

As Melanie has already said, this is a pro investment/pro competition strategy and we believe it will support the rollout of gigabit capable networks to around 80% of the UK on a commercial basis, and public funding will be needed to support the rollout to the final 20%. But as you know, the government has already announced its intentions here.

So now on to slide 3 for those of you who are following it. Turning first to our pricing decisions. This is a significant departure to the pricing approach that we've taken in previous market reviews.

Firstly, we have stepped away from cost base pricing which we have done in previous pricing reviews, and today we announce that we are indexing prices of the lowest speed products, those at 40/10 and below to CPI.

For higher speed products, we continue to allow pricing flexibility for Openreach. And importantly, where a customer chooses to take a lower speed product, 40/10, over an FTTP line, we will allow Openreach to charge a premium to reflect the superior quality and reliability of the service that that customer will get because they will be using FTTP. That premium is £1.70 per month.

These decisions give BT and the other investors the margin they need to invest and support competition at the wholesale level.

We've taken the approach in our review, as you know, to divide the country into different geographic areas. So, what we call Area 2, which we see as areas where there's a prospect of material competition at scale and Area 3 where we see this is less likely. In other words, in more rural areas. As BT has committed to build into 3.2 million premises in Area 3, we have been able to extend the same pricing decisions across all parts of the UK. That gives really helpful consistency of regulation to BT and also supports smaller networks that may want to build in rural areas.

As Melanie has said, this is a long-term commitment. We've said today that we do not expect to reintroduce cost-based pricing in either Area 2 or 3 until 2031 at the earliest.

Secondly, we're confirming proposals today to enable Openreach to switch-off the existing copper network, area by area, once the fibre network is built out. And this is clearly not only more efficient for Openreach because it won't need to be running two networks at once, but it also supports their business case, de-risks that business case by promoting uptake of fibre.

We believe these decisions provide the regulatory enablers that BT have asked for and give them what they need to be able to invest in full fibre. But we also have to hold BT to account to do their part to make the strategy work, the competitive strategy overall. So, we continue to require Openreach to support alternative network builders by making available with ducts and poles. This process has significantly improved and there has been a huge amount of uptake in the use of ducts and poles in the past year, despite all the lockdowns and the challenges. But we will be continuing to maintain really close eye on this.

We're also expecting Openreach to maintain quality of service standards on its copper networks, because we know that millions of consumers will continue to rely on those networks over the coming years. So, our statement also sets out the quality of service standards that Openreach will be held to over the next five years.

Thanks. I'm going to now hand over to Dave who's going to talk a little bit more about how our decision support investments by both BT and other network builders.

David Clarkson: Thank you very much, Lindsey.

Moving on to slide 4 where I'll talk a little bit about regulation to support investment by Openreach and others. So, this is just a little bit more detail on top of what Lindsey has just set out.

So central to our regulatory structure is access to BT's ducts and poles such that BT's competitors and other operators could also roll out fibre networks faster without having to dig up the roads multiple times. So that's our central part.

Then in terms of our pricing, I'll just go through these very quickly. So, indexation for the entry level 40 meg product, so that will stay flat in real terms going up with CPI. We think that this actually leaves margin in the system for BT and others to invest. Not only does it allow

BT to invest, but it should also allow them to accelerate the depreciation of the copper assets to avoid stranded assets.

The other one is on the pricing flexibility for the higher speed services. So these are those services that the new networks are able to support. What we would want is we would want the investors building these networks to be able to set the prices for these so they can try and sort of gain a premium and get a fair return on those investments.

The premium for FTTP. So this is tied into the copper switch off, which I'll move on to in a minute, and this is where BT replaces its network with fibre and it moves customers on to it, and they are still taking that entry level 40 meg product. They can do so with a regulated price, but that price would be £1.70 more per month compared with the copper services. That's to reflect the extra value that that service brings, not just to consumers, but actually in the supply chain as it should lead to lower faults and therefore low maintenance issues.

A very key part of this structure is the copper switch off. Different than all other broadband upgrades in the last two decades, this is really a replacement of the copper network. Once the new network has been built, it is obviously sensible if we can close the old network down, avoid the duplication of costs of running the old and the new networks, and so get a customer base on the new network. What we've set out here is we've set out a staged approach to roll back regulation, area by area, and those areas are the BT exchange footprints as BT builds its new network.

The last two boxes that are on this slide is about us ensuring that we give support to competitors over the coming years. There is quite a lot of competitive activity in the market at the moment, but it is still quite nascent and these competitors are still quite small. We would not want to see pricing practices which could inadvertently hamper the establishment of those competitors.

And so what we've done here is on geographic pricing, so this is the very targeted local pricing that maybe BT or Openreach could do. We've said that by default that should be prohibited. However, we do recognize that there could be cases where it is in fact necessary and is justified. So, we've put a process in place where Openreach can ask for consent on those cases.

Other types of contract, like long duration contracts and volume discounts. We're conscious that these could be an issue. We have not prohibited them; rather, we have actually said that there should be a 90-day notice period so that us and the rest of the industry can have an opportunity to look at those before they come into effect.

Lindsey mentioned it earlier. The approach we're taking, although we do see differences in different parts of the country in terms of competitive conditions, our Area 2 and Area 3, in light of the Openreach commitment to build 3.2 million in our Area 3, the more rural areas, we've actually set the same regulatory approach to pricing across both those areas. So we have a consistency. We see this as being very useful from a consumer point of view and also from an investor point of view, because if we're honest, we're trying to set this boundary today for five years in the future, and we know that we probably won't get it precisely right. Having the same regulation in both areas will actually mitigate any effects if it isn't in the right place.

Moving on to slide 5, a big part of this is how we might regulate in the future and the fair bet. We are conscious that these are big investments and their payback periods are very long term. So, we feel that it's right that we go the extra mile and set out how we will regulate in the future.

What we've actually set out here today is we've said that based on the information currently available to us in terms of rollout plans and government intervention, we don't expect to go back to cost base controls, price controls, for at least ten years, taking us to out to 2031. In saying that, we are not saying that in ten years' time we will definitely go back to cost-based controls. We're saying that actually we'll get to that point and see what's happening in the market.

And we set this out in the document, but our thought process and approach here, which we've put down in the document, is of course we would like there to be competition that's actually developed as a result of this. If that is the case, actually we will be stepping back from regulation altogether and letting the market take over. That's where we would like to get to.

Of course, it could be that in ten years' time we don't have established competition, but there is still ongoing investment and competition. In that case, we're saying that we would look to regulate at that time in a way that would continue to support this.

If we find that, in fact, investment and competition potential has dried up at that time, again, that doesn't necessarily mean that we would go straight into cost base controls. Instead, we would look for market outcomes – what's the outcome for consumers, is Openreach doing good deals with its customers, the ISP's. And particularly, because we know that we are going to see differences in competition across the country, something that we've laid out here is, if we have some areas that are competitive and some areas that are not competitive, provided the consumers in the not competitive areas are receiving the same deals, the same products and prices as those available in the competitive areas, that is going to make us much less likely to want to intervene. Because the consumers would be getting good outcomes.

Finally, of course, there is a possibility that we might need to set cost based controls in the future and we set out in this document how we would go about that to ensure that the fair bet is honoured. And we are saying that we will actually look at the investments taken, the risks faced at the time, what the cost of capital was at the time, and ensure that the returns earned had sufficiently rewarded those risks.

We've actually set out some detail of the mechanics of how we would do this and depreciate the investment itself such that any upside earned in the early part of the investment cycle, before regulation, could be kept and enjoyed. And, any returns after that, of course, we would give the opportunity to earn the cost of capital. Thus, overall, over the whole investment cycle there is a good opportunity to earn a return above the cost of capital. And we set this out in some detail in Volume 4 of the document.

I'm going to hand back now to Melanie. I think we're going to get ready to take some questions.

Melanie Dawes: Thank you very much, Dave and Lindsey. I'll just wrap up the presentation.

Looking at our final slide, our conclusions, just to bring home once again some of the things we're trying to do here. This is very much about a framework that's pro-investment and pro-competition. We know that that means it needs to be a long-term framework, we're providing more long-term certainty and direction I think than Ofcom ever managed to achieve before. And as a result of that, we do think the investment case has never been more clear or more compelling.

We think that we've addressed the regulatory enablers for BT and provided a clear path to honour the fair bet with the opportunity to earn and return that's fair above the normal cost of capital. And there's a good offer here for challengers to access the ducts and poles, and also by our wider pricing decisions.

So, we'll open it up now for questions. I think I'm going to hand over to Rohit to help us do that, but also to our operator, Ben, who will steer us through. Thank you.

Rohit Goel: Thank you, Melanie. So before we move to questions, I should say that we have a large number of participants on the call, so if you don't get an opportunity to ask, then please do get in touch with me, Rohit Goel, analyst.relations@ofcom.org.uk.

I would ask that if you could please keep questions to today's announcements and pick up any other matters with myself after the call.

Ben, we're now ready to take questions, please.

Coordinator: Thank you. [Operator instructions]. The first question is coming from the line of Carl Murdock-Smith from Berenberg. Please proceed. Your line is open.

Carl Murdock-Smith: Good morning. Congratulations on finally getting there with this review.

I suppose my question would just be in terms of what would you point to as the main differences in today's statements versus the consultation at the beginning of last year? Thank you.

Melanie Dawes	Thank you very much for the question. I'm going to pass that one over to Dave.
David Clarkson	Thank you very much for the congratulations. You're right, it's been a long journey for us. In terms of the main differences, to be honest, there's not a lot of differences compared to the consultation. We spent a long time getting to the consultation and the process started back in early part of 2018. So, the main components you'll see here were very much the same in terms of the indexation, the price flexibility and the premium. There is a little bit more detail around the copper switch off, of course, that we set out here. But I think probably the biggest new thing in the document is how clearly we've actually set out the future regulation and the fair bet. I know that we've discussed this in various calls with yourself in the past and we've taken the feedback that you've given us on that, and we absolutely do recognise the scale and the length of these investments. And quite unusually for us, we took the decision to actually be explicit about how we would be regulating, how we intend to regulate out over the next decade and in fact beyond. So, I think that that's really the main differences that I would point to.
Carl Murdock-Smith	Brilliant. Thanks and congrats again.
David Clarkson	Thanks a lot.
Melanie Dawes	I think we can take our next question, Ben, if anyone else has a question for us.
Coordinator	The next question is coming from the line of James Ratzer from Newsweek Research.
James Ratzer	Good morning, Melanie and team. Thank you. Two questions. The first one, I'd just like to hear a little bit more on the detail around the long-term contract and geographic pricing flexibility, if Openreach did come to you and said that they had a proposal with an ISP for a long-term bulk volume discount contract or to ask for geographic discounting in a certain area. What would be the key metrics you'd be judging on to kind of judge those proposals? And secondly, just like to understand in practice the economic depreciation term you referred to when you talk about assessing the fair bet beyond 2030, that you'd look at I think just the economic depreciation of the assets rather than the accounting depreciation. Can you again just explain a little bit more how that might work? Did that imply by 2030 only a tiny fraction of the current assets would be depreciated? Thank you.

Melanie Dawes	Thanks very much for the questions. I'll pass those over to Dave and Lindsey who are in a room together and I'll leave you to work out who's going to answer which one.
Lindsey Fussell	No problem. I'll answer the question on long-term contracts and then I'll hand over to Dave on economic depreciation, if that's okay. So on long-term contracts, as Dave said, we have prohibited geographic pricing as part of this review, but we have said that if BT does have proposals, we will look at those and be prepared to consider them. So it's not an absolute prohibition if they come up with something that we think looks sensible. And the reason for that, what we're concerned about is that whilst we are very confident about the prospect of competition in this market, we do know that it's nascent and it's early, and if BT choose to geographically price and offer discounts in areas where new competitors are just in the early stages of building, that could have a really detrimental impact on the competition really early on. So that's the kind of thing that we will be particularly concerned about on geographic pricing. As I say, there may be occasions where we will be prepared to relax that. We have for example already offered BT some flexibility in the trial areas in Salisbury and Mildenhall. Going on to other kinds of long-term contracts that don't involve geographic elements, we have taken a bit of a different approach here, so those aren't banned. We've said that BT just needs to notify 90 days in advance, we will have a look at them, give us and others in the market the chance to look at it beforehand. And I think what we'll be thinking about there is what is the impact here on that competition? I think it's quite possible to think of some long-term deals that BT might want to offer to its CP's. For example, discounts to get them to move their customers from FTTC up to the full fibre product. But what we would obviously be concerned about is if those deals required that the CP's keep large amounts of volume with BT, thus preventing them, the other competitors from competing for the business of those CP's.
David Clarkson	Thank you, Lindsey. I guess I'd just add a couple of things there. Obviously, the main thing that we'd be looking at is to ensure that actually any pricing deals don't unfairly undermine new competition. I know that the document is big that we put out today, so I can point you to Volume 3 and there is a section in there which goes into this detail and sets it all out for you. On our point of economic depreciation. So this is in the event – and I did lay out that there are many reasons that we might not get there – but this is in the event that we do have to set cost based controls in the future. Of course we know that the cash flows of these investments are going to be negative for a long, long time in terms of cash flow; there's going to be a lot of investment going in and not much revenue coming out in the short-term, because obviously as volumes grow and so on. So, what we're saying is, is when we look at this investment, rather

than do this accounting depreciation, which just depreciates possibly a proportion of it each year, we will do an economic depreciation. And what we're really looking at there is we are going to be looking at the revenue earning potential of the asset rather than just time.

And of course in the early years, because the networks new and you probably don't have many customers on it, it's revenue earning potential is much, much lower than it will be in the later years when the network is full. Consequently, that means that we would actually be looking to actually depreciate the asset slower in the early years. Obviously, that means that we would be depreciating much faster in the later years or leaving more of the assets for the later years. That's important for giving certainty to the investment. Because what we're then saying is, should we actually regulate in the later years at cost, we would do so on the basis of actually having quite a lot of the asset base still remaining, because that's what economic depreciation would do. And in doing it this way, any upsides earned against a low depreciation in the early part of the investment cycle can actually be kept and we can leave that to BT or whoever.

So that sort of is our thinking on economic depreciation. And again, I could point you to Volume 4, Section 1 where we go into the details of that as well. So, it's in the documents, and obviously after this call you can get in touch with us and we're happy to provide more information if necessary.

James Ratzer — Great. Thank you.

Melanie Dawes — Ben, can we have our next question? Thank you.

Coordinator — The next question is coming from the line of Maurice Patrick from Barclays.

Maurice Patrick — Good morning, guys. It's Maurice from Barclays. Thanks for hosting the call. Very much appreciate it.

So, one of the questions investors asks is the certainty of returns. I know you've tried to address it today. But just to understand, in the document you talk about if there isn't infrastructure competition, then you would look to price regulate or likely to price regulate focused on cost-based returns. But you also say in the presentation, look, if some areas are competitive and some areas aren't, then if consumer pricing isn't different, then we're less likely to intervene? Should we interpret that therefore as, if there's infra competition in some places and not others, that in the area that there isn't, you wouldn't necessarily price regulate, even though in the document it seems like it said you would do.

Melanie Dawes — I'll ask Dave to come in on that in a moment. But I think the overall philosophy here is that absolutely we're looking for market conditions as our trigger for how we regulate in the future. And if there is competition, or even if there's competition emerging, we would look not to regulate if we can. It will all be about what's there, what's available for the consumer and how the overall setup is working for them. But, Dave, do you want to answer that specific question?

And I should just say, by the way, that we're very aware that obviously it's a very long document, so if it's helpful for us to flag particular pages that you can look at, then we can do so either after the presentation or during it, as Dave has already been doing. Dave, over to you.

David Clarkson Thank you very much.

In terms of our future approach, the way I see this, and I think the way that we have tried to set it up in the document, is we're going into this with a mind-set that we hope we don't have to go into price regulation. So, we're looking for all of the things that would help us get to that position, if you like. The first one is, of course, if we get competition, absolutely we shouldn't go for price regulation.

But to the point that you ask about that in some areas we're certainly not going to get competition, we know that and in other areas we would. And here what we're saying is it's sort of what's known as the common pricing constraint. If we found that the customers in the areas where there wasn't competition were getting the same products and the same prices as those in the competitive areas, then we are likely to be satisfied that actually they're getting a fair outcome and that is going to make it much less likely that we are going to want to do price regulation.

We may still regulate in terms of access because there isn't competition, but actually we could be a much lighter touch in our regulation. This is also set out in Volume 4, Section 1 where we talk about pricing, so that's the area. We'd very much like to get to that place, because our primary objective is getting these networks built for consumers and then ensuring consumers get good products and a good deal on the back of them.

Maurice Patrick Thank you, guys.

Melanie Dawes Next question, Ben. Thank you.

Coordinator The next question is coming from the line of Jerry Dellis from Jefferies.

Jerry Dellis Good morning. Thank you for taking my questions. I have two questions, please.

Firstly, what would you define as being BT's cost of capital on the FTTP build? I think you refer to a cost of capital for the other UK telecom segment in Volume 4, but it would be interesting for you to spell out precisely, please, where you think BT's cost of capital is on the fibre projects specifically.

Then secondly, if you do find yourself having to intervene to implement price controls, what target return on BT's fibre investment would you have in mind? Thank you.

Melanie Dawes — Thanks for the question. Dave, over to you again, I think.

David Clarkson — Thank you. I'll certainly pick up the first one and then hand it to Lindsey.

So, in this document we have consciously, in fact, not set out what we think the FTTP WACC is at this stage in time. What we have set out in the document is we set out what we think the group WACC is and how we would sub-divide that into the different areas of Openreach, other UK telco's and then the rest of BT.

Now, the only number that we actually use to set any prices in this review is actually the Openreach number where we set the prices for dark fibre and for duct and pole access. So, our reasons for not trying to tease out an FTTP WACC is simply because we're not using it at this point in time and we don't want to send people off in certain directions. Instead, the way that we would like to look at this and the way that we set it out in the document, is should we need to regulate in the future, what we would be doing is we would be going back and looking at points in time where the investments were made and what the appropriate WACC was at that time, and what the risk was at that time. So that's how we would actually do it.

So we haven't actually set out a number and I'm not going to try to, but clearly the number will be somewhere north of the Other UK telco's, because it would be a risk premium on top of that figure.

Lindsey Fussell — Thanks, David. Just to pick up a second point a bit more on sort of target return.

I think the first thing, as we said, is we do see this as an entirely different kind of framework to build an entirely new network. So, we're hoping that it's competition that's going to be determining the level of commercial return to any player, including BT. And as Dave just set out in answer to the previous question, our bias here will be against intervention and letting that competition play out for as long as we can.

If we do get to the point that we think that we need to re-enter and look again at pricing, I think, as David just said. Firstly, we'll look at the risks that BT faced at the point that they made the decision to invest; and secondly, that the cost of capital that existed at that time. And what we will look to satisfy ourselves is that the amount of returns that BT have earned during the investment have satisfied or are above the satisfy them, compensate them for the level of risk that they've faced. We will definitely allow them to keep the upside that they've made up to that point and then look to regulate for the rest of the cycle so that they earn above the cost of capital over the investment cycle as a whole.

Jerry Dellis	So historically you tended to allow a 300-400 basis point return above cost of capital. Would that be the sort of benchmark you would have in mind?
Lindsey Fussell	As I say, we're not setting a target return at this point, but I think it's a fair comment to say that historically we have allowed BT to keep returns around 3% to 4% above the cost of capital. I think we have a good track record of making sure that the fair bet is honoured in that way.
Jerry Dellis	Thank you.
Melanie Dawes	Thank you very much for that. Very important set of questions. Over to the next one, please, Ben.
Coordinator	The next question is coming from the line of Nick Delfas from Redburn.
Nick Delfas	Thanks very much for the follow up on Jerry's question. Obviously, you hope that there won't be any need for price regulations in 2030, but could you just clarify what we're talking about here in terms of the fair bet return? Are you talking about an IRR whereby you have the cash outflows from the investments, the inflows, and then the terminal value is the asset base with economic depreciation versus accounting depreciation; and you'll look at that IRR, you'll compare it to the WACC, which you're not telling us what you think it is today, but it's a figure that is set as at today, rather than an as at 2030; and you'll allow an excess return over that WACC. Is that the way we should be thinking about what you believe the fair bet is? Thanks.
David Clarkson	Okay, I think I'll pick up that question. I think, broadly, how you just set that out is how we see it. Effectively, we would be looking at the return over the entire investment cycle, so the entire sort of economic life of the investment and the assets, if you like. And what we would be doing is, we would be looking at all of those years before any regulated prices come in, and looking at what the sort of returns were there, what were the risks, was there reasonable compensation. And then we would be looking to ensure that we set up any charge control, such that any sort of returns above WACC were then being tried and kept. For the second part, if you like, of the investment cycle, where the charge control would exist, we would be setting up in our normal way to ensure that BT was able to earn its normal cost of capital. The point then being, is that the returns over the entire investment cycle will be above the cost of capital, because we'll have the period before regulation that should exceed the cost of capital to cover the risk, and reward the risk, and then the returns after the point of intervention, which should allow the normal cost of capital. Thus, overall, the returns for the entire investment cycle would be above the cost of capital.

Nick Delfas

So, just to clarify, I mean, obviously, the part that we're interested in, in particular, or at least the part that there's been history of, is the part until economic regulation kicks in, when, as Jerry was saying, people are expecting a few hundred basis points excess return over WACC before regulation; and then the second part is, during economic regulation where, obviously, returns will be much closer to WACC. That's the right way of thinking about it?

David Clarkson

So, what we'd be setting up, from the point of any intervention, would be to ensure cost per capital. Up to that point, we're not actually coming out with a pre-defined figure here. Actually, we're saying, basically, it's up to you and the market. You can sort of attempt to make as much as you like, and the more efficient you are in doing this, the more you potentially could make. And we're not saying that it's one or two or three. We're saying, whatever you can do in the market over the next ten or whatever years, it's up to you.

Then what we're saying is, is that what we're then going to do is we're going to say, look, we're not going to try and claw that back in any way. We're going to try and ensure that that can be kept through the way that any subsequent intervention takes place.

Nick Delfas

That's very clear. Thanks so much indeed.

Melanie Dawes

Thanks very much. So, next question, if we may.

Coordinator

The next question is coming from the line of Robert Grindle from Deutsche Bank. Please proceed. Your line is open.

Robert Grindle

Good morning, and thanks, everyone. PIA is a large part of encouraging alt fibre builds in your document this morning. Some gripes from the industry, but does Ofcom view that the current PIA setup pretty much does what it needs to do, or does it need tweaks from here?

And second question is, separately I attended some of the Project Rollout Conference yesterday. Some of the operators are saying that both regulator and government underestimate the demand for alt operators to build in Area 3. My question is, are you just being consistently surprised about the level of interest from the altnet providers, be it in rural or urban? Thanks so much.

Melanie Dawes

Thanks very much. Just to say on your second point, I mean, it's great if we're hearing that there's been more appetite for commercial build, even in some of the less competitive areas. So, I'll leave my colleagues to say more about that, and how it fits in with what the government's doing, but I think that's really good news actually.

On PIA, again, Dave may want to say a bit more. I mean, look, I chair, on a quarterly basis, a meeting to oversee how we're doing on PIA, and all of the CEOs from the altnets can come, Openreach are there. We're holding them to account for how the system's working. And, of course,

	look, this is challenging, just by its very nature, and Openreach would be the first people to say this. This is an old set of systems, an old set of ducts and poles. There's lots of issues with weather and waterlogging, and so on. And so, in a way, what people are seeing into is quite some of the operational issues that Openreach deal with day by day. So, we're working through all those, though, or Openreach and others are working through those. And actually, what's been quite exciting is that, in the last year, we've seen a big increase now in the take-up of ducts and poles. It's around tenfold over the last 12 months. So, we will remain absolutely on this. It will remain a priority for me. It's a really important part of the system. It's operationally complicated, but it's beginning to come through. But I would expect people to be constantly wanting more around the edges and air their views, and we've set up the systems to allow that to happen, so that we can hear the problems, and then get Openreach and others on to resolving it as quickly as possible. Dave, do you want to come in on that, or on the question about Area 3?
David Clarkson	I was pretty much going to cover what you said. It appears that you've now become an expert in ducts and poles in your year with us, so you've pretty much covered all of it. So, that covers it all. I mean, look, PIA is not straightforward. It will constantly evolve, because that is the nature of it, but we do have an industry working group set up. We have our Telecoms Adjudicator that's overseeing it. And you just heard, Melanie, herself, is chairing these sessions every three months. It does appear to have improved, and it's in a reasonable place, but let's not be complacent. There will always be improvements that can be made as we go forward, and we're expecting to work alongside the Telecoms Adjudicator and industry to make sure that those improvements happen.
Lindsey Fussell	I mean, just to add, if you want some stats on that, we have had a huge increase in the use of ducts and poles in the past year. This year we've seen providers ordering around 23,000 kilometres of duct usage, and 140,000 poles to deploy their networks. When we look at those figures from May 2019, it was only 2,500 kilometres and 12,000 poles. So, you can see there's been a huge increase in that, and that there's just a lot of confidence that the system is becoming increasingly fit for purpose, and really effective for providers to use. On the question on Area 3. I mean, look, I think we're delighted to see that there is all sorts of different companies thinking about building both in Area 2 and 3. In relation to Area 3, of course, we're not yet certain that there will be a scale competitor to Openreach. That seems a bit less likely than in Area 2. But the great thing is that, because we have been able to apply the same pricing and regulatory consistency across the whole of the UK, that gives those altnets the same margin

and advantage to build as altnets building in Area 2. So, we think that gives them the best chance to be successful.

Robert Grindle: Thank you.

Melanie Dawes: Thanks very much for the questions. You can tell we're quite enthusiastic about PIA. When Dave calls me an expert, I know I really do have something to be proud of.

But I think we'll move on to our next question, if that's okay.

Coordinator: The next question is coming from the line of Polo Tang from UBS. Please proceed. Your line is open.

Polo Tang: Good morning, everybody. Just two quick questions. The first one is, can I just clarify the point on long-term contracts for Openreach? Are you basically saying that anything involving minimum volume commitments on FTTP are not allowed because you're concerned about it impacting emerging competition? That's the first question.

Second question is really just about market structure. If you fast forward to 2031, what's your view on what the UK fibre market would look like if regulation, fibre regulation, is working the way you want it to? So, specifically, how big a role do you think players such as Virgin Media, and altnets like CityFibre and Hyperoptic, will play in the new fibre landscape? Thanks.

Melanie Dawes: Thanks very much for the question. I'll ask Lindsey or Dave to come in again on the first, and also perhaps to follow-up on the second.

On your second point, the headlines are that overall, we think that what we're announcing today, by way of our decisions, will support about 70% of the country having a choice of networks over the next sort of five years or so. And then once you add in Openreach's commitment in more rural areas, which covers another 10%, you then get to the 80% commercial build. And beyond that, it's about the government coming in and subsidising the build in a way that we're familiar with.

But, Dave and Lindsey, do you want to follow up on that and on the first question?

David Clarkson: Yes, I'll go. I'll pick up the pricing question.

Look, there are lots of different pricing structures that could be adopted. We're very conscious that some of them will be really good for promoting the take-up of fibre. In fact, we want to encourage them. And that's indeed the reason that we're not looking to put a prohibition on these pricing structures, and instead saying, well, let's look at what's in the art of possible here. But, of course, we are conscious that there is a line in there that could be crossed, that actually could undermine some nascent competition. And it's really that line that we just need to avoid crossing.

We actually think that there are many pricing structures that will be acceptable and will be good to promote the take-up of FTTP. And, in fact, there are several already in the market, and we don't have a problem with them at all. So, it's absolutely not a case of any sort of volume, or any commitment on the take-up of fibre we would find bad and unacceptable. On the contrary, there is just some that could stray into the territory that we would just need to be careful about.

Lindsey Fussell	On your second question, I mean, look, I think success in 2031, it is in that 70% of the country having a range of networks being built, and that's likely to look different in different places. Different networks will go to different places. Might involve a range of different companies, including the ones you mentioned. But we're really confident. We're really encouraged by the commitments that a number of companies, like CityFibre, have already made. And so, we think we have a really good prospect of getting a 70% commercial build achieved.
Polo Tang	Thanks.
Melanie Dawes	Thanks very much. On to the next question. We have about another ten minutes; is that right?
Rohit Goel	Yes, that's right.
Melanie Dawes	Great.
Coordinator	Your next question is coming from the line of Adam Fox-Rumley from HSBC. Please proceed. Your line is open.
Adam Fox-Rumley	Thank you very much, and thanks for the presentation this morning. I had a question, firstly, on Area 3, please, because in the original consultation document, you made reference to the £5 billion worth of government support for rural areas. But the current government budget only envisages £1.2 billion to be made available over the next five years. So, I wondered if that had impacted your thinking at all, or whether that's really kind of a separate topic. And then, secondly, there have been big changes to the corporate tax regime in the UK. A fairly small question here, but those haven't been factored into the WACC calculation at this point, from what I can see. Is mechanically the next point that they can go in at the 2026 review, at the next review? Thanks.
Melanie Dawes	Thanks very much. On your first question, you're right. I mean, obviously, this is very complementary, what we're doing, to what the government's doing, but we haven't sort of factored it in, because what we've done is a market analysis. And so, that's at the heart of our approach. Lindsey, do you want to pick up the second question and expand on the first? I think we'll try and kick through these last few questions as

quickly as we can, so that we can allow as many as possible before 9:30.

Lindsey Fussell — Okay, certainly. I mean, firstly, on Area 3, I mean, I think we've always been pretty clear that our objective here is to ensure commercial build firstly out to 70%, and then, frankly, Openreach commitment on the 3.2 million, that's been able to be extended to 80%. And the government funding is going to be needed for that final 20%.

It's obviously up to the government to then determine what pace they release that funding and their procurement approach. But as Melanie said, we think this is really complementary to that.

Dave, do you want to pick up the question on tax?

David Clarkson — Yes, sure. So, clearly, we did notice the corporation tax change in the budget, and we did actually put a note in our WACC annex when we discuss it.

I mean, I'm not going to claim to be a WACC expert here, but you will see from our annex, when we talk about WACC, there are loads of variables in there, and there's always a distribution. We did look at the recent change and we felt that where we were and other changes actually were also going through at the same time, we felt that the WACC that was coming out was particularly for Openreach, because as I said earlier, that's actually the only figure that we used to set any prices. We felt that it was in an okay place and we could run with that.

But in terms of future WACC calculations, yes, of course, absolutely we will be looking at all of the factors that exist at the time and again looking at those distributions and coming up with again what we think is the right and fair WACC at that point in time. So, the corporation tax at that point will certainly be reflected in it.

Adam Fox-Rumley — Thanks very much.

Melanie Dawes — Thanks a lot. Next question, if we may.

Coordinator — Your next question is coming from the line of James Barford from Enders Analysis. Please proceed. Your line is open.

James Barford — Good morning. I had a question about altnet. If an altnet builds out in a rural area where there's clearly only the economics for one full-fibre network, what would you want to happen in that situation? I mean, consider that Openreach might decide to build out on the grounds that it'll make money for increasing its overall regulatory asset base and therefore bankrupt that altnet. Would you want it to do that or would you want it to decide not to build and eventually withdraw copper and would you even allow it to take that approach?

Lindsey Fussell — I think on that one, look, this is a competitive strategy and a strategy based on competition. So whilst we think it's a lot less likely that we'll get competition in Area 3, if an altnet does build and then somebody else chooses to overbuild them that's certainly not something that we'd be looking to stop or to prohibit. I think what we want to do is give all the altnets the best possible chance to succeed, but in a competitive environment. So we certainly wouldn't want to stop overbuild in Area 3 if it does happen.

David Clarkson: I think you asked a question about copper switch off in there as well, so I'll just pick that up. What we set out, and again it's in our copper retirement section, which is in Volume 3. If Openreach and other people wanted to overbuild whether it's an Area 2 or Area 3 we don't mind. Equally, if Openreach decided that it didn't want to overbuild and it wanted to do some deal with the altnet and close its copper network that's also fine. And we've actually set that out explicitly that they could do that and indeed we would support them doing that. So, it really becomes a commercial competitive choice at that point and that is the framework that we're trying to set out at this point in time.

James Barford: Understand. Thank you.

Melanie Dawes: Next question.

Coordinator: Your next question is coming from the line of Charlotte Perfect from Arete Research. Please proceed. Your line is open.

Charlotte Perfect: Hi, thank you. My question is around Area 3, just a bit more there. Does the principle that that is aligned to Area 2 in scope and level last beyond 2026? If so, I guess what are the reasons to keeping Area 3 as Area 3? Area 3 just looks like Area 2, so why not just call it Area 2, all of it? What are the main differences there? Thank you.

David Clarkson: Thanks, Charlotte. I'll take up that one. To some case, it might sound a bit arcane, the structure that we're dealing with but we here we are looking at the competitive conditions that exist across the UK. I think it's pretty clear that there are differences in competitive conditions we've seen between one end of the country and the other. And look, we could all bicker about where the line is drawn but it has to be drawn somewhere and what we are saying is within Area 3 we do think that there is just substantially less prospects or sustainable competition and therefore we do need to treat it differently.

And of course what we're ultimately after here is we're ultimately after consumers being protected or indeed getting a good deal. And in Area 2, we're comfortable that the competitive dynamic would ensure that they will get a good deal. In Area 3 we don't have that competitive dynamic. And hence the commitment given from Openreach is the way of ensuring that they do get the investments, and so that's what allows us to level up the two areas.

In terms of beyond 2026, and again, we set this out in the document. Yes, it's our intention that we will keep them locked together and that's because we believe, looking at people's plans, that there will be continued rollout in Area 3 beyond 2026. We think there will be some commercial rollout, in fact, beyond 2026. But, there will also be government interventions certainly beyond 2026, and in fact to the question earlier about the 5 billion but actually we know 3.8 billion of that is going to be spent after 2026 and that will be in Area 3. And whilst that's government funded, because the government funding is a GAAP funding model, it will actually draw commercial investment out during that period. And so, on the basis that this is how we see the world playing out we will want to keep Areas 2 and 3 in alignment.

Charlotte Perfect: Thank you.

Melanie Dawes: Thanks very much, David. We've just got a minute left. I think we have two questions. Ben, I wonder if we can just very quickly ask both questioners, one after the other, to pose their questions and then we'll come back to Ofcom one final time to give answers. So, if we can just try and wrap up in a couple of minutes but just give everyone a chance to ask the questions they have.

Coordinator: Your next question is coming from the line of Sam McHugh from Exane. Please proceed. Your line is open.

Sam McHugh: Thank you, guys. I have two quick questions. On the long-term contracts, does your concern around the volume commitments extend to BT Consumer contracts with Openreach? That's the first one.

And then secondly, when it comes to assessing the target returns and fair bet on fibre. How should we think about the mean capital employed in FTTP? So if BT is spending £600 or so to invest in fibre, how much gets allocated to the PIA market versus I guess what would some kind of new allocation in their regulated accounts for fibre? Thanks very much.

David Clarkson: So, on the long-term contracts with BT Consumer, it depends what form they take, but I think my starting position would be that we'd probably have much less concern or probably interest in how they set them up. We'd have to look at the time clearly, but it's definitely not the focus of our regulation and certainly not the focus of this review which is completely at the wholesale level.

On your second point, if I understand it correctly, this is any investments that actually BT and Openreach are putting into the network now that ultimately flow through to making the ducts and pole access better. Yes, it's our intention to absolutely capture those. And indeed, in setting the charges for ducts and pole access over the next five years, we've taken a forward-looking approach of exactly what sort of activity is going on in that network. And not surprisingly, with all the activity of deployment of fibre actually that we're seeing at the moment there is more cost going into that network and that is reflected in the price that we just set out.

Sam McHugh: If I could just follow up very quickly, sorry. If I think about BT and they're talking about a £12 billion investment in fibre, should we be thinking that that is eventual mean capital employed that you'll be looking at for the return and then the economic depreciation is on that full amount or will it be less than that or are there other things that go into that? I don't know if you can add any clarity at all on that.

David Clarkson: So, the £12 billion of course is the total investment in fibre network. Only a small portion of that would be flowing into ducts and pole access because a big portion of it would clearly be the installation of the fibres and the fibre equipment and so on. So, if we're talking about what flows into the ducts and pole price it would be a portion, probably quite a small portion of that. If we're talking about the value if we were to ever set cost base charges for fibre services then it would be the £12 billion.

Sam McHugh: Thank you, guys.

Melanie Dawes: Thanks very much. Look, although I think we have one last question, we will follow up with that person offline. I think we have to wrap up now.

Can I just thank everybody for joining us this morning? Thanks to my colleagues who were in Riverside House, I'm at home, for answering all the questions. Thank you, Rohit, for organising it, and thank you, Ben, for compering from your end.

Look, I hope everyone enjoys digesting the material, reading the document. We look forward to seeing your reactions. It's a big moment for us today of course, but we really hope that this is a turning point and a real move forward on broadband investment.

So, thank you very much for joining us and do follow up with any further questions that you have as well. We're very happy to answer anything that you have queries about. But meanwhile, good morning and thank you very much.

Coordinator: Ladies and gentlemen that concludes your conference call for today. You may now disconnect. Thank you for joining and have a very good day.