

Philip Jansen
Chief Executive
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20 October 2021

Dear Philip

Thank you for your letter of 24 September.

We welcome your revised plans to pass 25m premises with FTTP by December 2026, including 6 million premises in harder to reach areas. We recognise that building an FTTP network requires significant private investment which is likely to have a long pay-back period and carries some risk. As you know, our Wholesale Fixed Telecoms Market Review (WFTMR) decision establishes a regulatory framework to create the right conditions to incentivise such investments.

I note the assumptions set out in your letter that enabled you to recommend the 25m premise FTTP investment to the BT Board. This is clearly a matter for BT.

In our WFTMR decision, we have confirmed a range of important regulatory enablers that support and de-risk investment in FTTP and set out how we would expect to approach regulation in the future, including on the fair bet.¹

As I know you appreciate, we cannot prejudge what actions we will take, as any pricing decisions in future reviews will be made in the light of the circumstances and legal framework applicable at that time. However, while investment plays out, we would not expect to intervene in a way that hampers that investment.

We expect investment in new networks to take place over much of the next decade, and certainly into the next review period (2026-31), and on this basis we do not expect to introduce cost-based price controls until at least 2031. Throughout the 2026-31 period, we would expect our starting point to be that the same wholesale access prices would apply in each of Area 2 and Area 3, as we expect ongoing investment - commercial and state funded - in both of these areas.

At present, we only have knowledge of commercial plans and state interventions that run into the period 2026-31. However it is possible that investment and competition could continue beyond this period. If this proved to be the case, we would look to regulate in a way that continued to support this, while ensuring that consumers continue to be protected.

In the future there may be areas where there is no on-going investment, and competition has not emerged and is not expected to. In these areas we would expect to look at consumer outcomes. It is possible that consumers in these areas benefit from competition through a common pricing approach (i.e. Openreach adopts the same prices here as in more competitive areas), or that

¹ In particular Volume 4, paragraphs 1.110 to 1.123.

Openreach has committed to supply on attractive commercial terms. If that is the case, it may be that light touch regulation is appropriate (or even no regulation on prices).

Where none of these circumstances apply, we may be required to set cost-based prices going forward. We do not believe that it is appropriate for the regulator to predetermine a particular return target, or a period of time before we might intervene further and regulate fibre prices.

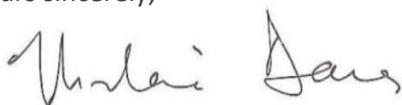
Our approach to setting cost-based prices would ensure that operators have a fair bet on their investment. An investment is a fair bet if, at the time of investment, the expected return is equal to the cost of capital. In the case of BT's full-fibre investment, we believe that the measures we are proposing support BT's full-fibre investment and significantly de-risk the investment case. However, we accept that some risk remains, and that BT should be allowed the opportunity to earn and keep a higher return than normal if it is successful.

We have set out how we will achieve this in the WFTMR:

- Should we need to regulate in future, we would check to ensure that BT had a fair bet. Our guiding principle in assessing this would be to consider whether, at the time BT took the decision to invest, it would have gone ahead with the investment if it had understood the regulation we were proposing to adopt. In doing this we would assess the risks BT faced when making the investments and the cost of capital relevant to those investments at the time they were made. We would then look to ensure that the expected returns were sufficient to ensure that it had been compensated for those risks i.e. the fair bet had been honoured.
- In setting any future charge control, our policy would be to ensure that BT could keep the upside it had earned up to that point and ensure that it has the ability to earn its cost of capital going forward.
- We would expect to use economic depreciation rather than accounting depreciation when looking at Openreach's full-fibre investment. Economic depreciation calculates depreciation based on the revenue earning potential of assets (and the services those assets provide) rather than based on a set amount of cost each year (as with accounting depreciation).
- Under this approach, BT would be able to earn a return above its cost of capital over the whole full-fibre investment cycle, even if cost-based regulation were introduced part way through the investment cycle.

We look forward to continuing to work closely with BT as full fibre is rolled out across the UK.

Yours sincerely,



MELANIE DAWES