Promoting competition and investment in fibre networks

Initial proposals – Approach to remedies

Virgin Media's response

05 July 2019

Non-confidential Response

EXECUTIVE SUMMARY

We welcome the opportunity to respond to Ofcom's consultation on its approach to remedies ("**the consultation**") in its forthcoming wholesale fixed telecoms market review.[1]

This consultation represents a further step in the process of Ofcom setting out its objectives for a renewed approach to telecoms competition regulation and the methodologies it intends to adopt to achieve these. As with our response to the PIMR, BCMR and the initial consultation on geographic markets, we broadly support Ofcom's objectives and its intended approach. Ofcom states that its goal is to support investment and competition in ultrafast services and to do so as widely as possible. We support this goal. Recent announcements from a range of potential investors demonstrate that Ofcom's trajectory is the right one. Ofcom's proposed approach will be a good foundation for investors' support in achieving this goal, if the eventual detailed proposals stay true to Ofcom's core goal.

However, it is clear that if these proposals are not well calibrated, Ofcom may not unlock new (and accelerate existing) investments as it intends. Now is the time to reappraise the approach to regulated pricing. It is not clear to us that carrying forward the pre-existing pricing approach (with some adjustments), is the right choice. Similarly, Ofcom's assessment of the extent of potentially competitive areas appears pessimistic. As the details of the proposals are developed and debated, Ofcom should resist calls to dilute these proposals or become faint-hearted. Doing so would risk maintaining the status quo and ensure that the incumbent's dominance is assured for another generation – thereby missing a major opportunity to deliver benefits to consumers, and the UK as a whole.

Ofcom's next decennial strategic review will presumably occur in 2025, within the forthcoming consolidated market review period. This review will likely determine whether Ofcom again affirms its strategic aspiration to encourage investment at a future date, or instead, whether it can move on to discuss how it will manage a market where infrastructure competition is already proliferating.

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[1] https://www.ofcom.org.uk/consultations-and-statements/category-1/promoting-investment-competition-fibre-networks-approach-remedies

1. INTRODUCTION

In response to the PIMR,[2] we noted that this consultation would "be the litmus test for whether we were right to take the leap of faith in Ofcom putting investment at the heart of its decision-making."[3]

We are reassured that Ofcom continues to recognise the central role its policy will play in whether or not greater levels of infrastructure competition will emerge and be sustained. However, it remains clear that it will be the details of the proposals set out in the full consultation in late-2019 that will ultimately determine whether Ofcom achieves its goals.

For now, we have to continue to have faith that Ofcom will sustain its focus on these goals as it develops the details of its proposals. This time inconsistency problem is a key challenge inherent to Ofcom's plans. Ofcom cannot fetter its future discretion nor disregard evidence available at the time it undertakes a market assessment. It is therefore important that its package of proposals is carefully analysed, swiftly proposed, debated and concluded with Ofcom's strategic objectives at the heart of its conclusions.

Given many aspects of these proposals are new methodologies that Ofcom will apply to these markets, whether that be designing and applying a Regulatory Asset Base ("**RAB**") model, an extended market review period, determining the right level for a non-cost orientated anchor price or estimating where investment may or may not emerge in the future; it is important that Ofcom engages extensively with stakeholders. Where Ofcom adopts these new approaches, it should not seek to simply adapt its existing pricing methodologies for the sake of familiarity; this risks not meeting Ofcom's (and Government's) objectives. A new approach and a different emphasis of regulatory objectives is likely to warrant changes to the detailed methodologies adopted. In this case, we think this change is justified for the 40/10 anchor price as well as how to ensure the new framework remains up-to-date over the course of longer review cycles.[4]

Government and Ofcom have set a challenge to industry to develop and deliver ambitious plans for investment in UK communications infrastructure. These ambitions, whether measured by coverage targets, the number of head-to-head infrastructure competitors, deployment of specific technologies or timing and pace of rollout, are ambitious. Those that take up this challenge should

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[2] https://www.ofcom.org.uk/consultations-and-statements/category-1/physical-infrastructure-market-review
[3] https://www.ofcom.org.uk/__data/assets/pdf_file/0024/139461/virgin-media.pdf, page 7
[4] For example, if Ofcom were to determine a need to re-categorise geographic areas within the market review period where investment has taken place.

have a fair opportunity to benefit from delivering these outcomes, those that do not, should work within the constraints of which they have had clear and fair warning.

Government's and Ofcom's plans encourage new entrants into the market, new business cases to be formulated and participants to compete in areas of the market they previously may not have considered. In many cases providers will do this ahead of consumer demand, with the legitimate expectation of long-term payoffs underpinned by a stable regulatory backdrop. These proposals call on industry to be ambitious and take a calculated risk. Ofcom has a pivotal role to play in making that risk manageable. This requires it to be bold, have the courage of its convictions and not be swayed by the siren calls from those seeking to perpetuate the approaches of the past.

It is important that this consultation is set in the context of the holistic package of proposals Ofcom intends to bring forward. As a consequence, this response should be read in conjunction with our views provided on Ofcom's PIMR, BCMR and its initial consultation on geographic markets.

The remainder of our response is structured as follows:

- In **Section 2** we comment on Ofcom's proposed remedies in potentially competitive areas;
- In **Section 3** we discuss Ofcom's proposed remedies in non-competitive areas;
- In **Section 4** we discuss Ofcom's proposed FTTC 40/10 anchor pricing approach in more detail;
- In **Section 5** we provide comments on the risk of regulatory error;
- In **Section 6** we provide our responses to Ofcom's consultation questions;
- **Annex 1 [✂]**; and
- **Annex 2** incorporates a Communications Chambers publication commissioned by BT, Sky, Telefonica, Virgin Media and Vodafone.

2. REMEDIES FOR POTENTIALLY COMPETITIVE AREAS

We broadly support Ofcom's proposed approach to remedies in potentially competitive areas. Whether or not these areas ultimately transition to be effectively, rather than remain potentially, competitive will in part be dependent on establishing a regulatory environment that supports investment materialising.

It is important that Ofcom's remedies recognise that network investment is risky and takes time. It is likely that while there is the prospect for investment in a given geographic area, it may not emerge (or be completed) during the timeframe of 2021-26. Ofcom has, we think effectively, signalled its intentions to investors about its 'direction of travel'. Nevertheless, some investors or some investments will be contingent on these intentions first being realised and therefore preliminary consultations will need to crystallise into final statements before decisions are made.[5] This reality reinforces our view that clarity on Ofcom's long-term intentions, without fettering its discretion, would be in the interest of all stakeholders.

Below we comment briefly on Ofcom's proposals in potentially competitive areas. We also comment in particular on its intended approach to the 40/10 FTTC anchor product as well as the role of PIA.

Where possible, we avoid repeating comments that we made in response to Ofcom's preliminary consultation on geographic markets. As a consequence, these comments should be read in conjunction with that response.

Proposed remedies

Broadly, Ofcom proposes to maintain network access obligations, maintain inflation-adjusted 2021 prices on anchor broadband as well as leased line prices, with higher bandwidth broadband services not subject to price controls.

Network access

We agree that it is necessary and proportionate for existing network access obligations to be maintained in potentially competitive areas. Removing such obligations, while no doubt providing

[5] **[✂]**.

strong incentives to existing wholesale customers of Openreach, would be disruptive to these CPs and damaging to consumers and therefore premature.

Charge controls

Ofcom proposes to impose a charge control on MPF, the anchor 40/10 FTTC product as well as leased line services, including ≤1Gbit/s and >1Gbit/s. Where charge controls would apply, they would be set to remain flat in real terms as at 2021 prices.

Broadly we agree that it is proportionate to maintain charge controls in prospectively competitive areas for the products Ofcom has proposed. This support is offered with two conditions.

Firstly, it is vital that Ofcom sets out its proposed mechanism and timeframe for reassessing the designation of areas. We provide more comments on this topic in section 5. Ofcom currently proposes to undertake its holistic review of these markets every five years or more. If any review of the need for reclassification were to be delayed for many years or excessive time periods for migration were to be introduced for transition between competitive categories, we would be concerned that BT could be artificially constrained by regulatory remedies that should no longer apply in a particular location, given that effective competition would have been judged to be present. Similarly, alternative providers that have invested in the area would be competing against both the incumbent and the regulatory regime that was no longer appropriate.

Secondly, it is not clear to us that a charge control on >1Gbit/s leased line services is warranted in prospectively competitive areas. As Ofcom notes,[6] rival investors in these areas may adopt an approach of offering leased line services to business or public organisations akin to CityFibre's anchor tenant model. We anticipate there could be positive incentives derived from introducing pricing flexibility for higher bandwidth leased lines. This is likely to spur investment by alternative networks and may also encourage existing customers to reassess their wholesale supplier.

We acknowledge the countervailing view, for example expressed by Hyperoptic,[7] that without charge control protections, this could lead it to substitute active services from BT to PIA. However, we note that it would potentially have opportunities to substitute to an alternative competitive supplier or to unlock further opportunities from the flexibility that transitioning to backhaul using PIA would offer.

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[6] The consultation, ¶2.17

[7] https://www.ofcom.org.uk/__data/assets/pdf_file/0026/136637/Hyperoptic.pdf, page 4

We agree that no charge control should apply for higher bandwidth FTTC products or for fibre broadband services. This will provide an incentive to BT to invest and will support investment decisions of other CPs, including Virgin Media, who are developing or delivering on business cases which compete to provide ultrafast services.

Equivalence of inputs/non-discrimination

We agree that existing EoI/non-discrimination obligations should remain in place, even in the case of fibre broadband services. Many CPs that currently purchase wholesale broadband services from BT will need to continue to serve customers using BT's network, even when establishing new wholesale suppliers in some geographic areas and these obligations provide important safeguards to those customers.

Prohibition of geographic discounting

We agree that prohibiting geographic discounting is likely to be a prudent restriction to impose on BT during this period of nascent network investment when alt-net investors may be seeking to enter a particular geographic area. BT will have an incentive to seek to protect existing areas from new entrants.

While it may not have specific insights on particular locations that a new deployment is imminent, it would be able to identify categories of towns and cities where it might anticipate a risk either to existing network investments or prospective investments.

Dark fibre

We agree it would neither be appropriate nor proportionate to require a dark fibre access remedy in prospectively competitive areas. This is also consistent with Ofcom's conclusions in the PIMR that a dark fibre backstop is not necessary. Requiring dark fibre is likely to undermine incentives for CPs to invest themselves by self-building or using PIA and dampen incentives for CPs, for example MNOs, to consider alternative wholesale partners as part of a broader network connectivity strategy. A dark fibre remedy could reduce potential for critical mass (or credible threat of it) to emerge to challenge Openreach's market position in competitive areas.

Ofcom should remain focused on making PIA fit for purpose and establishing it as the widely available passive remedy that underpins its broader strategy. The introduction of a dark fibre access remedy would undermine the progress on PIA. Duplicative passive remedies would be disproportionate for areas designated as potentially competitive and could ultimately undermine the investment incentives that Ofcom is seeking to foster.

MPF/FTTC (40/10)

Ofcom's proposals for stable pricing of FTTC 40Mbit services from 2021 are similar to Virgin Media's proposed approach in the 2016 WLA.[8] At the time, we identified this as a pragmatic option that would protect consumers but would also sustain incentives for existing investments during that review period. In this context, we welcome intent of Ofcom's approach. Nevertheless, Ofcom should be more ambitious in pursuit of its goals.

Ofcom notes that its proposals "are designed to support a step-change in investment in fibre […]"[9]. In our view, while Ofcom's proposals would begin to unwind the previous damaging price reductions introduced in the 2016 WLA, it will take time for pricing to recover to the pre-2016 WLA levels which we advocated to maintain <u>existing</u> investment incentives. It is not clear to us that these proposals will necessarily result in the 'step-change' that Ofcom desires.

Clearly, we recognise a number of existing CPs and new entrants have announced plans to deploy networks since 2016. However, Virgin Media would be amongst the first to recognise that it cannot be assumed that all these plans will be realised to the scale or within the timeframes originally announced. With hindsight we will know whether or not the various announced plans from various CPs came to fruition, or if new plans are hatched during the market review period. We think it is right that this review should seek to maximise the potential for securing network investment. This forthcoming review period presents a window of opportunity for potential investors to compete for the infrastructure market of the next generation. If bold proposals are delayed to future reviews, that window of opportunity may have already closed if Openreach has made substantial progress on its own investment programme. By the same token, Openreach may not progress that programme to its fullest extent if it does not have sufficient incentives or does not face competitive pressures from other investors.

Ofcom signalled its intent for a 'strategic shift' in the DCR, however, in our view, it only properly contemplated implementing its strategy in the Summer of 2018[10]. Ofcom's plans indicate that the

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[8] In response to that review we argued that a CPI-CPI safeguard cap would be an appropriate nationwide charge control price cap on GEA 40/10 and MPF services.

[9] https://www.ofcom.org.uk/__data/assets/pdf_file/0021/142572/promoting-competition-investment-overview-of-plans.pdf, ¶1.7

[10] https://www.ofcom.org.uk/__data/assets/pdf_file/0025/116539/investment-full-fibre-broadband.pdf

new regulatory landscape will be set by 2021. While this timeframe will likely be deceptively short, in our view Ofcom should use this time to undertake two key areas of analysis to inform its thinking on the price of the 40/10 anchor: consumer attitudes about willingness to pay for broadband service more broadly as well as CPs' appetites for investment. We think both of these topics should be central to Ofcom's ultimate conclusions on the appropriate price to set in the forthcoming review.

Investment appetite

Ofcom's intended approach to setting the 40/10 anchor is to encourage investment in potentially competitive areas; investment by BT, Virgin Media and others. Stable real terms pricing is undoubtedly more benign than previous market review decisions, but it is not clear that it is any more than that.

In the consultation Ofcom does not present any evidence that this is sufficient to unlock more investment or accelerate investment plans. It is not clear to us that these proposals usher in a 'step-change' to meet Ofcom's objectives. Instead, it seems to assume that it is better than the counterfactual of the significant year-on-year price reductions it has previously implemented. For the avoidance of doubt, we do believe that these proposals are welcome respite. However, they must go further if Ofcom truly wants to achieve the full extent of its ambitions.

Ofcom's proposals on the price of the anchor will, for the foreseeable future, be a strong constraint on higher bandwidth services. In tandem with BT's volume based FTTC discounts we are likely to see sustained downward pricing pressures. If Ofcom's intention is to unlock new and/or accelerated investments, engaging with CPs on their investment plans and outlook must be at the heart of its considerations. This is not to propose that Ofcom tailors its approach to any particular potential investor, but instead to better understand the potential effect of its proposals on how investors view the market. If Ofcom's goal is that its proposals induce investment, it needs to know more about other actors, beyond what 'enablers' Openreach needs for its decision making.

We welcome Ofcom's recent consultation on its approach to modelling fibre network costs.[11] Developing a firm understanding of the costs a variety of potential investors will face is an important first step to understanding whether Ofcom's proposed remedies will have the effect it intends.

Willingness to pay

[11] https://www.ofcom.org.uk/consultations-and-statements/category-2/investment-competition-fibre-networks-approach-model

Previous WLA/FAMR market reviews have been focused on BT's costs as well as BT's 'fair bet'. Through this and other recent preliminary consultations Ofcom has signalled its intention to move beyond its previous narrower focus of tailoring its regulatory approach to act as one of the constraints on BT: instead it now looks to act as an enabler for potential investors to provide sustained competitive pressure on the incumbent.

In the time that has elapsed across the various historical market reviews, limited focus has been placed on consumers' willingness to pay. Broadband has progressively played a greater role in society and in the lives of UK citizens. Over recent decades it has arguably morphed from a luxury, to commonplace to a mainstay for the vast majority of households. Annual Ofcom reports consistently describe the growing amount of time that households spend online (and no doubt utility derived) and the growing array of uses that citizens' broadband services support. Watching TV, listening to the radio, contact with friends and family are often transitioning to online services at a rapid pace. Evidence suggests that UK consumers have experienced extraordinary gains in the value of money in the telecommunications sector.[12]

If Ofcom's ambition for rollout of competing high-quality full fibre broadband is real and consumers' desire for world-beating broadband connections is real, the forthcoming market review presents an opportunity to reset expectations on industry and for consumers. If, as we suspect, this is a prospect that consumers value, it is an opportunity that should not be overlooked. In our view Ofcom should seek to analyse UK consumers' attitude to broadband pricing.

Between 2006 and 2016 average household spend on communications services fell by 8% in real terms[13]. Over the same period expenditure on fixed internet and mobile voice and data fell by nearly 6%. Just 2% of UK adults have reported "affordability issues"[14] with regards to their communications services according to the most recent Ofcom/Kantar analysis.

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[12] For example, see Annex 2 of this response.

[13] Ofcom: Pricing trends for communications services in the UK (May 2018) https://www.ofcom.org.uk/__data/assets/pdf_file/0030/113898/pricing-report-2018.pdf

[14] Defined as those who have been behind on their payment for any communications services by one month or more in the last year, or have sold items/taken out a loan as part of their monthly spending in order to afford communications services. https://www.ofcom.org.uk/__data/assets/pdf_file/0026/95138/Affordability-of-Communications-Services-Tracker-2016.pdf

Average household spend on telecoms services per month: 2006-2016

Source: Ofcom / operators/ ONS
Notes: Adjusted for CPI. Historic telecoms figures have been re-stated, so are not comparable to those published in previous reports. Television excludes spend on subscriptions, download-to-own and pay-per-view online TV services.

Note that this decline in household spend has coincided with an exponential increase in data consumption made possible by investment in broadband technologies capable of handling greater data loads. For example, Ofcom reports that average monthly mobile data consumption per active subscriber increased from 0.2 GB per active subscriber in 2012 to 1.9 GB in 2017 (an eight-fold increase).[15] Watching online video is the main driver of massive increases in fixed-line data use; the average residential broadband connection now uses 240GB of data, up from 17GB in March 2011.[16] This has obvious implications for unit prices for all consumers. Other 'utilities' do not manifest this phenomenon.

Quality Adjusted Unit Prices

The Financial Times covered a story on 18 January 2018 "*ONS's crossed telecom wires raise question over inflation figures*". It explained that official data show the prices of telecoms goods and services were flat between 2010 and 2015. Over the same period, total telecommunications turnover declined slightly; this means the real output of the industry fell over the period.

The problem with this is that the official data on prices ignores the quality improvements in the services provided. To capture this effect the Office for National Statistics17 looked at throughput; it

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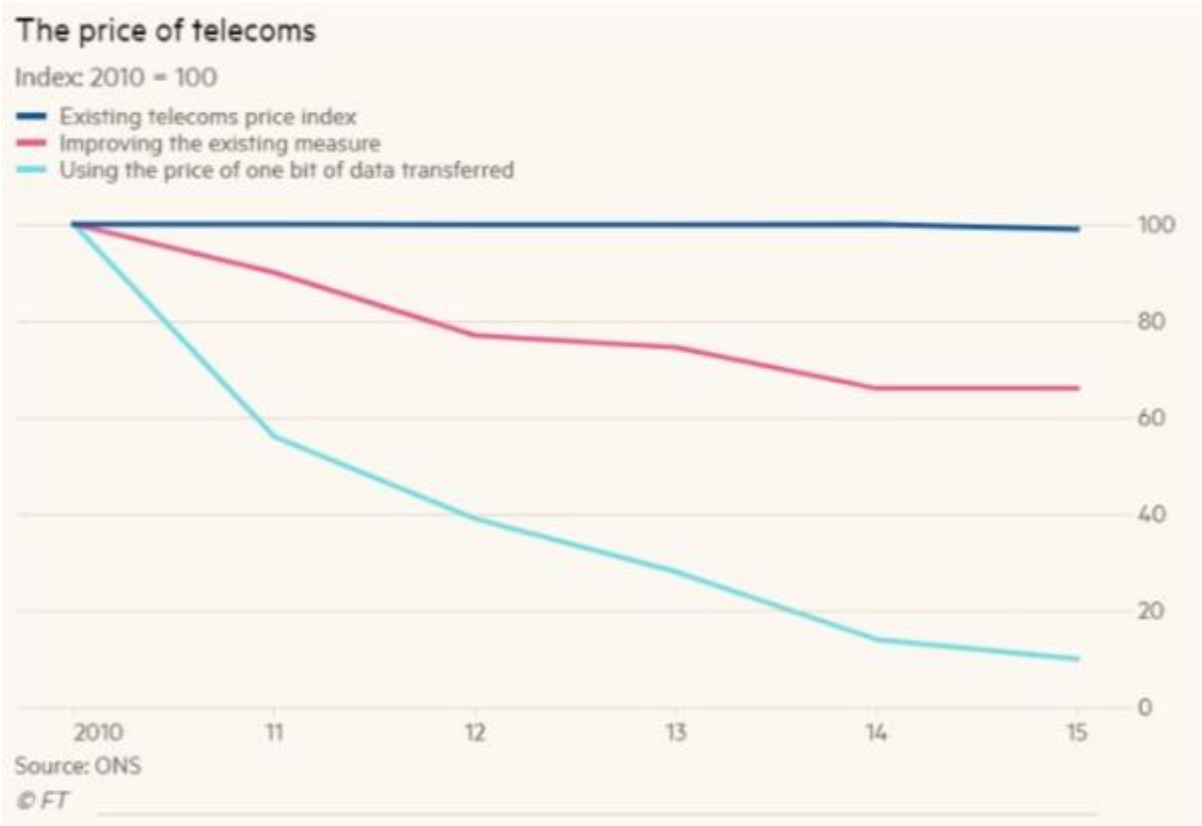
[15] https://www.ofcom.org.uk/__data/assets/pdf_file/0022/117256/CMR-2018-narrative-report.pdf, figure 4.1
[16] https://www.ofcom.org.uk/__data/assets/pdf_file/0022/117256/CMR-2018-narrative-report.pdf, page 21, https://www.ofcom.org.uk/__data/assets/pdf_file/0020/130736/Connected-Nations-2018-main-report.pdf, page 2
[17] https://www.escoe.ac.uk/wp-content/uploads/2017/02/ESCoE-DP-2017-04.pdf*)*

converted each telecommunications service into a measure of transmitted data to quantify the price per bit over time. The graph below shows the effect on the price of telecommunications goods. The light blue line shows that the price per bit of data has declined by 90% between 2010 and 2015.



This does not, however, mean that retail prices need necessarily to rise. Rather, what is needed is to prevent erosion of value in infrastructure investments. Moreover, in our view the more important measure for consumers is the overall value and benefit that they accrue from connectivity services.

This is borne out by recent research undertaken by A. T. Kearney[7], that finds the price of broadband and WiFi services is less important to European consumers than factors such as network quality, coverage and access to innovative products.

Therefore, while we consider Ofcom's proposals to be positive and over the longer review period should provide investors with certainty about the value of investments they may be considering making, Ofcom could and should consider going further if it is intent on underpinning a 'step-change' in investment already planned or announced to date, which consumers may be willing to support.

3. REMEDIES FOR NON-COMPETITIVE AREAS

Virgin Media broadly supports Ofcom's approach to non-competitive areas. Where there is no prospect of competition emerging within an acceptable timeframe, it is reasonable that Ofcom works closely with Openreach to ensure that these areas do not fall behind. A RAB model approach is a way to enable this. However, we caveat our support by noting our concerns regarding Ofcom's current approach to geographic modelling below.

The detailed specification of the RAB model will be key to ensuring that Openreach has the appropriate incentives to expedite investment in these areas and to do so in an efficient way that provides value for money for end users. Early sight of this in the consultation is helpful, but all stakeholders should be involved in future rounds of more detailed design decisions.

Based on Ofcom's preliminary consultations, we believe the extent of these non-competitive areas is currently understated; with insufficient account taken of the prospective use of PIA. The characteristics of the product and the impact these have on infrastructure investment economics need to be reflected in Ofcom's assessment of prospective investment. In the full market review, alongside refining its geographic analysis, we believe Ofcom should assess the merits (and if appropriate the mechanism) to reclassify non-competitive areas into prospectively competitive areas.[18]

Proposed geographic areas

Ofcom's description of geographic area categories provides latitude for interpretation:

> ***"Category 2 Potentially competitive areas***
>
> *We propose to identify areas as potentially competitive if they are not already effectively competitive but:*
>
> - *An alternative ultrafast network or networks is/are present; and/or*
> - *Alternative providers have sufficiently specific plans to build in the area; and/or*
> - *We consider there is a possibility of network build.*
>
> *…*

[18] In Section 5 we discuss this broader issue of regulatory risk and its consequences in more detail.

Category 3 Non-competitive areas

We propose that Category 3 will comprise geographic areas that do not meet our assessment of being considered viable for rollout. This will typically be rural areas, villages and smaller towns and will be areas where there is currently no existing alternative network and there are limited prospects of significant network rollout (other than by Openreach)."[19]

The three tests proposed for potentially competitive areas exhibit increasing room for discretion. Presence of other networks is essentially a matter of fact; 'sufficiently specific plans' leaves some room for judgement; and 'possibility of network build' is highly dependent on Ofcom's modelling and thresholds.

It seems likely therefore that the marginal areas – which could find themselves in Category 2 or 3 – are those without current or planned alternate provision, but which Ofcom could assess as having the possibility of network build. Ofcom identifies such areas based on premises density and a clustering of sufficient such postcodes so as to represent critical mass for deployment. Per Ofcom's illustrative analysis, areas of possible network build represent 11% of total premises.

We recognise that these definitions will evolve and crystallise during the full wholesale fixed telecoms market review and we also acknowledge that even the final set of criteria will require a degree of regulatory judgement.

Consequently, it is important that Ofcom develops a clear understanding of the relevant factors that potential infrastructure investors take account of when determining whether, and if so where, to invest and reflects these factors in its own assessment. This is particularly important given the result of designating an area as non-competitive is proposed to be the imposition of a dark fibre remedy and establishment of a RAB model: two remedies that will be challenging and disruptive to remove if the designation were subsequently found to be in error.

Ofcom's modelling approach and PIA

Ofcom notes that:

"Our proposed package of remedies has been developed against the background of our current intention that rival networks will have unrestricted access to Openreach's duct and pole infrastructure. We consider that unrestricted access to Openreach's duct and pole

[19] Ofcom, Promoting investment and competition in fibre networks: Approach to geographic markets, 11 December 2018

infrastructure will play a crucial and increasing role in promoting network build in potentially competitive areas during the review period and in the longer-term."[20]

We agree that PIA will play an important role in determining whether or not Ofcom's objectives are met over the forthcoming market review period and in the long-term. The price reductions, process improvements and more recent usage liberalisation are important factors in making the product workable and scalable. Virgin Media has been actively involved in the product's development and considers that it could play an important role in our on-going network investment via Project Lightning, if it can be made fit for scale use.

In its Overview, Ofcom notes that "We must ensure investment in fibre networks is not focused exclusively on larger towns and cities, and that smaller communities also benefit from fibre connectivity." [21] It is in this context that we continue to believe Ofcom's current set of proposals do not reflect the prospective role of PIA.

Currently, Ofcom's approach to assessing the likelihood of competitive build relies heavily on premises density and clustering.[22] This is consistent with Virgin Media's historical approach to self-build Project Lightning and supported by information we have submitted to Ofcom as well as bilateral discussions we have held with Ofcom. We are also confident it represents the factors other infrastructure investors will take account of when identifying build opportunities.

However, this approach is not appropriate for PIA. Other factors, for example, the likely capacity and state of repair of Openreach's network, also become more important when considering PIA. **[✂]**.[23]

Furthermore, Openreach is currently developing plans to transition from a per meter charge for PIA customer connections to a fixed single-rate charge for overhead and underground separately. While the pricing details are currently absent, this change would further reduce the importance of premises density when considering build opportunities.[24]

[✂].

Proposed remedies – specific comments

[20] The consultation, ¶2.6
[21] Ibid., ¶1.4
[22] For example, https://www.ofcom.org.uk/__data/assets/pdf_file/0005/130001/Consultation-Promoting-investment-and-competition-in-fibre-networks.pdf, ¶4.19
[23] **[✂]**.
[24] **[✂]**.

RAB

In the consultation Ofcom sets out some of the high-level design choices it will need to consider when developing the RAB model. Broadly we support the potential approach Ofcom puts forward:

- Charge controls on WLA copper services, with pricing flexibility for fibre services, mimics the approach in potentially competitive areas and provides some flexibility for higher-grade fibre services which support BT's investment case.
- Limiting the applicable RAB costs to those that would otherwise not be incurred (on the assumption that BT would not invest) is appropriate, though the specific treatment of any common costs incurred to serve profitable areas would need careful consideration.
- Allocating the 'RAB mark-up' as widely as possible to those consumers who would expect to benefit from the investment appears reasonable. We note this may raise concerns for customers that only take landline services. There is also merit in considering how best to communicate such an approach to consumers and increase transparency in how this process between Ofcom and BT is conducted.[25]
- We agree that that the RAB should be designed to ensure BT delivers on its investments. The design approach should embed commitment mechanisms and public reporting where possible. As noted above, it is likely that transparency and effective public communication of progress and monitoring will help to mitigate concerns that the 'RAB mark-up' is either unfair or ineffective.

Where possible, Ofcom should consult (whether formally or informally) with stakeholders as it develops this approach with BT. This would help to provide transparency to a process that otherwise might be considered to have been developed in isolation. It will also enable dispassionate comment from alternative network investors[26] on the assumptions proposed.

Dark fibre

As noted above, we are concerned that Ofcom's current geographic modelling has not yet been calibrated to reflect the potential use of PIA. As we (and Ofcom)[27] note, even rural areas are likely to

[25] For example, we note concern expressed by MPs about this approach, http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/digital-culture-media-and-sport-committee/the-work-of-ofcom/oral/102456.pdf, Q159 and Q160.
[26] As, by definition, this regime will relate to geographic areas where Ofcom considers no prospect of alternative investment will arise.
[27] For example, the consultation, ¶3.34

have material demand for dark fibre or alternative high-capacity connectivity. Mis-categorisation of a geographic area could divert potential revenue streams from leased line (or competing dark fibre solutions) to the regulatory remedy,[28] which in turn could forestall investment. Broadly, we are not convinced of the incremental benefit offered by a dark fibre remedy in these areas, particularly given the availability of PIA, the risk of mis-categorisation and the difficulty that would arise if the requirement for the remedy were subsequently reversed.

Geographic discounting

In light of our concerns regarding geographic mis-categorisation, as well as the overriding risk of regulatory error (see Section 5 of our response), we believe Ofcom should reconsider preventing geographic discounting. In the event a CP intends to invest in an area Ofcom has determined to be non-competitive, it is likely that the business case for such an investment will be more 'marginal' than other areas. It is also likely to take longer to deploy such a network than in denser areas. These factors would mean that BT may have a greater incentive (and more effective foresight) to react to competing build in the way Ofcom identifies as a concern in potentially competitive areas.

[28] For example, an MNO decides to consume the dark fibre remedy rather than contemplate a broader partnership with a CP considering investment in these areas.

4. FTTC 40/10 PRICING APPROACH

Below we discuss Ofcom's proposed approach to anchor pricing in potentially competitive areas. In particular, we comment on these proposals in the context of how the pre-existing FTTC pricing structure was derived, and considerations on the 'fibre premium' that Ofcom proposes for a 40 Mbit/s product delivered by FTTP rather than FTTC.

These observations build on our comments in Section 2 regarding whether these pricing proposals will be effective in supporting Ofcom's broader goals for the market review.

Ofcom's pricing proposals

In potentially competitive areas (Category 2), Ofcom proposes to continue with the FTTC 40/10 anchor product, but at a price (MPF+GEA) that increases with inflation from 2021. The starting point will be the regulated rate that has already been set.[29] It has also suggested that it will apply a 'mark-up' to this price when the service is provided over FTTP (after copper switch-off), based on "the value of the additional benefit to customers and access seekers of the 40/10 product being provided over a fibre network".[30]

Prices in competitive areas (Category 1) will be unregulated. In non-competitive areas (Category 3) they will be based on a RAB approach (across FTTC and FTTP). Given the wide array of factors that will inform the RAB approach are yet to be developed by Ofcom, our comments below focus on Category 2.

The theoretical basis for setting wholesale regulated tariffs

The underlying rationale for cost-based regulated tariffs is to support productive and allocative efficiency. Ofcom notes:

> *"When wholesale inputs are substitutes in the provision of a given downstream service, the main function of relative prices is to signal to users which wholesale service they should use*

[29] Ibid., ¶2.19
[30] Ibid., ¶5.20

> *in order to minimise costs (for productive efficiency). ... This points us towards setting the price differential of substitute services at LRIC and allocating common costs accordingly".*[31]

Allocative efficiency arises when price equals the marginal cost of production. At this price, consumers who value the service at or above the cost of production will buy it, ensuring welfare is maximised. (Equally, those who do not value the service above the cost of production will not buy it, avoiding welfare destruction).

Both forms of efficiency fundamentally rely on prices being set in line with costs. Then customers' decisions to buy or not – based on that price – lead to an optimal level of production.

Issues with carrying forward the existing tariff to the new regime

How tariffs are currently calculated

Both MPF and GEA prices have been set on a LRIC+ basis, though the methodology differs. MPF tariffs are based on a top-down approach (starting from BT's Regulatory Financial Statements), whereas GEA prices are based on a bottom-up approach, using an Ofcom model. Thus, the effective FTTC wholesale tariff (MPF+GEA) is set by a combination of two quite different methodologies, each of which is based on a raft of specific modelling decisions, many of which are themselves contentious.[32] We do not revisit this debate here.

However, as a general point, there is an inherent regulatory risk in extending the applicability of the 2018 determination. In deciding to set a three year charge control period to 2021, Ofcom itself noted:

> *"[G]iven the extent of supply-side changes anticipated over this market review period (e.g. further new network investment, investment in systems and processes such as quality of service and the implementation of the new PIA remedy) as well as potential demand-side changes (e.g. demand for different voice and broadband forms of access), there is a risk that our forecast of efficient costs becomes outdated, which may also distort investment*

[31] Ofcom, *Wholesale Local Access Market Review: Statement – Volume 2; Charge control design and implementation*, 28 March 2018, ¶2.46

[32] See for instance Virgin Media's comments on two of the relevant consultations: Virgin Media, *Virgin Media's response to Ofcom's WLA – Consultation on Possible Approaches to Fibre Cost Modelling, May 2016*; 17 June 2016 Virgin Media, *Wholesale Local Access Market Review*, June 2017

> *incentives. This forecast uncertainty would be mitigated by adopting a shorter charge control period [i.e. not longer than three years]."*[33]

In effect, by rolling forward an adjusted FTTC tariff, Ofcom appears to have concluded that the risks that were previously mitigated as a result of a short charge control period are diminished sufficiently despite the prospect of moving to five-year review cycles or more.

There are also some specific issues that have particular relevance as the assessed tariffs are carried forward into the new regime, related to depreciation and geographic scope.

Depreciation approach

Ofcom used current cost accounting rather than economic depreciation to calculate the capital cost component of GEA pricing. This has the effect of spreading the capital cost evenly over the life of the relevant assets, rather than spreading the cost pro-rata to utilisation in a given year. This in turn means that the calculated unit cost is lower in periods where utilisation is high, and vice versa. (If economic depreciation is used, calculated unit costs are not affected by utilisation in a given year).

This matters because the period 2018/19 – 2020/21 may include 'peak FTTC'. Beyond 2020/21, FTTC volumes may begin to fall, as it begins to be displaced by FTTP (from Openreach and others) and potentially 5G-FWA. If FTTC penetration does then begin to fall, the mechanics of Ofcom's calculation would imply a need for FTTC prices to rise. Instead, Ofcom proposes to carry forward the 2020/21 figure (albeit with a CPI increase).

Geographic scope

In calculating the GEA tariff, Ofcom considered only the part of the country where Openreach had deployed GEA commercially. That is, it excluded the less dense areas where Openreach's deployment was subsidised by BDUK and local government. Openreach nonetheless offered GEA on the same tariff nationwide. The very purpose of the subsidies in non-commercial areas was to enable (or accelerate) rollout and support uptake via these consistent, national GEA prices. However, transitioning the GEA tariff set as Ofcom proposes, to the new regime creates a number of potential conflicts.

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[33] Ofcom, *Wholesale Local Access Market Review: Statement – Volume 2; Charge control design and implementation*, 28 March 2018, ¶3.20

Firstly, these prices will apply in Category 2 areas. But there is no reason to expect that the geographic scope of Category 2 will necessarily match the scope of commercial areas for the FTTC deployment. Ofcom's estimate is that 69% of premises will fall into Category 2. As it happens, this is quite close to the 70% that is the scope of the FTTC commercial footprint. However, it is not safe to assume that the 69% sits within the 70% - the two areas will substantially overlap, but they are not necessarily 'nested'.

Further the 69% is likely to vary over time, for example as:

- Ofcom's initial estimate of Category 2 is likely to be revised following stakeholder feedback from Ofcom's preliminary consultations;
- Areas will be re-designated out of Category 2 into Category 1, meaning that costs in Category 2 will 'average up'; and
- New deployment methods (and use of PIA) may mean that Ofcom shifts Category 3 areas into Category 2. The transition of these 'high marginal' areas into Category 2 will again average up costs. See Sections 3 and 5 for further comments on this topic.

Put another way, the region of the country for which (adjusted) FTTC rates will be applied will increasingly drift away from the region of the country on which they were originally assessed, creating a mismatch. It is not clear to us that Ofcom has considered whether underlying changes in the appropriate geographic scope have been adequately reflected in its pricing approach.

Issues of averaged pricing

Issues also arise because the FTTC rates will be flat across Category 2, and Openreach will not be allowed to offer regional discounts, based on Ofcom's current proposals.

Regulated tariffs have long been set on this basis, with national models developed to set prices. This is simpler for: cost-modelling the tariffs; for the access provider; and for access seekers, who are in turn able to offer flat national retail prices.

However, this approach inevitably embeds cross subsidies. Tariffs are higher than otherwise might be expected for urban areas, MDUs, areas with high adoption and so on. Conversely, they are lower than otherwise might be expected for rural customers and the like. Consequently, the former group cross-subsidises the latter group. Absent substantial market entry by other infrastructure investors, this is not a material problem for Openreach – the cross-subsidies are evidently sustainable in the current regulatory and market context.

The sustainability of this cross subsidisation may deteriorate over time if competing networks are (as they are likely to be) focused on the most cost effective areas to serve. It is not clear to us that Ofcom has considered whether its proposed approach will lead to prices changing sufficiently to accommodate this rebalancing of the geographic areas that will contribute to the pool of wholesale active services that Openreach sells.

Issues with the fibre premium

The fibre premium in context

As we have noted, Ofcom plans to apply a 'mark-up' to the effective 40/10 tariff when the service is provided over FTTP (after copper switch-off), based on "the value of the additional benefit to customers and access seekers of the 40/10 product being provided over a fibre network".[34]

Further, Ofcom is coupling this approach with two other components, to create an output price that is a mishmash of factors which provides no obvious justification to conclude it is the 'right' price.

	FTTC pricing based on 2018 cost modelling out to 2021
+	Inflation adjustment from 2021 onwards
+	FTTP premium after copper switch off
	FTTP 40/10 tariff

We recognise Ofcom is proposing this approach, in part, to achieve its objective of encouraging full fibre investment. We have been clear in this and previous consultation responses that this is an objective we endorse. However, we are concerned that the proposed approach, which seeks to repurpose and augment pre-existing methodologies, will not result in a clear basis for determining these prices. Tying the pricing approach to a previous WLA review outcome is likely to become increasingly unjustified over time. For Virgin Media, this raises concerns about the longevity and regulatory certainty embedded in these proposals; something that Ofcom has been clear it is seeking to reinforce.

Setting the fibre premium

Ofcom bases its argument for the fibre premium on the additional value delivered, namely:

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[34] The consultation, ¶5.20

"   *a) A slightly higher and more stable speed.*

b) Fewer faults and so will deliver a more reliable service for consumers.

c) Access seekers will benefit from cost-savings in the value chain as a result of delivering a more reliable service to customers." [35]

Ofcom's UK Home Broadband Performance Report demonstrates that FTTP products are better able to consistently deliver their advertised speeds.[36] FTTP also has advantages regarding latency, packet loss, jitter and DNS resolution time & failure rate. For a number of these metrics, the difference may not be material to the end-user experience, however. In the context of reliability, Frontier Economics (in a report for the NIC) noted that:

"network faults are a rare occurrence (currently around a 0.05% chance of a fault on a line in a day). While there are differences between the propensities of different broadband technologies to fault, this will simply make a rare occurrence even rarer, so that consumers may not be able to objectively perceive differences between the different technologies."[37]

In the context of speed it has, in practice, been difficult to reliably assess the value to consumers of incremental broadband speed. It will be even more challenging to assess the value of quality within a particular broadband speed tier. Therefore, while we welcome Ofcom's intent, an exercise to quantify an FTTP premium is likely to involve substantial discretion for Ofcom. Instead we believe there is merit in Ofcom embedding its core objective in its approach to pricing.

In response to the last WLA, Virgin Media provided Ofcom with a range of consumer research that illustrated the challenge associated with willingness to pay for speed.

Regarding FTTP vs FTTC 40/10 Ofcom goes on to say:

"Given that these services are not precisely comparable, we are concerned that setting the same charges for the 40/10 service on the copper network and fibre network may undermine incentives to invest in fibre."

This is a non-sequitur. For instance, if FTTP were cheaper to provide, it would attract investment on that basis, quite apart from any quality differential. Indeed, it could even be argued that the greater

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[35] Ofcom, *Promoting competition and investment in fibre networks: Initial proposals - Approach to remedies*, 29 March 2019, ¶5.19

[36] https://www.ofcom.org.uk/__data/assets/pdf_file/0020/147332/home-broadband-report-2018.pdf

[37] Frontier Economics, *Future Benefits of Broadband Networks*, 12 December 2017

reliability of FTTP is a reason for a *lower* price, since the main beneficiary of fewer faults is Openreach itself (which has the responsibility to repair them), not access seekers.

In practice, Ofcom's quality argument appears, in part, a vehicle to enable its broader objective of investment incentives. Further, since Ofcom is seeking three networks across most of the country, it is investment incentives for both Openreach and other operators that matter.[38]

Therefore, a better question regarding 40/10 FTTP would be "how does the deployment of FTTP by Openreach change the investment incentives for third parties?" If Ofcom does not sustain the opportunity for viable investment by third parties after Openreach FTTP deployment, it is effectively enabling Openreach to foreclose competition if it is first to market.

Of course, the availability of Openreach FTTP has a major impact on the business case of other investors (including Virgin Media):

- It deprives them of the ability to provide speeds that Openreach can not
- It deprives them of the ability to provide reliability that Openreach can not
- It increases the relative barriers to switching to higher speeds on the alt-net. (With FTTP in place, upgrading to higher speed on Openreach involves no truck roll or need to be home for the customer)
- It deprives alt-nets of the unique 'full fibre' marketing proposition
- It greatly reduces the potential of customer pre-commitments to derisk the alt-net business case (since why pre-commit to the alt-net when the customer is already on Openreach FTTP?)
- It allows Openreach's access seekers to provide free (or cheap) upgrades to higher speeds, enhancing incumbency advantages vs new entrants

All these factors will mean that alt-nets can expect a much lower share of the market if Openreach has deployed FTTP in a given area, with severe consequences for their investment case. If Ofcom intends to preserve investment incentives, then it will need to think more widely than simply setting a quality-based premium for wholesale 40/10. If that consideration is a factor in its assessment, it should be explicit.

Establishing a price setting mechanism with this goal in mind would provide a clear basis to underpin the new regime. It would be transparent about its goals and have a robust foundation which we

[38] As we have previously noted, for example, https://www.ofcom.org.uk/__data/assets/pdf_file/0024/139461/virgin-media.pdf, page 6

would expect would make it more sustainable over future market reviews. This in turn would further reinforce investor certainty and would likely reduce the risk of appeal. Ofcom's approach should have consumers' willingness to pay and CPs' willingness to invest at its heart.

5. RISKS OF REGUALTORY ERROR

As Ofcom notes, its proposed approach to the wholesale fixed telecoms market review "represent a significant departure from our historical approach to economic regulation."[39]

We welcome Ofcom's goal "to encourage and enable significant, long-term investment in full-fibre broadband to give customers a choice of networks where feasible, while allowing companies who build these networks to make a fair return."[40] However, a consistent theme throughout our response is that there is a significant risk of unintended outcomes – or indeed opposite effects - if Ofcom does not construct the specific elements underpinning this approach in the right way. Certainty for investors is a key factor in designing these elements and will go some way to mitigating the risk. As a consequence, below we discuss some of the potential causes and consequences of these unintended outcomes and propose mechanisms that Ofcom may consider as it moves towards commencing the full review later this year.

Review cycle

Ofcom reiterates that it intends to transition from its current three-year review cycle to five or more as part of its forthcoming wholesale fixed telecoms market review. Virgin Media continues to support this transition. Particularly during a period which may be characterised by intense investment in network infrastructure it is important that Ofcom provides as much certainty and clarity to investors (and potential investors) about the regulatory environment in which those business cases will operate.

The uncertain border

Ofcom has specified Category 1 (competitive) as those areas with three existing ultrafast networks. This is a bright-line test, and therefore there is likely to be little ambiguity as to which regions are in Category 1. The ambiguous border is that between Category 2 and Category 3.

The presence of a non-Openreach ultrafast network will be sufficient to designate a region as Category 2, and again this is a bright line test. However, a region can also be deemed to be Category

[39] https://www.ofcom.org.uk/__data/assets/pdf_file/0021/142572/promoting-competition-investment-overview-of-plans.pdf, ¶1.7
[40] Ibid., ¶1.2

2 if an alternate network has specific plans to build, or if Ofcom considers "there is the possibility of network build".

This last criterion represents a judgement by Ofcom. It is to be based on a modelling process, and the outcome is both currently uncertain and potentially in error – that is, the results are not yet known, but once they are, there is every possibility that regions Ofcom deems to be non-competitive do in fact attract non-Openreach investment (or vice-versa).

Ofcom's modelling process

To identify areas with 'the possibility of network build' Ofcom first applies a rough 'premises density' threshold test, by excluding postcodes with an area of more than 100,000m^2. Effectively, this identifies areas with urban levels of premise density.

Ofcom's next step is clustering. Contiguous post codes (with an area of less than 100,000m^2) are grouped into clusters. Roughly 55,000 such clusters are identified. However, many of these clusters are small. For instance, for a small hamlet, the cluster might constitute just a single postcode. Ofcom excludes clusters with fewer than 20,000 premises, on the basis that these are likely to be too small to be economically viable (notwithstanding their premise density). Applying this filter leaves just 183 clusters out of the original set of 55,000. These 183 clusters represent roughly 19m premises, and Ofcom deems these regions to be potentially competitive.

Potential regulatory error

Therefore, Ofcom's model depends at heart on just two assumptions – premises density, and critical mass of premises. This is a far simpler approach than is used by telcos making the decision of where to deploy. Gigaclear, for example, uses a model that is based on more than 50 variables (including issues such as Openreach quality, income levels, soil type and so on) to decide where to deploy. By definition, therefore, commercial operators will reach different decisions on where to deploy than suggested by Ofcom's model. (Indeed, this has already happened – some of Gigaclear's Oxfordshire deployments are in postcodes Ofcom deems non-competitive).[41] Further, while Ofcom may vary its thresholds over time, it is not obvious how it will take into account factors that may alter FTTP economics over time, such as growing consumer demand, lower costs due to PIA, and so on. We believe Ofcom has defined these constraints too tightly, as well as confining its methodology to self-

[41] For example, OX10 6, Berrick Salome

build infrastructure. Ofcom should take further account of the prospect for PIA to change the factors that determine potential build opportunity areas.

Consequences of error

Non-competitive area placed in Category 2

Impact on stakeholders

Such an error primarily has consequences for Openreach and its customers in the region in question. Since the region will not be subject to the RAB approach that Ofcom proposes for non-competitive regions, FTTC customers will not be required to cross-subsidise FTTP deployment – but absent this subsidy, Openreach may be unlikely to deploy FTTP in the short- to medium-term.

For non-Openreach operators, such an error matters little. If the region in question is truly uneconomic for a second network, designating it as Category 2 makes no difference – the investment economics are unchanged.

Error correction

From Ofcom's perspective, this type of error could be problematic. It reduces the probability that the area will get FTTP, and is it likely to go undetected. Many 'genuine' Category 2 regions will not see investment right away, or perhaps for several years. Thus, the absence of investment in the misallocated region will not necessarily ring alarm bells.

Potentially competitive area placed in Category 3

Impact on stakeholders

A region that could sustain competitive investment that gets misallocated to Category 3 may potentially become *more* attractive to alternative networks (including Virgin Media). Depending on the details of Ofcom's RAB approach, Openreach's wholesale FTTC prices may well be increased in this area, improving the prospects for competitors.

The availability of cross-subsidy within Category 3 may encourage Openreach to deploy FTTP (and monitoring or commitments mechanisms in the RAB are likely to ensure it). However, this anyway was a risk, given that this area is actually potentially competitive, and Openreach might therefore deploy FTTP defensively.

A potential downside for alternative networks in an inappropriate Category 3 designation is that under this categorisation, Ofcom has proposed that Openreach geographic discounts are not prohibited.[42] Thus Openreach could offer targeted discounts in response to a new FTTP deployment. In addition, this misallocation will lead to the introduction of a dark fibre remedy into an area that had the prospect of competitive investment. Presence of this remedy could lead potential business or wholesale telecoms customers to opt for that passive remedy where they may otherwise have sought supply from an alternative network or deploying via PIA themselves.

In the round, the competitive impact is not clear. How would this flow through to retail pricing? Such discounts will be narrow in geographic scope. Will BT Retail, Sky and TalkTalk add complexity to their retail offers by flowing these discounts through to end users? Perhaps not, and if not then the impact of Openreach's discounts on the alternative network's retail position may be small. Of course, if the alternative network is relying on wholesale revenue, the targeted Openreach discounts are problematic.

For customers this misallocation is also problematic. Effectively FTTC customers in the region will be required (via the RAB approach) to cross-subsidise FTTP deployment which would potentially have taken place anyway without subsidy in their area. In the event that competing investment arises, customers, rightly, may question the purpose of the RAB mark-up they are being induced to pay. Given the central thrust of Ofcom's strategic objective is to support investment and competition in ultrafast services and to do so as widely as possible, this would appear to be a risk it should seek to minimise.

Error correction

This form of mis-categorisation will be self-evident – the first home passed by an Openreach rival will show that Ofcom's model was wrong. However, there will be difficult decisions for Ofcom to make in responding. If Openreach has already deployed FTTP, it may feel it has a legitimate expectation of being able to recover the costs of that investment through the RAB. Further, FTTC prices are likely to be lower in Category 2 than in Category 3, and thus a re-categorisation will directly damage the returns from the FTTP investment (since there will effectively be a lower anchor price). Openreach might deploy capital in good faith based on Ofcom's initial categorisation, only to have its returns materially damaged by Ofcom's later re-categorisation.

[42] Ofcom, *Promoting competition and investment in fibre networks: Initial proposals - Approach to remedies*, 29 March 2019, ¶3.43

More contentiously, alternate networks may feel they too have a legitimate expectation of a stable regulatory environment in the region in question – though of course they will, by definition, know the region is mis-categorised when they choose to make the investment.

At minimum, it would seem right that Ofcom addresses in advance how it will deal with this type of categorisation. For instance, it may be that the categorisation is maintained for x years after the first alternate network is deployed. This would allow all operators to make investment decisions with at least some knowledge of the associated risk. Whatever mechanism Ofcom may adopt, it is important that it develops a clear approach at the outset of the review so that all stakeholders are aware of the relevant risks and the approach Ofcom will adopt where such errors are identified.

Updating Ofcom's categorisation

In our response to Ofcom's preliminary geographic markets consultation (and above) we noted that there may be a need to consider interim reviews during these longer market review cycles to ensure that the remedies imposed remain applicable to any given geographic area.

As we note above, both type I and type II errors exist and have consequences. If Ofcom identifies competitive areas as non-competitive, consumers may subsidise rollout unnecessarily and alt-net investment may be crowded out by a dark fibre remedy; both of which would be difficult to undo. If Ofcom identifies a non-competitive area as competitive, it risks delaying rollout in the hopes that competitive build will occur.

Clearly, introducing any interim reviews would risk counteracting some of the benefits of certainty and stability that a longer review cycle should offer. Interim reviews could erode the regulatory stability that alternative infrastructure operators would value when making investment decisions. Equally, interim reviews could undermine the reduction in risk that Openreach may benefit from as part of a RAB model approach to non-competitive areas.

Consequently, in the full review later this year, Ofcom should carefully consider if mechanisms are available to establish a framework that provides the stability necessary to support investment, but in a way that responds to competitive conditions as they emerge. Without this, there may be a risk that the stability offered by a longer review period is eroded. For example, if investments during the market review period resulted in a geographic area having met the characteristics that would imply it should be re-categorised to 'competitive', retaining existing regulatory remedies that are appropriate for 'potentially competitive' areas may undermine the incentives for existing Openreach wholesale customers to consider alternative providers.

If Ofcom were to consider introducing a mechanism to enable geographic areas to be reclassified during a market review cycle, it would need to determine whether this would be ad-hoc or to some pre-determined frequency. It may also need to consider the need for notification periods or transitional arrangements to ensure that existing wholesale customers of Openreach have sufficient time to review or amend their existing arrangements.

6. CONSULTATION QUESTION RESPONSES

For completeness, we provide responses to Ofcom's questions below. These should be read in conjunction with the main body of our response.

Question 2.1: Do you agree with our overall approach to regulation in potentially competitive areas?

We broadly agree with Ofcom's proposed framework for its approach to remedies in potentially competitive areas. Ofcom's approach to regulating these geographic areas will be central to achieving Government's targets for network investment as well as Ofcom's aspirations for more intense network competition in areas where it can be sustained.

Ofcom has signalled it intends to depart from its previous approach in favour of promoting investment in infrastructure ahead of short-term price reductions. We think this recalibration is the right choice and the necessary approach to bring about the changes in the market dynamics that many stakeholders want to see.

It is clear that this strategy warrants a different approach dependent on the economic and commercial realities that differentiated geographic characteristics create. The remedies framework Ofcom proposes will enable it to make more targeted and tailored choices to reflect these differences consistent with Ofcom's objectives. These choices will need to be carefully calibrated to avoid regulatory risk and unintended consequences. The impact of errors is likely to be amplified with this more targeted approach. As a consequence, it is important that Ofcom maintains engagement with stakeholders as it concludes these preliminary consultations and progresses towards the full wholesale fixed telecoms market review.

Question 2.2: What is your view of our access and charge control proposals for wholesale local access services in potentially competitive areas?

As noted in the body of our response, we broadly support Ofcom's proposals in potentially competitive areas. We believe Ofcom's proposals on access, the application of charge controls as well as prohibition of geographic discounting are appropriate and proportionate remedies to apply in geographic areas that have the potential for competition to emerge.

Question 2.3: What is your view of our access and charge control proposals for leased line services in potentially competitive areas?

Consistent with our response to the BCMR and our view of Ofcom's proposals for wholesale local access services in competitive areas, we agree with Ofcom's proposed approach to leased line services. Ofcom's proposed safeguard caps for ≤1Gbit/s appear to be an appropriate mechanism to provide certainty to investors and existing Openreach wholesale customers.

However, it less clear to us that there is merit in imposing a charge control for >1Gbit/s. Potential consumers of such services are expected to have an effective PIA remedy to substitute to (or to seek supply from competing networks entering the market).

Question 3.1: Do you agree with our overall proposed approach to regulation in noncompetitive areas?

In areas Ofcom identifies as uncompetitive, it proposes that Openreach will be required to provide a dark fibre access product and that Openreach's fibre network rollout will be enabled and sustained by adopting an approach akin to a RAB methodology.

In principle we see the merits of a RAB approach to areas where competition will not arise, however, we are cognisant that the details and assumptions selected within the RAB model are key to understanding what the potential impact of it may be.

Historically we have been sceptical of the merits of a regulated dark fibre access remedy. Broadly we have viewed it as dampening incentives for infrastructure investment and damaging for owners of infrastructure. **[✂]**. Making a cost-based dark fibre access remedy available in these areas would likely make this (and therefore Openreach) the default option for mobile networks.

Question 3.2: Do you agree that a RAB charge control framework is appropriate for noncompetitive areas? If not, please explain why you think an alternative is more appropriate.

We broadly agree that a RAB framework for non-competitive areas is a logical approach to meeting Ofcom's objectives.

Question 3.3: Do you have any comments on the design of a RAB charge control for noncompetitive areas?

Please see the main body of our response for Virgin Media's initial comments on the factors Ofcom has provisionally proposed to consider and its intended approach. Transparency and engagement with stakeholders will be an important consideration when developing the full design for such an approach. This transparency would be beneficial to the ultimate design of the model as well as ensuring the end-users as well as wholesale customers are effectively engaged throughout the process.

Question 3.4: Do you agree with our proposal to introduce dark fibre in non-competitive areas?

Virgin Media sees limited incremental benefit to the introduction of a dark fibre remedy that cannot be achieved by an effective PIA product. When we also consider the risks of mis-categorisation as well as the risk of gaming (such as the remedy encroaching on competitive and potentially competitive areas), we remain unconvinced that a dark fibre remedy would be an appropriate remedy to introduce in non-competitive areas.

Question 4.1: Do you agree with our proposed overall approach to QoS?

Virgin Media has no substantive comments on Ofcom's proposed QoS approach at this time.

Question 5.1: Do you agree with our overall approach to transitioning regulation as BT deploys its new fibre network?

Virgin Media has no substantive comments on Ofcom's proposed approach to transitioning regulation as BT deploys its new fibre network at this time.

Question 5.2: Do you agree our proposal not to require BT to offer new forms of wholesale access to its copper network?

Yes.

ANNEX 1

[✂].

ANNEX 2

Please see the Communications Chambers report appended separately to this response.