

# **CityFibre response to the WLA Area 3 Consultation**

**Non confidential**

**22 Sept 2020**

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# 1 Executive Summary

- 1.1 This document comprises our formal response to Ofcom's consultation entitled '*Promoting competition and investment in fibre networks: Wholesale Fixed Telecoms Market Review 2021-26 - Pricing wholesale local access services in Geographic Area 3 with a BT Commitment to deploy a fibre network*', published on 29 July 2020.<sup>1</sup> We henceforth refer to this as the 'Area 3 Consultation'.
- 1.2 In January 2020, Ofcom published its wholesale fixed telecoms market review (WFTMR) Consultation<sup>2</sup> which set out its proposed approach to regulating all wholesale fixed telecoms markets, including the Wholesale Local Access (WLA) market. A key component of Ofcom's WFTMR Consultation was its proposals to apply different regulatory approaches in different parts of the UK.
- 1.3 Critically, Ofcom proposed a significantly different form of regulation in those parts of the UK where Ofcom considered there to be no material commercial deployment or plans for such deployment (i.e. WLA Area 3), when compared to locations in which Ofcom considered there to be either existing gigabit-capable networks or firm plans for such networks to be deployed over the coming years (i.e. WLA Area 2).
- 1.4 Specifically, Ofcom took the view that while Area 2 regulation should prioritise investment incentives for all operators, Area 3 regulation should be focussed on providing incentives for Openreach to invest. Given this view, Ofcom proposed significantly different forms of price regulation in Area 2 and Area 3. We summarise Ofcom's proposed approach as set out in the January WFTMR Consultation below:
- **Scope of price caps:** Ofcom proposed to only impose a price cap on the 40/10 FTTC variant in Area 2. In contrast, Ofcom proposed that in Area 3 all FTTC variants should be price controlled. In other words, Ofcom proposed a greater extent of price regulation in Area 3.
  - **Level of price caps:** Ofcom proposed for Area 2 to cap prices at their current level (CPI+0). In contrast, Ofcom proposed that in Area 3 prices should be based on Openreach's costs, which would ultimately result in prices fall by as much as 15% per year.
  - **Geographic discount:** Ofcom proposed to prohibit geographic discounts which would have the effect of would deterring alternative network rollout. In Area 2 Ofcom propose this prohibition for all WLA services including FTTP, in Area 3 Ofcom propose this prohibition for all WLA services except FTTP.
- 1.5 Given the significant difference in remedies that Ofcom proposed would apply to Area 2 and Area 3, we considered (as set out in our WFTMR response) that postcode sectors in Area 3 would be much less attractive for investors compared to Area 2 locations. In other words, Ofcom's proposals would create a 'cliff-edge' between Area 2 and Area 3 location from an investor's perspective.
- 1.6 On 29th July 2020 we heard two announcements:

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<sup>1</sup> [https://www.ofcom.org.uk/\\_data/assets/pdf\\_file/0030/199155/consultation-bt-commitment-area-3-fibre-network.pdf](https://www.ofcom.org.uk/_data/assets/pdf_file/0030/199155/consultation-bt-commitment-area-3-fibre-network.pdf)

<sup>2</sup> <https://www.ofcom.org.uk/consultations-and-statements/category-1/2021-26-wholesale-fixed-telecoms-market-review>

- i. An announcement from **Openreach** regarding its intention to deploy commercial full fibre to 3.2m premises in WLA Area 3 (this 'voluntary commitment' was made to Ofcom in a letter dated 26 June 2020);<sup>3</sup> and
  - ii. An announcement from **Ofcom** about the implications of this Openreach commitment on Area 3 regulation. Specifically, Ofcom are now minded to adopt more pro-investment regulation in Area 3.<sup>4</sup> Specifically, Ofcom propose to mirror the Area 2 proposals (in terms of scope and level of price caps) in Area 3. Furthermore, Ofcom propose to also impose restrictions on BT in Area 3 in terms of geographic discounts, i.e. again mirroring the approach in Area 2.
- 1.7 It is clear that these linked announcements reflect a negotiated outcome between BT/Openreach and Ofcom. CityFibre has assessed both the *direct* effects of this change in regulation on our own investment plans, and the *indirect effects* and indeed risks inherent in entering into this type of 'regulatory contract' with BT/Openreach at this critical phase of network investment.
- 1.8 In terms of direct impact, the effect of Ofcom's new proposals would be to provide much greater investment incentives in Area 3, when compared to the January 2020 proposals. Furthermore, aligning pricing across the whole of the UK will (in our view) provide a simpler regulatory regime which will give more certainty to investors. In basic terms, a single national regulated price for broadband will avoid the added risks and complexities associated with sub-national price regulation.
- 1.9 In addition, a single approach to price regulation across the UK will provide much greater flexibility for investors, who will now be able to be more dynamic in terms of deployments. In contrast, the previous 'cliff edge' effect would have meant that Area 3 locations (especially those located nearby to Area 2 locations) would be unattractive for investors. Under the new proposals all of these locations are now 'on the table' for commercial deployment.
- 1.10 Furthermore, Ofcom's new proposal to expand the FTTP geographic discount prohibition to Area 3 provides much needed regulatory protection against anti-competitive Openreach activity, in those Area 3 locations where rivals have already, or are minded to deploy fibre.
- 1.11 The overall direct effect of Ofcom's new proposals is therefore to make Area 3 locations much more attractive for fibre network builders, which will better support the achievement of the Government's ambition for ubiquitous full fibre and Ofcom's objective of promoting competition and investment in fibre networks.
- 1.12 We do however have some concerns about the *indirect* effects of Ofcom's approach.
- 1.13 First, the choreographed nature of these announcements, notwithstanding this current consultation, sends an unfortunate signal. BT/Openreach is only one of several significant investors who have an appetite to make substantial investments across the whole market, including in Area 3. In general, it does not improve alternative investors' faith in the pro-competitive nature of Ofcom's regulatory regime if 'side-deals' appear to be undertaken bilaterally with BT/Openreach.
- 1.14 Second, we are not clear that the specific commitments made by BT/Openreach reflect particularly good value for UK plc in terms of addressing the genuinely hard to reach parts of

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<sup>3</sup> [https://www.ofcom.org.uk/data/assets/pdf\\_file/0032/198860/openreach-letter-26-june-2020.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0032/198860/openreach-letter-26-june-2020.pdf)

<sup>4</sup> Ofcom (2020) 'Promoting competition and investment in fibre networks: Wholesale Fixed Telecoms Market Review 2021-26 - Pricing wholesale local access services in Geographic Area 3 with a BT Commitment to deploy a fibre network' [\[Link\]](#)

the country. The locations identified by BT/Openreach in their initial announcement on 29 July include many large population clusters that are adjacent to existing or planned builds from Openreach or other market participants. Arguably these locations should never have been included in Area 3 in the first place. There is very little genuinely challenging rural deployment in Openreach's (apparent) commitment.

- 1.15 Third, the timing of this announcement is unfortunate from the wider perspective of ensuring that the anticipated BDUK 'Outside In' programme delivers value for the money for the Government, specifically by ensuring competition in bidding for intervention areas. The BT/Openreach plan appears to create a footprint of deployment that is optimised to make it difficult for firms such as CityFibre to expand outwards from Area 2 via 'near adjacent' Area 3 exchange areas to then address rural exchanges that may receive subsidy under the 'Outside In' programme.
- 1.16 This latter point highlights what for us is an increasingly important area requiring Ofcom's engagement, which is the need for much greater transparency of Openreach's build plans. The Government recognised in its Future Telecoms Infrastructure Review that lack of clarity on these plans can destabilise competitive investment and create a hold-up problem for altnets. The need to address this problem is now even greater as a result of the Government setting a much more challenging target of achieving national full fibre coverage by 2025.<sup>5</sup>
- 1.17 Given all this, we set out below the key messages from this submission:
- i. **Promoting competition and investment in fibre networks:** Ofcom's new proposals provide much better investment incentives, especially for rivals to BT (than compared to its previous proposals for Area 3). As a result, Ofcom is now proposing regulatory conditions that will more effectively support the achievement of its overarching strategy of promoting competition and investment in fibre networks across the UK.
  - ii. **On the basis of Ofcom's revised Area 3 pricing proposals, we are now minded to rollout full fibre into some Area 3 locations:** Given that Ofcom is now proposing regulation in Area 3 that is more geared toward providing investment incentives, we are considering a number of Area 3 locations that we may deploy into.
  - iii. **Openreach's commitment shows that much of Area 3 is commercially attractive, provided the right regulatory conditions are in place:** Entirely consistent with what we set out in our WFTMR response, provided that the right regulatory conditions are in place, much of Area 3 is viable for commercial deployment. Openreach have clearly demonstrated this point through its commitment.
  - iv. **Ofcom is entirely correct to prohibit FTTP geographic discounts in Area 3:** Given the existing rival deployments in Area 3, and the scope for significant further commercial deployment by rivals to Openreach, it is critical that Ofcom do not allow Openreach to engage in anti-competitive geographic discounts which effectively foreclose rivals network builders.
  - v. **Notwithstanding Ofcom's proposals, the process for arriving at them should be more transparent:** Notwithstanding our views on the specific proposals, we wish to highlight that Ofcom have provided little clarity on the evolution of discussions with Openreach including Ofcom's assessment of the various options it has considered

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<sup>5</sup> The voluntary commitment that the Government extracted from Openreach to publish its plans is no longer being complied with, but conversely Ofcom now has much more extensive power to gather information on build plans and publish these via the powers granted to it following transposition of Article 22 EEC. We call on Ofcom to take urgent steps to implement the Article 22 process and ensure (a) that BT/Openreach cannot deter alternative investments by the kind of announcement made on 29 July and ensure that any commitments it does make are duly complied with.

and the pros/cons of each. We consider that for such significant changes to Ofcom's proposals, especially when the cause of that change is engagement by a single stakeholder (and furthermore an entity with SMP), Ofcom must provide full transparency and details on the dialogue, even if portions of it must be redacted.

- vi. **Ofcom should apply its powers under the new EEC transparency mechanism:** In doing so, Ofcom should carefully monitor Openreach's plans both to ensure that the commitments they have made are met, and that the specific nature of these plans do not have anti-competitive intent, most notably in reducing the likely of competitive bidding for 'outside in' subsidy awards.

1.18 The remainder of this document is structured as follows:

- **Section 2:** sets out relevant background for this submission, including a summary of Ofcom's proposals in the January 2020 WFTMR Consultation as well as an overview of our response to those proposals.
- **Section 3:** sets out Ofcom's new proposals as set out in the Area 3 Consultation, and our views of them.

## 2 Introduction

2.1 In this section we provide the relevant background and context for this submission. We begin (in Section 2.1) by summarising Ofcom's proposals in the January 2020 WFTMR Consultation in regard to the WLA market. We thereafter (in Section 2.2) provide an overview of our response to those proposals, as set out in our formal WFTMR response.

### 2.1 Ofcom's (January 2020) WFTMR Consultation proposals for the WLA market

2.2 In January 2020, Ofcom published its WFTMR Consultation which set out its proposed market definition, significant market power (SMP) findings and remedies across all wholesale fixed telecoms markets. This includes the Wholesale Local Access (WLA) market which corresponds to a number of regulated broadband products such as Metallic Path Facility (MPF) which provides copper-based broadband and Generic Ethernet Access (GEA) which is the basis for FTTC and FTTP services.

2.3 A key component of Ofcom's January Consultation was its proposals regarding geographic markets. Firstly, Ofcom proposed that the relevant 'geographic unit' (i.e. the building blocks upon which a WLA geographic market is defined), should be based on postcode sectors. There are 9,558 postcode sectors across the UK. Ofcom proposed this geographic unit on the basis of its view of the need to strike a reasonable balance between pragmatism and ensuring the ability to identify differences in competitive conditions between locations.

2.4 Having identified a relevant geographic unit, Ofcom then proceeded to define three geographic areas for the WLA market:

- **'WLA Area 1'**: Postcode sectors where there are at least two established gigabit-capable rival networks to BT. Ofcom consider that currently no postcode sectors meet this definition.
- **'WLA Area 2'**: Postcode sectors where there is either; i) existing material gigabit-capable network deployment, or ii) actual build plans for such deployment. In other words, Area 2 does not include all locations that could support commercial deployment, such as from a rival to BT.<sup>6</sup> On the basis of this definition, Ofcom consider that Area 2 comprises 6,037 postcode sectors equating to 21.3 million premises (i.e. ~70% of UK premises).
- **'WLA Area 3'**: Given the above, Ofcom are proposing that Area 3 comprises all the remaining postcode sectors, i.e. for which there is no existing material gigabit-capable deployment and no plans for such deployment. On the basis of this definition, Ofcom consider that Area 3 comprises 3,521 postcode sectors equating to 9.2 million premises (i.e. ~30% of UK premises).

2.5 Ofcom then proceeded to assess competition in each of the above markets. Ofcom conclude that Openreach has Significant Market Power (SMP) in both Area 2 and Area 3, and on that basis proposed a number of SMP remedies to address its competition concerns.

2.6 Most critically, Ofcom proposed a significantly different form of regulation in Area 3 compared to Area 2, specifically that Area 3 price regulation was less geared towards providing

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<sup>6</sup> In Ofcom's view, if there are no plans to deploy as of today (or by the time of the WFTMR Statement in April 2021), then a location cannot be part of Area 2.

investment incentives. Ofcom justified this based on its view that Area 3 is less likely (than Area 2) to see material commercial deployment:<sup>7</sup>

*“We give less weight in Area 3 to setting charge controls that incentivise rival network investment, as we do not believe that there will be material competitive fibre deployment in these areas.”*

2.7 In Table 1 below we provide a high-level comparison between Ofcom’s proposed remedies in Area 2 and Area 3 in the WLA market, as set out in its January 2020 WFTMR Consultation.

**Table 1: Price regulation proposals in the January 2020 WFTMR Consultation for WLA Areas 2 and Area 3**

	Area 2	Area 3
Scope of price caps	<ul style="list-style-type: none"> <li>Ofcom proposed to <b>only price-cap FTTC at the 40/10Mbps</b> level, and allow pricing flexibility on all higher bandwidths, to support the fibre investment case.</li> <li>FTTP would only be price-capped at the 40/10 level, and only once copper services have been withdrawn.</li> </ul>	<ul style="list-style-type: none"> <li>Ofcom proposed to <b>price-cap all FTTC bandwidths</b> (e.g. 40, 55 and 80Mbps variants).</li> <li>For FTTP, only the 40/10 variant would be charge controlled, with pricing flexibility allowed for higher speeds.</li> </ul>
Level of price caps	<ul style="list-style-type: none"> <li>Ofcom proposed to move away from the long-standing approach of setting price caps based on BT’s costs.</li> <li>Instead, Ofcom proposed to adopt a <b>CPI+0 approach</b>, whereby (for MPF and the 40/10 FTTC variant) <b>prices will simply be capped at current levels plus an allowance for inflation</b>.</li> <li>The price cap for the 40/10 FTTP variant, will be based on the FTTC equivalent price, plus a £1.50-1.85 allowable mark-up as a ‘fibre premium’.</li> </ul>	<ul style="list-style-type: none"> <li>Ofcom proposed to set <b>price caps on the basis of BT’s costs</b>, for MPF and all FTTC variants.</li> <li>On this basis, Ofcom’s analysis indicated that FTTC prices in Area 3 would <b>fall by between 5.75% and 15.00% in each year</b>, for the next five years. This could result in prices falling by as much as 50% in Area 3 by 2026.<sup>8</sup></li> <li>For FTTP, the 40/10 variant would be capped at costs, with a mark-up for a ‘fibre premium’ to allow for the recovering of fibre investment costs.</li> </ul>
Geographic discounts	<ul style="list-style-type: none"> <li>Geographic discounts are prohibited in the first instance for all WLA services, <b>including FTTP</b>.</li> </ul>	<ul style="list-style-type: none"> <li>Geographic discounts are prohibited in the first instance for all WLA services, <b>excluding FTTP</b>.</li> </ul>

Source: CityFibre

2.8 As a result of the significant divergence in remedies that Ofcom proposed would apply to Area 2 and Area 3, we considered that there would be a ‘cliff-edge’ effect, in that postcode sectors

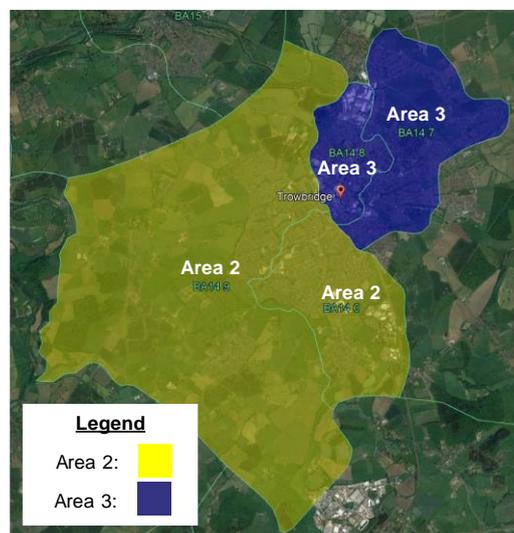
<sup>7</sup> Ofcom. WFTMR Consultation. Volume 4. Para 2.7

<sup>8</sup>  $100 * (1-.15)^5 = 44.4$

in Area 3 would be much less attractive for investors compared to Area 2 locations. This is both because the regulated prices in Area 3 would be cost-based and therefore are likely to be much lower than Area 2 (especially by the end of the market review period), and also that in Area 3 Openreach would be free to launch geographic discounts on FTTP services.

2.9 Critically, this could have very material implications for investors in a town or city where some postcode sectors are in Area 2 and some are in Area 3. In Figure 2 below we show a real-world example of this issue based on the Wiltshire town of Trowbridge. The effect is to make deployment of the entire contiguous region much more difficult.

**Figure 1** Analysis of post code sector allocations in Wiltshire town of Trowbridge



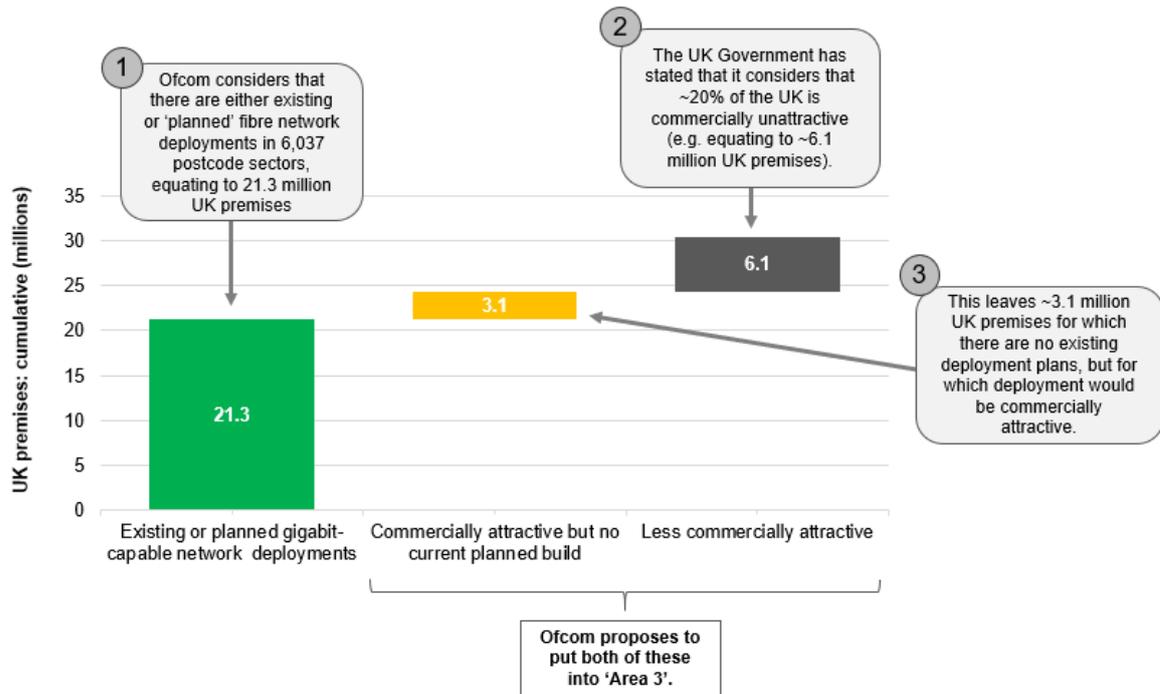
Source: CityFibre/GOS analysis based on Ofcom's allocation of post code sectors to Areas 2 and 3 in file 'Illustrative assessment results (post code sectors by category)'

## 2.2 Summary of CityFibre's response to the WFTMR Consultation proposals

2.10 In our WFTMR Consultation response, we set out clearly our dissatisfaction with Ofcom's proposal to allocate commercially attractive post code sectors to Area 3. We motivated this with reference to the Government's own assessment that 80% of the UK can support commercial fibre deployment, and that by implication Area 3 should only comprise of 20% of UK premises (and not 30%).

2.11 We set all this out in a diagram, reproduced in Figure 2 (below):

**Figure 2** Ofcom’s proposed approach to WLA geographic markets in light of the UK Government’s assessment of commercially attractive Ofcom’s proposed approach to WLA geographic markets in light of the UK



**Government’s assessment of commercially attractive locations**

Source: CityFibre analysis based on Ofcom and DCMS data

- 2.12 In short, we were directly challenging Ofcom’s fundamental assumption, that in Area 3 there is unlikely to be material commercial deployment from rivals to Openreach.
- 2.13 What ultimately matters however is the actual regulation that applies, and not how the geographic markets are delineated. From this perspective, market definition is simply a means to an end (solving some competition concern) and not an end in itself.
- 2.14 The impact of market definition is only felt once the proposed remedies have been taken into account. As such, any issue with Ofcom’s proposals must be based on the combination of market definition and the proposed remedies in those markets. They are essentially an indivisible whole.
- 2.15 In our WFTMR response, we set out the risks of Ofcom’s proposals (to allocate commercially attractive locations to Area 3), given the proposed remedies in Area 3 did not provide the right investment incentives. Ultimately, we said that Ofcom’s proposed Area 3 regulation will kill the

commercial business case for deploying fibre in Area 3, that would otherwise have taken place. In regulatory language, this is known as 'regulatory failure'.<sup>9</sup>

2.16 For these reasons (and others),<sup>10</sup> we stated that Ofcom must reconsider its proposed approach, and that there are two ways that Ofcom can do this:

- **Amend the market definition (i.e. Area 2/3 delineation):** This is the more logical solution, in that Ofcom is required to define markets on the basis of them having sufficiently 'homogenous conditions'. On this basis, one can argue that commercially attractive areas should not be allocated to Area 3, given that area 3 is largely made up of areas that are not commercially attractive. In other words, it's hard to see how Area 3 contains locations which are all broadly similar in terms of scope for investment.<sup>11</sup>
- **Amend remedies in Area 3:** The less direct solution would be to keep the market definitions the same but instead amend the Area 3 remedies to make them more geared toward providing the right incentives for rival fibre investors. The most obvious solution is to simply mirror the Area 2 proposals in Area 3.

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<sup>9</sup> Ofcom has previously defined 'regulatory failure' as follows: "*Regulatory failure arises when public intervention is unwarranted, or even when appropriate, it is subject to errors that significantly reduce its benefits*" Source: Ofcom (2009) 'The PRS Scope Review'. 28th October. Page 21. Footnote 26. [\[Link\]](#).

<sup>10</sup> For instance, we noted that Ofcom's proposal to use 'planned' deployments (and not simply commercially attractive areas) to delineate between Area 2 and 3 would fail to account for the ever-evolving nature of plans. For instance, plans made today could look very different in six-months' time. Furthermore, we noted that it is not clear how Ofcom intend to take account of deployment plans made after the WFTMR Statement is published in April 2021. For instance, we have recently increased our deployment ambition from 5 million to up to 8 million premises. However, we are still assessing which towns/cities comprise this incremental 3 million.

<sup>11</sup> Another way of putting all this is that we do not fundamentally disagree with Ofcom's proposal to adopt remedies less geared toward supporting rival fibre investment in Area 3 provided that Area 3 is defined as only those locations where rival fibre builders would not wish to go (commercially). The issue of regulation undermining investment only arises if there are location in that geographic market which are of interest to investors. As such, if Area 3 was defined as only the 15% - 20% of hardest to reach UK premises, then we most likely would have conceded that the scope for commercial deployment in Area 3 was very small.

### 3 Ofcom's new regulatory proposals for WLA Area 3 and CityFibre's views

3.1 In this section we set out Ofcom's new proposals and provide our views in respect of them, we have structured this section according to the following topics/issues:

- **Section 3.1** – Considers the regulatory objectives for WLA Area 3, and specifically the need to promote competition and investment in fibre networks.
- **Section 3.2** – Considers the revised Area 3 pricing proposals, with Ofcom now proposing to align Area 3 price regulation with Area 2.
- **Section 3.3** – Considers Ofcom's assessment of Openreach's business case for the 3.2m commitment.
- **Section 3.4** – Considers Ofcom's proposal to extend the prohibition on FTTP geographic discounts into Area 3.
- **Section 3.5** – Considers Ofcom's overall approach to assessing Openreach's offer and the subsequent consultation process.

#### 3.1 Regulatory objectives for WLA Area 3

3.2 As we discussed in detail in Section 2 of our WFTMR response, over the past few years Ofcom has made a strategic shift toward promoting infrastructure competition, and specifically to promoting competition and investment in fibre networks. We fully support this overarching strategic objective and applaud Ofcom's efforts in the WFTMR proposals to instil the right regulatory conditions to support this. We wish to emphasise however that ensuring all remedies link directly back to this overarching objective will be critical to achieving it.

3.3 In the WFTMR Consultation, Ofcom set out its view in regard to the right regulatory approach for Area 3, noting that its approach aims to balance excessive pricing concerns with providing incentives for Openreach to invest:<sup>12</sup>

*"In these areas, there is unlikely to be material commercial deployment by rival networks and the use of duct and pole remedy is expected to be limited. With little prospect of network competition our regulatory approach seeks to promote retail competition and prevent Openreach from setting excessive prices.*

*Our regulatory approach also aims to balance the desire for Openreach to invest and upgrade its network with the need of ensuring that it does not set excessive prices in these areas."*

3.4 Ofcom, reiterate this view in the Area 3 Consultation:<sup>13</sup>

*"In Area 3, we do not consider there to be the potential for a material competitive dynamic. In the absence of such a dynamic Openreach will face weak incentives to deploy new and better networks. Therefore, our proposed approach to remedies in Area 3 is to promote competition*

<sup>12</sup> Ofcom. WFTMR Consultation. Volume 3. Paragraph 1.27 – 1.28

<sup>13</sup> Ofcom. Area 3 Consultation. Paragraph 3.4 – 3.5 [\[Link\]](#)

*through access to Openreach's wholesale services while also supporting BT's deployment of a fibre network.*

*We therefore propose to exercise our discretion in favour of an approach that sets appropriate incentives for BT to invest in fibre networks, while protecting consumers from excessive pricing (including through a weakening of retail competition). We consider this will best serve the interests of consumers, as the roll-out of fibre networks will deliver long term consumer benefits."*

- 3.5 The above quotes show that Ofcom's starting position when it comes to Area 3 is that there is unlikely to be material commercial deployment by rival networks to Openreach.
- 3.6 As we set out in our WFTMR response (and reiterated in paragraphs 2.10 - 2.12, above), we consider that Ofcom's current definition of Area 3 (i.e. accounting for 30% of UK premises) will likely include a significant number of commercially attractive locations for rivals networks to Openreach. In fact, we have estimated that around one-third of Area 3 could be commercially attractive to rivals to Openreach. This analysis was itself based on the UK Government's assessment that only 20% of the UK will not be commercially viable for new fibre networks, which is significantly (~3m premises) less than Ofcom's proposed Area 3.
- 3.7 We therefore consider that Ofcom's view that there is no material scope for competition in Area 3 is entirely incorrect. Furthermore, we note the WFTMR responses from other operators, especially Gigaclear,<sup>14</sup> Jurassic<sup>15</sup> and Swish<sup>16</sup> clearly state that they are present and competing in Area 3 with fibre networks. For instance, Gigaclear note that their entire current and planned footprint falls within Ofcom's Area 3:

*"Gigaclear's network currently passes 130,000 premises and has recently secured funding to expand that footprint to over 500,000 premises within the timeframe of this market review. The entirety of this (current and planned) network build falls within Area 3, which Ofcom defines as 'where there is unlikely to be material commercial deployment by rival networks to Openreach' and within which Ofcom intends to 'encourage [the] BT investment case over that of alternative operators'."*

- 3.8 Given this we are pleased to see Ofcom recognising in the Area 3 Consultation that there is in fact scope for material commercial deployment in Area 3 (as currently defined). In other words, Ofcom now recognises that it is not just locations in Area 2 (as currently defined) that are commercially viable for fibre networks:<sup>17</sup>

*"a number of providers have indicated that they have ambitions to build in Area 3, with some rival investment taking place today. [...] While we do not expect widescale competing fibre networks to develop in Area 3 to the same degree as in Area 2, such build will bring value to consumers, for example, through greater or faster FTTP coverage and/or more choice."*

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<sup>14</sup> [https://www.ofcom.org.uk/data/assets/pdf\\_file/0028/199207/gigaclear.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0028/199207/gigaclear.pdf)

<sup>15</sup> [https://www.ofcom.org.uk/data/assets/pdf\\_file/0030/199209/jurassic-fibre-ltd.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0030/199209/jurassic-fibre-ltd.pdf)

<sup>16</sup> [https://www.ofcom.org.uk/data/assets/pdf\\_file/0030/199218/swish-fibre-ltd.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0030/199218/swish-fibre-ltd.pdf)

<sup>17</sup> Ofcom. Area 3 Consultation. Paragraph 3.41

3.9 Ofcom further note (in regard to its proposed remedies that):<sup>18</sup>

*“While we do not consider there to be scope for material network competition in Area 3, we consider that the proposed charge control is supportive of rival investment to the extent that it emerges.”*

3.10 While we disagree with Ofcom’s view that there is unlikely to be scope for material network competition in Area 3, indeed the quote from Gigaclear above suggests that there is already material network competition, we applaud Ofcom in seeking to maximise the potential for commercial fibre network deployment across the UK (i.e. including in Area 3).

3.11 In conclusion, we are pleased that Ofcom’s proposed regulatory approach in Area 3 now gives greater weight to the scope for commercial fibre deployment in Area 3, which will help to support the overall ambition of full fibre for all.

## 3.2 Ofcom’s revised proposals regarding Area 3 price regulation

3.12 This section sets out our views regarding Ofcom’s proposals regarding Area 3 price caps as set out in the Area 3 Consultation. We begin by summarising the key points from our response to the January WFTMR Consultation, before giving an overview of Ofcom’s new proposal in the Area 3 Consultation, and thereafter our assessment of these new proposals.

### **Ofcom’s January 2020 proposals needed reconsideration in light of the risk of foreclosing commercial fibre deployments in Area 3**

3.13 In our formal response to the WFTMR Consultation (and reiterated in paragraphs 2.15 - 2.16, above) we heightened the risks of Ofcom’s proposal to allocate commercially attractive locations to Area 3, given the proposed remedies in Area 3 would not provide investment incentives for rivals to Openreach. Ultimately, we said that Ofcom’s proposed Area 3 regulation will undermine the commercial business case for deploying fibre in Area 3, that would otherwise have taken place.

3.14 For these reasons (and others),<sup>19</sup> and in considering Ofcom’s overarching objective of promoting competition and investment in fibre networks, we stated that Ofcom must reconsider its proposed approach, and that in this regard Ofcom has two options:

- i. **Amend the market definition (i.e. Area 2/3 delineation):** We considered that this is the more logical solution, in that Ofcom should define markets on the basis of them having sufficiently ‘homogenous’ competitive conditions. On this basis, one could argue that commercially attractive areas should not be allocated to Area 3, given that Area 3 is largely made up of areas that are not commercially attractive. In other words, Ofcom would define Area 2 as all locations that are commercially attractive, leaving Area 3 to be all remaining areas (i.e. which are not commercially attractive).<sup>20</sup>

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<sup>18</sup> Ofcom. Area 3 Consultation. Paragraph 3.6

<sup>19</sup> For instance, we noted that Ofcom’s proposal to use ‘planned’ deployments (and not simply commercially attractive areas) to delineate between Area 2 and 3 would fail to account for the ever-evolving nature of plans. For instance, plans made today could look very different in six-months’ time. Furthermore, we noted that it is not clear how Ofcom intend to take account of deployment plans made after the WFTMR Statement is published in April 2021. For instance, we have recently increased our deployment ambition from 5 million to up to 8 million premises. However, we are still assessing which towns/cities comprise this incremental 3 million.

<sup>20</sup> Another way of putting all this is that we do not fundamentally disagree with Ofcom’s proposal to adopt remedies less geared toward supporting rival fibre investment in Area 3 provided that Area 3 is defined as only those locations where rival

- ii. **Amend remedies in Area 3:** The less direct solution would be to keep the market definitions the same but instead amend the Area 3 remedies to make them more geared toward providing the right incentives for rival fibre investors. This would address the concern that Ofcom would be undermining commercial investment (in Area 3) that otherwise would go ahead. The most obvious solution is to simply mirror the Area 2 proposals in Area 3.

### **Ofcom's proposed options for regulating WLA prices in Area 3**

3.15 In regard to the second option above, in Ofcom's January 2020 proposals, it set out two approaches for regulating WLA prices in Area 3; i) a forecast approach in which prices are set from the start of the charge control period based on forecasted/anticipated levels of deployment and thereby costs, or ii) a post-build approach whereby prices are adjusted only once build has been completed.

3.16 In regard to the forecast approach, Ofcom describe this as:

*"a typical CPI-X form of price cap which is set in advance and remains fixed for the duration of the control. The level of the X would be set to allow recovery of the fibre investment costs and based on a commitment from Openreach regarding the level of fibre deployment."*

3.17 Given the need for an Openreach commitment under the forecast approach, Ofcom flag that:

*"The main challenge with this [forecast] approach is confirming that Openreach's investment commitments would be sufficient and ensuring that Openreach delivers its committed investment programme. Our confidence that Openreach will meet its commitments will depend on the nature of those commitments."*

3.18 Ofcom stated clearly in the WFTMR Consultation that it has a preference for the forecast approach. This was for a number of reasons including it being "more straightforward to implement" and also providing wholesale customers with "greater certainty regarding prices" across the review period.

3.19 Ofcom also, gave recognition to the benefits to the issues raised by the Area 2/3 boundary, noting that a forecast approach could help to address those concerns. Ofcom noted the:

*"added advantages of a consistent pricing approach across geographies because there is uncertainty where the boundary between Area 2 and Area 3 will materialise over the course of the review period."*

3.20 However, Ofcom concluded in its WFTMR Consultation by stating that in the absence of sufficient commitments from Openreach it would not be able to adopt the forecast approach, and in that case would use the post-build approach.

3.21 On 29<sup>th</sup> July 2020, Ofcom published its Area 3 Consultation, in which it announced that Openreach had made a commitment that satisfies Ofcom, and, on that basis, Ofcom proposed

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fibre builders would not wish to go (commercially). The issue of regulation undermining investment only arises if there are location in that geographic market which are of interest to investors. As such, if Area 3 was defined as only the 15% - 20% of hardest to reach UK premises, then we most likely would have conceded that the scope for commercial deployment in Area 3 was very small.

to adopt a forecast approach. The proposals will in effect result in price regulation in Area 3 that mirrors that in Area 2:<sup>21</sup>

*“Openreach had suggested extending the proposed approach to charge controlling WLA services in Geographic Area 2 to Area 3, by indexing copper-based services of bandwidths up to 40 Mbit/s download, 10 Mbit/s upload (40/10) to inflation. We recognised that there could be added advantages of a consistent pricing approach across Area 2 and Area 3. However, we explained that to take this forward we would require a commitment from BT to build a fibre network in Area 3.*

*In June 2020, Openreach committed to build fibre commercially (i.e. without public subsidy) to at least 3.2 million premises in Area 3 cumulatively by the end of 2025/26.*

*In light of this commitment, we are consulting on adopting a forecast RAB approach in Area 3 by indexing copper-based services of bandwidths up to 40/10 and allowing pricing flexibility for higher speed services.”*

- 3.22 As such, Ofcom are now proposing that, based in its assessment, the BT Commitment provides a sufficient level of commercial fibre build to extend Ofcom’s proposed approach to pricing WLA services in Area 2 to Area 3 (i.e. under a forecast RAB).

### **Our assessment of Ofcom’s proposal to align WLA Area 3 price caps with Area 2**

- 3.23 Overall, we fully support Ofcom seeking to provide the right conditions for commercial investment in fibre, to as much of the UK as possible.
- 3.24 We consider that Openreach commitment makes clear that we were indeed correct when we stated that a significant proportion of Area 3 (as currently) defined is commercially attractive. We furthermore think that over time more and more rural locations will become commercially attractive as network builders streamline deployment approaches and reduce build costs.
- 3.25 Given this, and the great uncertainty over which locations will support commercial deployment over the coming years (as well as which locations will be subject to subsidy through the BDUK scheme), we fully support Ofcom’s move to align its approach to price regulation of WLA services across Area 2 and Area 3, i.e. across the whole of the UK.
- 3.26 We consider that a consistent approach to price regulation (in terms of scope of price caps and level) will provide the clarity and certainty required for investors seeking to make multi-billion-pound investments in new fibre networks. This is because the forecast approach will provide a more predictable path of prices for the coming years.
- 3.27 Under Ofcom’s January 2020 proposals, we considered that all Area 3 locations would not be of commercial interest to us. However, given these new proposals, we have now begun to re-assess which postcode sectors (currently defined as Area 3) that we consider could be commercially attractive for us. Our initial analysis has identified a number of such locations. We are examining these in parallel with our separate consideration of the Government’s planned ‘Outside In’ programme.
- 3.28 The two are closely linked, as it may well make sense for us to drive much further into Area 3 locations in order to link up existing urban/sub-urban build locations with potential Outside

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<sup>21</sup> Ofcom. Area 3 Consultation. Page 1.

In intervention zones, to create a contiguous footprint of urban centres and ex-urban and rural hinterland which we consider would be attractive to our CP customers to sell to, and might also allow us to facilitate CPs' migration away from copper on an earlier timescale.

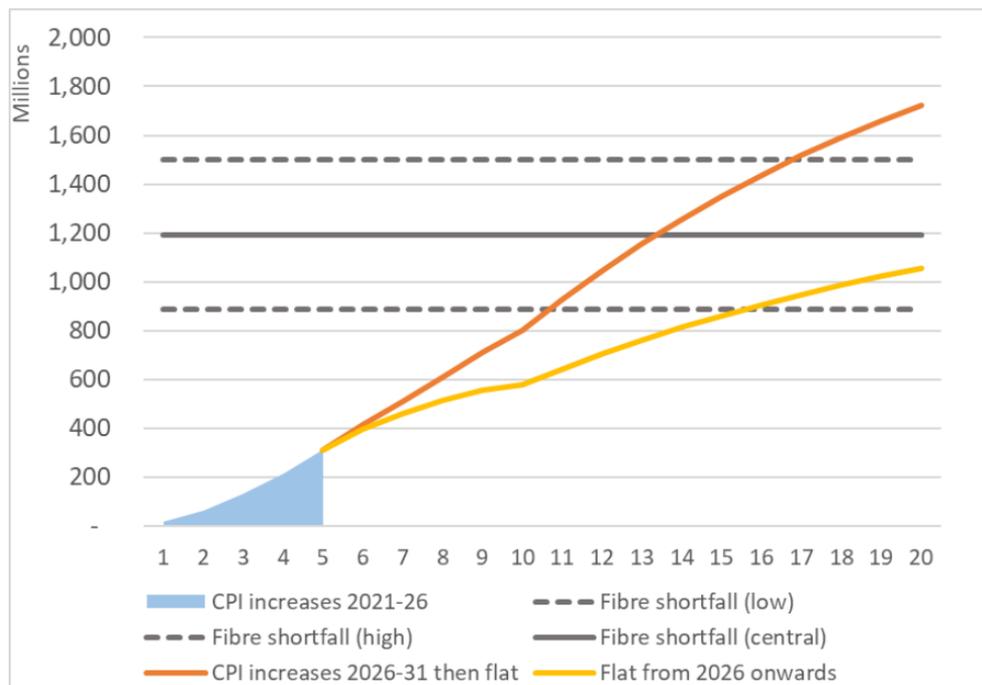
### 3.3 Ofcom's assessment of the Openreach business case for the 3.2m commitment in Area 3

3.29 In order to assess the most appropriate form of price regulation in Area 3, and specifically whether a CPI+0 based cap is reasonable, Ofcom have undertaken an assessment of the levels of cost recovery required during the next charge control period (given BT's plans to deploy fibre in Area 3) that would allow an expectation of cost recovery over the lifetime of the fibre and copper network.

3.30 Ofcom's approach is to assess over a 20 year period, what level of revenues Openreach would be expected to achieve, and then comparing that to the expected 'fibre shortfall' in order to see whether the CPI+0 falls within a reasonable range of cost recovery profiles.

3.31 We present below the output of the analysis conducted by Ofcom:

**Figure 3** Fibre shortfall and additional revenue estimates over 20-year investment lifetime (net present value, £m)



Source: Ofcom. Area 3 Consultation. Figure 3.1

3.32 As can be seen in the above figure, Ofcom's analysis highlights the level of anticipated revenues over the forthcoming market review period (in light blue). Thereafter, Ofcom makes assumptions regarding the level of revenues that will be achieved by Openreach, e.g. on the basis of pricing being flat in nominal terms from 2026 onwards (amber line), or pricing increasing by CPI from 2026-2031, and then being flat in nominal terms thereafter (orange line).

3.33 The key point however is that Ofcom’s modelling merely posits the possible degree of cost recover on the basis of a future regulatory regimes. What it does not do is provide any promise or guarantee as regards the level of revenue that will be permissible across the lifetime of the investment. On this basis, Ofcom will be able in future market reviews to assess the likely trajectory of cost recover and at such a time make the necessary adjustments to manage the risk of over or under recovery. Ofcom notes this explicitly in the Area 3 Consultation:

*“we note that we will have the ability to adjust pricing trajectories in future charge controls should it emerge that there will be a material risk of over- or underrecovery”*

3.34 Given this, we consider that there is no material risk from Ofcom’s proposed approach of applying a price cap in Area 3 on the basis of CPI+0 for the period 2021 – 2026, given that the timelines for payback are much greater than the 5-year review period in question. To the extent that at some point in the future Ofcom considers that an ongoing CPI+0 price cap in Area 3 will likely result in BT over-recovering, then at that time, Ofcom would be well placed to adjust the price cap accordingly.

3.35 In other words, the setting a CPI+0 price cap for the upcoming 2021-2026 period, does not appear to invoke any risk of over recovery for BT. Furthermore, setting a lower price cap, will introduce a material risk of under-recovery.

3.36 For these reasons, we consider Ofcom’s proposal to impose a CPI+0 price cap in Area 3 on the 40/10 variant reasonable in terms of ensuring that BT is able to recover its costs, while simultaneously managing the risk that BT may over-recover.

### 3.4 Prohibiting FTTP geographic discounts in Area 3

3.37 In the WFTMR Consultation, Ofcom set out (in Annex 15) a number of proposals regarding measures to address its concern that, BT, through Openreach, may adopt wholesale pricing structures which would deter alternative network rollout.

3.38 On the basis of this concern, Ofcom set out its intention to provide protection for new entrants, by prohibiting Openreach from offering geographically targeted discounts. Ofcom proposed that this would apply to all WLA services (MPF, FTTC, G.Fast, FTTP) in Area 2. In Area 3 Ofcom proposed that this provision would not apply to FTTP, noting that:<sup>22</sup>

*“In Area 3 we are not expecting large scale alternative rollout of FTTP, and the benefits of restricting Openreach’s geographic pricing flexibility (to promote entry) are likely to be lower than Area 2. In light of this, on balance we are not minded to apply the non-discrimination condition for FTTP in Area 3.”*

3.39 In the Area 3 Consultation, Ofcom state that in light of Openreach’s 3.2m commitment it is now minded to extend the prohibition on FTTP geographic discounts to Area 3:

*“a number of providers have indicated that they have ambitions to build in Area 3, with some rival investment taking place today. These providers have also argued that Openreach could use geographic discounts within Area 3 to deter rollout. While we do not expect widescale competing fibre networks to develop in Area 3 to the same degree as in Area 2, such*

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<sup>22</sup> Ofcom. WFTMR Consultation. Annex 15. Paragraph A15.47

*build will bring value to consumers, for example, through greater or faster FTTP coverage and/or more choice.*

*Given this, we consider that there is a case for restricting Openreach's geographic pricing flexibility on FTTP rental charges in Area 3, consistent with our proposed approach in Area 2. We are therefore consulting on an additional proposal to prohibit Openreach's ability to geographically target price reductions on FTTP rental charges in Area 3"*

- 3.40 We fully agree with this proposal, given the concerns that we set out in paragraphs 3.89 – 3.91 of our WFTMR response:

*"In addition to the above point about the impact on incentives to invest from price reductions, there are also other regulatory proposals which act to further lower investment incentives in Area 3 locations. Specifically, while Ofcom is proposing to prohibit Openreach from launching geographic discounts on FTTP in Area 2 (to address the concern that Openreach may use geographically targeted price reductions to deter alternative network rollout) this prohibition is not proposed to apply in Area 3.*

*Under these proposals, Openreach would be free to adopt geographic discount strategies in order to foreclose rivals in commercially attractive areas. As we set out above, these commercially attractive areas currently allocated to Area 3 are likely to account for ~3.1 million UK premises.*

*In other words, with Ofcom adopting its proposed postcode sector allocations (proposing to allocate postcode sectors to WLA Area 3 for which "there is no planned [rival MSN] build, but where build may be economic") taken in conjunction with the proposed WLA Area 3 remedies, Ofcom is likely to directly foreclose commercial deployment by rival MSNs to BT, to millions of UK premises."*

- 3.41 Given this we are very pleased to see Ofcom now proposing to extend the prohibition on FTTP geographic discounts to Area 3 which will provide much needed protections against Openreach anti-competitive conduct, both for rivals with existing operations in Area 3, and also for those considering deploying networks in Area 3 in the future.

### 3.5 Ofcom's overall approach to assessing Openreach's 3.2m commitment and the subsequent consultation process

- 3.42 Notwithstanding what we have set out above, we wish to note that we consider that Ofcom's approach could have been undertaken with a greater degree of transparency.

- 3.43 Specifically, we note Ofcom's proposals appear to be driven by a very short letter from Openreach, which itself provides little in the way of substantive evidence. While we accept that the Openreach letter may have just been the start of discussions between Ofcom and Openreach on the matter, we consider that all subsequent discussion should have been made clear to stakeholders, along with the evolution of what was being discussed set out clearly through the consultation process. We also note that, having initially published a list of planned locations that would equate to the '3.2 million' commitment, Openreach has subsequently withdrawn that information from its website.

- 3.44 We raise this not in a spirit of peevishness, but because of the great importance our investors attach to the overall transparency of Ofcom decision-making, and in particular their hitherto favourable perception that Ofcom is committed to a competitive model in which alternative fibre investors' plans are given considerable weight in Ofcom's deliberations. It is hard to square that approach with what appears to have been a bilateral negotiation with BT/Openreach, not least given the extensive evidence that we and others have already submitted in the WFMTR process of plans to build (or extend build) in Area 3.
- 3.45 Given this we note the lack of any such discussion in the Area 3 consultation, which merely refers to the Openreach letter as the basis for Ofcom reconsidering its whole approach to regulating prices in WLA Area 3.
- 3.46 It is also not clear what weight, if any, Ofcom has attributed to the impact on competition of Openreach's specific rollout plans. We have conducted an analysis of the locations named by Openreach as constituting the 3.2 million build which shows that the vast majority are adjacent to existing network deployments or already planned deployments. Indeed, in many cases, these locations are sizeable market towns that in our view should never have been included in Area 3 in the first place.
- 3.47 A plan that involves picking off the 'easy' bits of Area 3 does not obviously amount to the best value for money that Ofcom could secure via an easing of regulation. But more pertinently from our perspective, we consider that Ofcom should have in mind the wider impact of Openreach's planned deployment on BDUK's Outside In programme, as Area 3 regulation and that programme will co-exist and, in some respects, overlap in the period to 2026.
- 3.48 An obvious and logical approach for operators such as CityFibre to pursue in order to participate in the Outside In programme is to extend outwards from existing urban deployments, via Area 3 exchange areas on the margins of our current builds, in order to address rural exchange areas marked for intervention under the Outside In programme. If Ofcom's permissive approach actively encourages Openreach to target its build on those intermediate Area 3 exchange areas, as appears to be the case from the information that Openreach put into the public domain on 29 July, this may have a very significant, unintended effect to undermine the ability of CityFibre and others to compete for Outside In intervention areas.
- 3.49 In several important respects the issues that this consultation raises highlight the need for Ofcom to take urgent measures to improve transparency across the board concerning future build plans, specifically those of Openreach.
- 3.50 The context for Ofcom's regulatory actions is overarching Government policy to secure fibre connectivity throughout the UK 'as soon as possible' with an indicative target to have achieved near-nationwide coverage by 2025. With this policy imperative in mind, the Government has recognised in the Future Telecoms Infrastructure Review that lack of transparency about build plans, especially those of the dominant incumbent Openreach, create a 'hold up' problem that could significantly reduce the pace of rollout.
- 3.51 The Government secured a voluntary commitment from Openreach following the publication of the FTIR statement to publish its forward plans sufficiently in advance, and with sufficient granularity, to allow other investors to adapt their plans and strategies accordingly. However, Openreach appears to no longer be complying with its voluntary commitment. It has stated it will no longer provide a forward view beyond the first quarter of 2021 and will instead merely provide a three-month advance notice of imminent build commencement. This is obviously insufficient to address the concern that the Government had recently identified. We have

discussed this with the Government who tell us they now expect Ofcom to address this problem using its statutory powers.

- 3.52 The Government has now implemented the European Electronic Communications Code, Article 22 of which creates a powerful transparency mechanism for national regulators to gather data from operators on their plans and as appropriate publish the results of this to provide clarity and confidence amongst investors. (This being part based on other EU countries' own experiences of national rollout plans being affected by hold-up problems as well as strategic behaviour in the form of operators either understatement or overstatement of plans, to obtain strategic advantage over their rivals).
- 3.53 Critically, using these powers would also allow Ofcom to take enforcement action if that kind of 'strategic' behaviour becomes apparent. This is crucial not to just to address the hold-up problem but also to underpin investor confidence in bidding for Outside In procurements where a previously undeclared commercial build in all or part of an intervention area post-dating an award could leave the Awardee facing substantial, unanticipated operational and commercial risk in fulfilling the contract.
- 3.54 As it becomes clear that, contrary to Ofcom's initial expectations in the first WFTMR consultation, that Openreach is not 'the only game in town' as regards Area 3/rural deployments, it is ever more important that Ofcom uses its full range of powers, including its new transparency powers, to ensure that all parts of the market can be competitively addressed and that the Government's Outside In funding programme is contestable.