



Melanie Dawes
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Dear Melanie

As I explained during our meeting of 7 September, now that the Wholesale Fixed Telecoms Market Review (WFTMR) Statement has been published, BT's Board considered, at its meeting on 27 July, BT's revised plans to pass 25 million premises with FTTP by December 2026, including 6 million premises in harder to reach areas, of which 3.2 million are committed in Area 3.

As you know, BT responded positively to the WFTMR Statement because it confirmed key 'enablers' which will support investment by BT and our competitors across Area 2 and Area 3 whilst protecting customers as we transition from copper to fibre. A 5-year regime is an important improvement on 3-year reviews for non-overlapping business and consumer markets. Also critical is Ofcom's intention to hold prices - for a set of baseline wholesale services - flat in real terms with a modest full fibre premium, and Ofcom's support for migration to help avoid the cost of running two networks in parallel.

However, even with these 'enablers', the decision being asked of the BT Board is momentous. The investment represents one of the most significant ever made by the company (around £15 billion) in what can only be described as unprecedented times. It spans multiple decades and much of the capital will be committed before BT has fuller information on the strength and nature of wholesale and retail demand. To put it plainly, the investment case is large and risky with limited opportunity to retrench, which I know you appreciate.

In assessing the prospects of this investment generating at least its ex-ante project cost of capital given the risks involved, the BT Board took a view on whether, and if so how, Ofcom would intervene to further price regulate fibre services. To reach this view, the Board relied heavily on detailed analysis of the WFTMR statement, coupled with the helpful statements made by Ofcom in speeches and investor briefings on the fair bet.

This letter sets out the public statements by Ofcom that the BT Board has relied on (and which future boards of BT will rely on) to confirm that BT's once-in-a-generation investment in full fibre will earn BT's shareholders (many of which are managers of funds on behalf of pensioners) at least the project cost of capital.

1. **The WFTMR Statement indicates that further regulation is not expected to be needed for at least a decade and that, longer-term, Ofcom is interested in market and consumer outcomes rather than BT's returns per se.** ^[1] This is reassuring as we (and other investors) need a stable, consistent, investment-friendly regime, or indeed less (or no) regulation where commercial dynamics are delivering good outcomes for customers.
2. **The WFTMR Statement also indicates that investors should not bear the risk that regulatory charge controls in the future might push down project returns in ways that would make them regret making the investment decision now.** ^[2] This is critical because it reassures the BT Board that any future regulation will not remove upside returns in ways that reduce those expected today below the project cost of capital for FTTP.
3. **More specifically on the fair bet, I observe, and have reassured the BT Board, that the upside BT must have the opportunity to earn to balance risks is aligned with signals that Ofcom has provided.** The BT Board is aware of the upside opportunity we assess is needed (based on a comprehensive analysis of the full range of ex-ante risks and the project cost of capital) in order for BT to expect, at the point of committing to the investment, to earn the ex-ante project cost of capital. The Board has been informed that this position is consistent with the remarks Ofcom has made (at an analyst and investor call on 18 March 2021) that a WACC appropriate for FTTP would be 'north of' 7.8% (due to higher systematic risks) and its reference to a historic uplift of 3-4% in the context of the FTTC fair bet. I also place reliance upon the letters from your predecessors which indicate that the application of the fair bet to FTTP should be seen in the context of Ofcom's track record; specifically, the approach it adopted for FTTC, where BT enjoyed pricing flexibility for ten years and was given the opportunity to earn and keep returns of 15%.
4. **The WFTMR confirmation that, if Ofcom did intervene to set cost-based regulated prices, it would use economic depreciation to set charge controls.** As Ofcom points out, this sensibly aligns cost recovery (in regulated scenarios) with the revenue earning potential of the assets and creates upside opportunity even if cost-based controls are imposed during the life of the investment.

Taken together, this is how I envisage today's risks being reflected in any future decisions on whether and when to impose further regulation. These are the assumptions that enabled me to recommend BT's 25 million premises fibre investment case to the BT Board, and the assumptions upon which they relied to support the investment. I also informed the BT Board that if Ofcom takes a different view of risk when assessed ex post, or if it changes its position on the principles or mechanics of the fair bet as outlined in this letter, then the expected return on the investment, as measured today, could fall below the project cost of capital for FTTP such that the investment decision is regretted.

I ask you to note these critical assumptions and clarify if you think that I have mis-applied the principles for future FTTP regulation set out in the WFTMR Statement and your investor briefings.

Yours sincerely



PHILIP JANSEN

cc: Sabine Chalmers

^[1] WFTMR 2021, Volume 4, paragraphs 1.111 to 1.113

^[2] WFTMR 2021, Volume 4, paragraph 1.117