Wholesale Fixed Telecoms Market Review

Response to Ofcom's consultation

Executive summary

Sky supports the policy objective of promoting the widespread availability of gigabit-capable broadband in the UK, including fibre-to-the-premises. In our response to Ofcom's market review, we make three key recommendations that we consider will help realise this goal while protecting consumers.

First, Ofcom's approach to promoting network competition where viable should not unduly prevent network builders and large retailers agreeing transformative, long-term agreements to underpin new network investment. Second, Ofcom should impose a price cap on Openreach's 80 Mb/s service instead of 40 Mb/s. As 80 Mb/s is more widely adopted, its price will be a more effective constraint on the prices of Openreach's faster services and therefore better protect consumers without inhibiting investment. Third, raising Openreach's regulated minimum service levels for provisioning and repair while widening their scope to FTTP will protect consumers and improve overall confidence in the broadband market, which is particularly important as consumers look to migrate to new gigabit-capable services.

These steps are even more necessary under Ofcom's proposal to allow Openreach's regulated price caps to rise with CPI from 2021 because consumers will be paying higher prices for their existing services as a result. In this response, we do not address this proposal as we are continuing to assess our position in light of the significantly deteriorated economic outlook, recently triggered by the COVID crisis.

As the UK's largest independent broadband retailer, we have a strong interest in offering better broadband services to our customers and will play a vital role in ensuring that there are high levels of take-up. It is this prospect of mass market adoption of gigabit-capable broadband that underpins any FTTP investment case and ensures that roll-out can occur with enough scale and pace to meet the UK's ambitious policy goals. And it is the widescale adoption of gigabit-capable broadband – not availability *per se* – that will drive the UK's economic growth and competitiveness over the coming decade and beyond.

Accordingly, it is important that Ofcom's approach to regulation does not restrict large retailers like Sky from committing to moving their customers to these new networks *en masse*. For this to happen, network builders (whether they are altnets or established operators) and retailers will need to reach commercial agreements that provide long-term certainty of supply at economic rates to enable the retailer to drive take-up. Such agreements can include commitments for FTTP to be rolled-out at a defined scale and pace and, therefore, are uniquely able to deliver the Government's policy goals for gigabit-capable broadband coverage – something which regulation alone cannot. These types of agreements are also commonplace in sectors where there are large upfront investments upstream and uncertain demand downstream.

Sky's 'investment' is to use our marketing, operational and customer service expertise to promote enhanced broadband services strongly to our customers with compelling propositions and prices that ensure there are high levels of adoption. This will be a huge undertaking and the effort and investment required by Sky should not be underestimated. As well as low average willingness to pay for more speed and quality, customers are also faced with a disruptive, costly installation of a fibre line into their premises. For the best part of a decade, this would be a high priority programme tying-up significant resources within Sky and occupying a substantial share of our customer engagement. Naturally, there is a considerable opportunity cost to Sky of devoting so many resources over a sustained period to such an

endeavour. Sky is a broad business with a wide range of attractive options for how it deploys its resources. However, if the conditions are right and we can commit to driving take-up of gigabit-capable broadband, we will be pivotal to the success of full fibre investments.

While the COVID crisis has underlined the economic importance of broadband, it also throws into sharp relief the long-term challenges of achieving widescale adoption of gigabit-capable broadband and the important role that retailers will need to play. Although some consumers may now place more value on faster speeds, the current crisis has demonstrated that for the vast majority current broadband services are more than adequate despite substantially increased usage. For the minority whose existing service is insufficient, there are already better broadband products available today that they can move to that will better serve their needs. In addition, average willingness or ability to pay for more speed could deteriorate further given the potential for a deep, sustained recession and a long-term 'scarring' of the economy leading to high levels of unemployment and a squeeze on household incomes.

If anything, this amplifies the need for long-term certainty for retailers. Therefore, when assessing such agreements, it is important that Ofcom properly weighs the benefits that long-term commitments can deliver in terms of the widespread roll-out and adoption of gigabit-capable broadband against the potential impact on network competition.

If CPI-0% charge controls are implemented, Openreach would earn large excess profits on its copper and fibre-to-the-cabinet services (Ofcom indicates it could be as much as £340 million over the five-year market review period and £903m if non-regulated FTTC services are included) which Ofcom accepts[1] are unnecessary to incentivise Openreach to roll-out FTTP and, in fact, are a disincentive. The least consumers should expect in such circumstances is that the more limited pricing protection that CPI-0% charge controls offer is applied to the most widely adopted product and Openreach's service quality improves.

Today, around three-quarters of broadband customers subscribe to a superfast service and average home broadband speeds are over 60 Mb/s. This is likely to grow materially over the market review period. Increasingly, the prices of slower broadband products, such as those based on Openreach's 40Mb/s service, will exert a weaker constraint on the prices of faster products. Applying the charge control to Openreach's 80 Mb/s service will better protect consumers and is unlikely to have a material impact on FTTP investment cases.

Low service quality for provision and repair continues to cause considerable consumer harm and is a barrier to the widespread adoption of gigabit-capable broadband. Ofcom's proposal to not raise the minimum service levels that Openreach is required to achieve and to not extend them to FTTP is likely to undermine consumer confidence to switch or migrate their services. As the market transitions to gigabit-capable networks, it is even more critical that consumers can engage confidently with the market and switch *en masse* to the new networks. Therefore, it is important at this stage that Ofcom imposes on Openreach higher minimum service levels and extends them to FTTP.

[1] Paragraph 1.24, Volume 4, WFTMR consultation where Ofcom states that it *"agree*[s] *that higher FTTC prices will increase the relative profitability of remaining on FTTC compared to investing in FTTP, all else equal."*

Establishing the right conditions for consumers and retailers to embrace gigabit-capable broadband is an important step towards unlocking its full benefits and meeting the Government's ambitious targets.

Sky supports the policy goal of promoting the widespread availability of gigabit-capable broadband in the UK

Widescale take-up of gigabit-capable broadband can bring substantial economic benefits to the UK. Broadband already plays a key role in the economy and ensuring that more consumers and businesses have access to the superior speed, consistency and performance that full fibre and other gigabit-capable services can provide is critical to the UK's future international competitiveness and productivity. Sky wants to be able to offer these superior broadband services to all its customers and therefore supports the Government's ambitious target to deliver gigabit-capable broadband to most UK homes by 2025.

The benefits of gigabit-capable broadband are widely reported on by economists and acknowledged by UK policymakers when justifying policies aimed at promoting investment in full fibre networks. For instance, WIK Consult found in 2018 that gigabit-capable networks *"can deliver tangible benefits to consumers – both directly by benefiting end-users, and indirectly by creating spill over effects that benefit the economy, society and the environment"*[2] and that increasing overall average broadband speeds is likely to have a positive impact on economic growth[3] – something that is critically important given the OECD's recent finding that the UK's level of full fibre penetration places it near the very bottom of all OECD countries.[4]

However, the conundrum for network builders, retailers and policymakers is how to promote investment in these new networks when many of the benefits that would accrue to consumers are not currently reflected in their average willingness (or ability) to pay for more speed and the spill-over benefits for the wider economy are external to the fixed broadband market.

[2] Paragraph 0.5, WIK Consult 'Benefits of ultrafast network deployment' (2018) – https://www.ofcom.org.uk/__data/assets/pdf_file/0016/111481/WIK-Consult-report-The-Benefits-of-Ultrafast-Broadband-Deployment.pdf.

[3] Ibid, paragraph 0.6.

[4] https://www.oecd.org/sti/broadband/broadband-statistics-update.htm. In a recent report for the Broadband Stakeholder Group, Oxera estimated the following benefits from full fibre and 5G connectivity: *"existing businesses will see increased productivity, with an expected impact of between 0.3% and 3.8% increase in turnover per worker per annum"*, *"*[s]*ignificantly improved connectivity can encourage new business start-ups, enabled by easier access to markets, lower barriers to entry and the development of new business models that are digitally dependent"* and *"*[t]*here will be private consumer benefits in terms of access to a greater number of services."* See: Page 2, Oxera 'Impact at a local level of full-fibre and 5G investments' (2019) – http://www.broadbanduk.org/wp-content/uploads/2019/09/Impact-of-full-fibre-and-5G-Publication-12.9.19_complete.pdf.

For FTTP to roll out at scale and pace, network builders and retailers need to agree long-term commercial deals

Deploying FTTP networks requires significant upfront investment. These investments will not occur at sufficient scale and pace unless network builders and their investors are confident of hitting or beating target roll-out costs and network revenues. If either of these are missed there is a strong possibility that further investment will be withheld or reduced. On the revenue side, in order to slow and ultimately reverse the high 'cash burn' in the early years of network investment, it is essential that large volumes of end users are moved to the new networks quickly. Retailers like Sky can commit to doing this if they have long-term certainty of supply at affordable rates.

The best way to 'de-risk' these investments is to allow network builders and large retailers to enter into long-term, commercially attractive agreements. Therefore, Ofcom should weigh carefully the benefits that such agreements can deliver in terms of widespread availability and take-up against their potential impact on network competition.

Widescale FTTP roll-out requires significant upfront investment

Achieving the Government's target to roll out gigabit-capable networks to most UK homes by 2025 requires a step-up in fixed network investment significantly beyond the levels of the last two decades. For each network builder, the investment required to roll out FTTP at scale is large, upfront and will only be recovered over a long period of time.

By way of illustration, BT recently announced[5] that it hopes to pass 20 million premises by the 'mid to late 2020s' – it has passed 2.6 million to date. At a target build cost of £300 to £400 per premises passed, this would constitute a £6 billion to £8 billion investment before accounting for final connection costs. If two thirds of homes passed by Openreach are connected and the average connection cost is £300 per premises this could account for a further £4 billion in capital expenditure. Overall Openreach's FTTP investment could be at least a £10 billion (BT said that its overall investment would be £12 billion) over up to ten years.

By way of comparison, Openreach's annual capex in 2019/20 was £2.1 billion and already includes some FTTP roll-out. Some capital expenditure on legacy copper services will also reduce as it is substitutional to fibre investment. While Openreach's incremental capital investment will be lower as a result, its mooted FTTP investment is nonetheless substantial. BT has sought to create financial headroom for, amongst other things, its FTTP investment by cancelling its dividends until 2021/22 and halving them thereafter.

For altnets, FTTP investment costs could be even higher and they do not possess the financial firepower of BT. For instance, in principle CityFibre has secured £4 billion in funding to roll out FTTP for up to 8 million premises[6] but this project

[5] BT Group plc Q4 and Full Year Results (2020) – https://www.btplc.com/Sharesandperformance/Financialreportingandnews/Quarterlyresults/index.htm.
[6] City Fibre press release 'CityFibre completes its acquisition of FibreNation increasing its rollout plans to pass up to 8 million premises' (27 March 2020) – https://www.cityfibre.com/news/cityfibre-completes-acquisition-fibrenation-increasing-rollout-plans-pass-8-million-premises/.

financing is likely to be strictly gated on meeting specific targets related to roll-out costs and network revenues.

FTTP investments face considerable demand-side uncertainty

Full fibre investment entails some risk given uncertainty over the expected build and connection costs and the overall level of long-term demand and consumers' willingness to pay.

In Openreach's case, BT has previously argued[7] that it considers an internal rate of return on its FTTP investment of around 15% as appropriate to account for this elevated risk, compared with Ofcom's proposed regulated cost of capital for Openreach when it is setting cost based charge controls of between 7.1% and 7.9%[8]. More recently, BT suggested that it expects to earn between 10% and 12% but is hopeful of much more[9]. Either way, this is a significant risk premium.

On the demand side, network builders and retail CPs face uncertainty and risk related to how many consumers can be connected to the new networks and how quickly, and the level of retail prices that consumers would be willing to pay.

We have previously provided Ofcom with evidence[10] that is consistent with other data[11] and which demonstrates that, on average, consumers have a low willingness to pay for more speed and quality. This is further demonstrated by the fact that many consumers have not switched to faster broadband services, even where they are available[12]. In addition, connecting customers to full fibre requires the installation of a new fibre line into a premises and introduces additional transaction costs for consumers (such as having to stay at home for an engineer visit and having their front garden dug up) which will mean that some are more inclined to stay on existing services in order to avoid disruption.

There is limited certainty about the level of future demand for FTTP services and, even if consumers do migrate *en masse* and quickly, there may be limited scope for revenue growth (in keeping with historic trends). For example, Ofcom's 2019 'Communications Market Report' found that average monthly household telecoms spend has declined slightly since 2018 but is largely flat (at around £83 per month). It would be incorrect to assume that fixed broadband is just like any other utility and that high prices rises can be 'forced' upon consumers without any drop off in demand and revenues. Consumers have more choice and their demand is not inelastic – they can spin down to lower speed, cheaper products, switch to other fixed networks or only take mobile services instead.

In cable areas, this issue will be exacerbated further by the scope for cable to respond competitively to limit migration and returns to new FTTP networks.

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[7] BT Group plc 'Q4 2019 Results – Earnings Call Transcript' (May 2019) – https://www.businessdaylight.co.uk/bt-group-plc-bt-ceo-philip-jansen-on-q4-2019-results-earnings-call-transcript/.
[8] Table A21.1 'Summary of WACC and component parameters', Annex 2, WTMR consultation.
[9] BT Group plc 'Q4 and Full Year results 2020' (May 2020) – https://www.btplc.com/Sharesandperformance/Financialreportingandnews/Quarterlyresults/2019-2020/Q4/Downloads/Webcast/q420-media-transcript.pdf.
[10] Charles River Associates (CRA) 'Willingness to pay for faster broadband' (July 2018).
[11] As Ofcom states in the consultation *"[r]esearch undertaken by stakeholders suggests consumers do not have a high willingness to pay for speeds above 40/10 and that speed is not the most important factor in decisions to switch provider."* (Paragraph 1.33(c), Volume 4, WFTMR consultation).
[12] For instance, in the 2019 'Connected Nations' report Ofcom found that although 94% of premises have access to superfast (i.e. ≥ 30 Mbit/s) broadband, only 54% of premises have signed up to them (or 57% of those able to take superfast services have done so). See: page 18, Ofcom 'Connected Nations 2019' (March 2020).

Recession and fixed wireless access (boosted by 5G) also have the potential to further reduce the available consumer demand and prices. FTTP investment cases are dependent on high levels of take-up or penetration so anything that reduces the addressable headroom puts these investments more at risk[13].

Overall, there is a risk that deployment costs will be too high while take-up and revenues are not high enough and that, as a result, investments either are not made or, if they are, at a far lower scale and pace than is required to meet the Government's roll-out target.

Retailers need long-term security of supply at economic rates

The key way to mitigate these risks is for the network builder to reach commercial agreements with large retailers before or at the start of the investment that provide a degree of certainty that the network revenues earned will be sufficient. This will require confidence that there will be high levels of take-up by consumers. By allowing large retail CPs to enter into long-term agreements with network builders to bring their subscribers onto the new network, builders can achieve a steady, minimum level of revenue that will help mitigate risk in the investment and provide more certainty that the investment will pay back[14].

Similarly, Sky (and Openreach's other external customers) require long-term security of supply at attractive wholesale prices and terms that account for consumers' low average willingness to pay for more speed and quality and the costly disruption of installing a new fibre line into a customer's home. In practice, this means that CPs must be able to agree wholesale prices and terms that enable them to price gigabit-capable services as close to existing standard and superfast broadband products as possible in the long term.

More importantly, as network builders roll out full fibre and the market transitions to gigabit-capable broadband, there is a real risk that the market power of the networks in areas where network competition does not emerge will become more entrenched. This may mean that, over time, these new networks have an incentive to exercise their market power by either increasing wholesale prices, reducing quality or both. As a result, unless Sky can lock-in attractive long-term wholesale deals now, there is a risk that we will be unable to provide network builders with the security of demand they require.

Ofcom may argue that it would intervene and regulate networks if they had an incentive to exercise their significant market power in this way. However, Sky cannot take comfort from this as Ofcom cannot fetter its discretion now and also wants to incentivise network builders by allowing above-WACC returns for a sustained period. It is unlikely that a large retailer could make a long-term commitment to FTTP without some certainty over rates and instead rely on potential Ofcom intervention further down the line.

The greatest chance therefore to ameliorate the investment risks that builders experience and demand-side constraints that retailers face is for them to enter into long-term agreements. Such agreements have the unique ability to underpin new networks' revenues at viable prices for a period as well as attract the large volumes

[13] See, e.g., Annex 1, Sky 'Response to Ofcom's Wholesale Local Access Market Review consultations' (June 2017) – https://www.ofcom.org.uk/__data/assets/pdf_file/0013/105025/Sky.pdf.
[14] Page 11, Sky, 'Approach to remedies: Response to Ofcom's consultation' (June 2019).

of end users quickly that are so important to the success of the network investments.

Recession and lower long-term economic growth as a result of COVID amplify the risks to retailers

The current COVID crisis has placed broadband firmly at the heart of the UK economy and elevated further its potential to drive the UK out of a COVID-induced recession and alleviate the high levels of unemployment and depressed household income that may last even once the economy has started to grow again. During lockdown many more people have depended on reliable broadband more often in order to work from home and perform essential activities (like shop online, schooling or video calling friends and family). Looking beyond the current crisis, we expect that these changing behaviours will become embedded with more economic activity being permanently conducted online and at home. More than ever, consumers and businesses will depend on high quality broadband.

However, while some consumers may be prepared to pay more for better broadband as a result of these changes, average willingness to pay may in fact decline as the effects of significantly higher unemployment, a squeeze on household income and far lower business revenues bite over the next few years. These trends amplify further the risks to network builders and broadband retailers associated with moving to gigabit-capable broadband networks – namely, being able to fund the significant upfront investments needed to roll-out new networks and generating enough consumer take-up to make the investments viable.

These risks are not so great that they cannot be solved commercially but they do emphasise the need for network builders and retailers to reach long-term agreements which provide each side with security of supply and demand. It is important that Ofcom's approach does not unduly inhibit this process.

Long-term agreements are a common way to overcome risks for projects with large, upfront investments and uncertain demand

The approach of striking long-term agreements is not novel at all and is a common commercial recourse in projects with large, upfront investments upstream and uncertain demand downstream.

This seems to be the case in relation to altnet FTTP investment in the UK with, for example, CityFibre's long-term strategic deals with Vodafone and, more recently, TalkTalk[15].

For larger, established networks such as cable and BT, Ofcom may consider that the anchor tenancy of their respective retail divisions is sufficient alone to underwrite their network investment cases but, while this tenancy helps, it is not enough by itself. Virgin Media's expansion of its network through Project Lightning has been relatively modest[16] and will become more difficult as it reaches more costly

[15] CityFibre press release, 'CityFibre acquires FibreNation and adds TalkTalk as strategic customer, increasing its rollout plans to pass up to 8 million premises' (21 January 2020) - https://www.cityfibre.com/news/cityfibre-acquires-fibrenation-adds-talktalk-strategic-customer-increasing-rollout-plans-pass-8-million-premises/.
[16] In 2017 when Project Lightning was launched, Virgin Media aimed to pass 4 million premises by the end of 2020. It has currently only passed 2.2 million. See: ISP Review 'ISP Virgin Media UK Reports Mild Broadband Customer Growth'

deployment areas. It is unsurprising therefore that Liberty Global has stated publicly that it is prepared to provide wholesale access to some of its new network roll-out[17]. This could increase its scale to underpin a more ambitious network expansion programme.

Similarly, for BT it is unlikely that BT Consumer alone will drive enough FTTP revenues for its FTTP roll-out ambitions (20 million premises passed by mid to late 2020s) to be realised. While BT employed a similar policy in relation to FTTC – whereby BT Consumer promoted FTTC strongly but Openreach's relatively high wholesale charges were not subject to regulatory price caps and did not incentivise its external customers to follow suit – it may not be possible to repeat that approach here as the BT's investment in FTTP is up to five times larger (£2.5 billion[18] versus £12 billion).

It is, therefore, important that builders and their external customer can agree long-term, transformative wholesale deals – or other commercial arrangements, such as co-investment – in order to ensure that roll-out occurs at scale and pace[19]. There are numerous examples from a wide variety of sectors where these types of agreements are commonplace.

In telecoms markets, there has been a recent trend for mobile and fixed infrastructure businesses to strike long-term deals with downstream telecoms businesses. A key feature of these new market structures has been for the infrastructure and downstream businesses to agree long-term tenancy arrangements:

- French operators Iliad and InfraVia closed a partnership deal in 2020 to accelerate fibre roll-out outside very dense areas. The deal involves the creation of a special entity to acquire, operate and roll out FTTP networks, with Iliad's brand, Free, being granted a long-term service agreement[20].

- Bouygues Telecom entered into an agreement with Cellnex in 2017 relating to the construction of 1,200 mobile towers, which includes a 15-year services agreement[21]. Bouygues Telecom also recently entered into a similar agreement with Phoenix Towers International covering the development of 4,000 towers over 12 years outside very dense areas[22].

- In Spain in 2019, building on existing long-term agreements MasMovil signed a national mobile roaming agreement and a hybrid indefeasible right of use

(6 May 2020) - https://www.ispreview.co.uk/index.php/2020/05/isp-virgin-media-uk-reports-mild-broadband-customer-growth.html.

[17] Paragraph 3.9, Ofcom 'Proposal to apply Code powers to Liberty Networks Limited' (January 2020) which states that "[t]*he Applicant has stated that it is willing to provide wholesale access to its electronic communications network to other telecoms providers on commercial terms.*"

[18] Openreach, 'A history of Openreach - Our creation, our independence and everything in between' - https://www.openreach.com/about-us/our-history.

[19] See, e.g., page 2, Oxera 'The long and short of it: the impact of long-term contracts as a commercial tool' (2007) where it stated that '[l]*ong-term contracts may favour investments by providing a more stable flow of returns, thereby reducing the risk premium that would have to be paid to investors in order to raise the required funds for a given project. This may be particularly the case in industries where operators' investments are sunk – that is, where the prospects are limited for recouping the value of the investment from a sale for use other than that which was originally intended (i.e, asset specificity).*" – https://www.oxera.com/wp-content/uploads/2018/03/The-long-and-short-of-it_Agenda.pdf.

[20] Iliad's press releases: https://www.iliad.fr/presse/2019/CP_030919_Fibre_Eng.pdf and https://www.iliad.fr/presse/2020/CP_280220_Eng.pdf.

[21] Bouygues Telecom's press release: https://www.bouygues.com/wp-content/uploads/2017/02/bouygues-telecom-and-cellnex-sign-agreement.pdf.

[22] Phoenix Tower International's press release: https://phoenixintnl.com/phoenix-tower-international-societe-au-portefeuille-de-blackstone-conclut-un-accord-avec-bouygues-telecom-pour-detenir-et-exploiter-jusqua-4-000-sites-en-france/.

FTTH agreement with Orange that enabled it to expand its reach, improve its economics and offer 5G services[23].

Elsewhere in other sectors, retail property developments (such as a project to build a new department store or mall) will often enter into long-term agreements with popular or household retailers at discounted rates. This guarantees the property developer a secure rental income for a period as well as attracts other, prospective tenants (who may benefit from the extra shopping traffic the anchor tenant generates).

Further non-exhaustive examples can be found in:

- energy generation infrastructure construction projects, which can also involve upfront long-term 'offtake' or power purchase agreements with energy suppliers[24];
- the pre-ordering of aircraft from manufacturers prior to production by airlines;
- agreements between landowners and forestry companies and between forestry companies and timber mills for the supply of logs[25]; and
- the supply of car components to car manufacturers.

What all these examples show is that often there are long-term contractual solutions to upfront investment risk that provide upstream businesses with enough security of demand and downstream businesses with sufficient security of supply.

Ofcom should be careful when promoting network competition that it does not unduly prevent important investment from happening at scale and pace

While long-term contracts can be effective at promoting investment in FTTP and are necessary to meet the Government's roll-out targets, there can be a trade-off in terms of reduced upstream network competition if these long-term commitments between builders and retailers reduce the scope for other networks to be rolled out. It is important that Ofcom weighs these trade-offs carefully when it assesses any agreements.

In its consultation, Ofcom has raised a concern that agreements between BT, the dominant network, and large retailers could stifle the emergence of more network competition. A key pillar of Ofcom's policy proposals is to promote more network competition, for example, via a third network to rival Openreach and Virgin Media. While *ex post* competition law will provide an effective backstop to prevent BT unduly abusing its market power and foreclosing its network rivals, Ofcom is clear

[23] https://www.grupomasmovil.com/wp-content/uploads/2019/10/190930_HR_Orange_-ENGLISH_Final.pdf
[24] See, e.g., https://www.cliffordchance.com/news/news/2019/10/clifford-chance-amsterdam-advises-windpark-fryslan-with-the-fina.html for an example of a 15 year contract related to the construction of a windfarm in Finland. See here for a similar example in the Netherlands involving a 16 year offtake agreement. See, e.g., https://www.marubeni.com/en/news/2017/release/20170131_2.pdf for a gas-fired power plant in Indonesia involving a 25 year power purchase agreement.
[25] See, e.g., page 9, Columbia Center on Sustainable Investment, 'Guide to Forestry Contracts - Understanding Key Provisions' (October 2015) - http://ccsi.columbia.edu/files/2016/10/GuidetoForestryContracts.pdf.

that it wants to go further than this by exercising its discretion under the application of its *ex ante* powers. Ofcom states:

> *"... we do not consider that the restrictions on Openreach's commercial terms resulting from competition law or other SMP obligations are sufficient to protect nascent entry. Therefore, while rival networks to Openreach are becoming established, we consider it appropriate to limit Openreach's commercial flexibility to a greater extent, including pricing arrangements that might normally be regarded as legitimate commercial reactions to competitive entry for operators with SMP."*[26]

While Sky supports Ofcom's ambition to encourage network roll-out by incentivising three-way network competition where viable, it is important that it properly balances the potential off-setting benefits of accelerated, widescale FTTP deployment and take-up that long-term agreements between BT (or other large established networks) and external retailers can deliver versus the potential for greater network competition.

The success of Ofcom's policy will be assessed by the amount of actual network build there is in 2025. Therefore, the prospect of more network competition is not an end in itself unless actual network roll-out happens. If progress towards the Government's objective is slow because Ofcom has restricted Openreach's commercial flexibility to such a degree that its roll-out is slower and smaller than it would otherwise be and there are limited off-setting benefits in terms of competing network competition, then this will be a significant failure.

Whatever the scope for three-way network competition, it is evident to Sky that BT will continue to be a key supplier for large parts of the country and, as such, it is important that it has the flexibility to reach agreements with its external CP customers that enable Openreach to accelerate its build and its customers to drive more take-up.

Therefore, Ofcom should not use regulation to dampen the ability for network builders and retail CPs to agree long-term, strong commercial offers. Competition law will often provide an adequate backstop against agreements that may have anti-competitive effects and, in practice, requires that Ofcom balance the *prima facie* impact of an agreement on competition against the off-setting benefits of increased network roll-out that agreements can bring. In exercising its discretion under its *ex ante* powers when assessing these long-term agreements, it must weigh carefully the real likely impact on network competition against any off-setting benefits that such agreements can deliver in terms of expedited roll-out and take-up.

[26] Paragraph A15.18, Annex 15, WFTMR consultation.

Ofcom should impose a price cap on Openreach's 80 Mb/s service as this will better protect consumers

As set out in Sky's response to Ofcom's 2019 consultation on appropriate remedies, we consider that the appropriate 'anchor' product is Openreach's 80 Mb/s service (rather than 40 Mb/s)[27].

In this consultation, Ofcom considers that Openreach's 40 Mb/s service would be an effective anchor on the prices charged for higher bandwidth services because (i) while volumes are increasing, this is mainly due to provider-led upgrades, (ii) analysis of retail prices suggests that 40 Mb/s continues to be a strong substitute for higher bandwidth services, (iii) consumers do not have a high willingness to pay for speeds above 40 Mb/s and most consumers are not willing to pay a significant premium for faster speeds, and (iv) the price of Openreach's 80 Mb/s service is constrained by the GEA discount contract and, in the longer term, will be constrained by the threat of alternative network build.

Overall Ofcom reaches a similar conclusion to the one it reached in the remedies consultation, that it *"expect*[s] *the constraint imposed by a 40/10 price cap on high bandwidth services would weaken somewhat over the review period, but not to the extent that it would not protect consumers from excessive prices."*[28]

Sky has rapidly migrated its broadband subscribers and now has [✂]% on 80 Mb/s services or above. We expect that by 2023 this will [✂]. Since the remedies consultation, the number of superfast broadband connections in the UK has increased from around two-thirds to just under three-quarters (74%) and average home broadband download speeds have increased from 50 Mb/s to over 60 Mb/s. We expect that this will grow even further by 2021.

There is a real risk that, in the absence of a price cap on Openreach's 80 Mb/s services, it will have a strong incentive to increase wholesale prices over the market review period. This will drive up costs and lead to higher retail prices, at a point when most UK consumers have successfully migrated to higher bandwidth services. This is especially worrying given that the proposed price caps on 40 Mb/s are not cost based and will allow BT's prices to diverge significantly from its costs over the market review period.

Ofcom's suggestion that Openreach will be constrained by doing so, either due to the GEA discount contract or the threat of alternative network build is not realistic. First, the GEA discount contract ends in August 2023, after which all rates revert to Openreach's rate card prices. [✂] Second, the threat of future build by alternative network builders is not enough to stop Openreach from increasing prices today and, in any event, alternative build is likely to be low throughout the market review period (for instance, even if successful, CityFibre may only have pass around 3m homes by 2030).

In addition, Ofcom suggests that even if Openreach does increase the prices of its 80 Mb/s service, consumers may simply migrate down to the price-constrained 40 Mb/s service because they are close substitutes. While consumers exhibit a low willingness to pay more for higher speeds, they also exhibit fairly high loss aversion – which means that while 40 Mb/s prices can act as a constraint to consumers

[27] Pages 20-21, Sky 'Approach to remedies: Response to Ofcom's consultation' (June 2019).
[28] Paragraph 1.35, Volume 4, WFTMR consultation.

considering upgrading to 80 Mb/s, they are less effective in preventing 80 Mb/s prices from rising for existing 80 Mb/s customers as they will be less inclined to spin down to lower speed services. If this were to happen, it would undermine the Government's strong ambition to increase full fibre penetration and to migrate consumers to higher speeds quickly,

Overall therefore, we consider that Ofcom should reset the anchor product at 80 Mb/s.

In order to better protect consumers, minimum quality of service levels should continue to improve and widen in scope

As the market transitions to gigabit-capable networks over the next decade or longer, it is essential that Ofcom better protects those consumers that may remain on legacy products for a long time – possibly forever in some areas – and instils greater consumer confidence in broadband markets generally so that more eligible consumers are inclined to switch to new gigabit-capable networks. Therefore, we do not agree with Ofcom's proposal to require Openreach to maintain only static minimum service levels ("MSLs") on a relatively narrow set of products.

Poor quality of service by Openreach in relation to both existing and new broadband products will harm those consumers on legacy products and further dampen consumer confidence in the market such that migration to gigabit-capable networks could be slowed down. It is, therefore, critical that Ofcom puts wider and more challenging MSLs on Openreach's existing broadband products, and that Ofcom introduces new service levels on FTTP.

Sky consistently delivers the best customer service in the UK but we can only control part of the broadband supply chain. We rely on the level of service that Openreach delivers and, in the absence of regulation, Openreach has little incentive to invest adequately in the underlying network, staff and processes that are required to deliver appropriate service quality.

Openreach's quality of service – including the number of faults it experiences, the length of time it takes to repair those faults and the quality and timeliness of provisioning – has improved gradually since Ofcom introduced MSLs in 2014. However, there is still a long way to go before it reaches an acceptable level. Openreach's service quality directly impacts overall satisfaction and confidence in broadband markets. Poor service quality undermines that confidence and acts as a brake on consumers engaging with the market and switching their services. For the last three years, Ofcom has surveyed customer satisfaction and it has found that the main reasons customers were dissatisfied with their broadband connection was 'poor or unreliable connectivity' or that it was 'not performing as it should'.

Further, the reality is that many consumers will not be able to receive FTTP services for at least a decade. Consumers in hard to reach areas (such as rural areas) or those with difficult and expensive access issues may never benefit from FTTP. There is a real risk that many of Sky's customers will still be on copper-based legacy services by 2026 and it is important that service quality for these services continues to improve – which is the least consumers should expect given the more limited pricing protection that CPI-0% charge controls offer.

In the absence of regulation, BT will not be incentivised to make the necessary investments to maintain and improve service quality. This is partly because the biggest beneficiary of reduced switching is the retailer with the largest subscriber base – namely, BT Consumer – which is able to retain its customers more easily as a result. Moreover, rightly or wrongly, some consumers also consider that as BT controls the access network via Openreach, purchasing communication services from BT Consumer will mean that they will be less exposed to the risks arising from low service quality than other Openreach-based communication providers.

As the market transitions to gigabit-capable networks over the next decade, it is even more critical that consumers retain confidence in the broadband market, its

suppliers and network operators so that they switch *en masse* to the new networks. This is why it is important that Ofcom extends MSLs to Openreach's FTTP services.

Therefore, we agree with Ofcom that it needs to continue to regulate BT's quality of service by imposing MSLs across the range of services where it finds that BT has SMP. But we consider that: (i) existing MSLs should not be kept static; (ii) Ofcom should introduce new MSLs for 'early life' faults; and (iii) Ofcom should put in place new MSLs on the FTTP anchor product.

Current MSLs are too low and not wide enough

Broadband is increasingly important to consumers. A 2017 survey found that 66% of residential customers would struggle to function without it[29]. The same survey also showed rising customer dissatisfaction the longer the time taken to repair a service. Around 79% of respondents said that they were dissatisfied when their broadband service took more than three days to be restored[30].

In addition, early life faults – including 'Dead on Arrivals' (where a fault develops within 8 days of activation), 'Early Life Faults' (where a fault develops within 28 days of service activation) and repeat faults cause significant harm to Sky and its customers. As set out below, of the approximately [✂] new customers that Sky takes on each year, around [✂] of these services are DOA or experience ELFs. In addition, around [✂] experience repeat faults, with that number slightly trending upwards over the last 18 months.

[✂]

The current health crisis caused by COVID means that many people depend on reliable broadband to work from home and perform other essential activities (like shop online, home-school or video calling friends and family). Looking beyond the current crisis, we expect that these changing behaviours are likely to become embedded in the way people work and live, which means that consumers need high quality, reliable broadband now more than ever.

We do not agree, therefore, with Ofcom's proposals to keep MSLs for copper-based services (MPF and GEA FTTC) static from 2021. It is not desirable during this market review period to lose focus on driving much needed improvements to provisioning and assurance performance, particularly given that many consumers will remain on copper-based services throughout the market review period.

Ofcom's response in the consultation is that increasing existing MSLs would stretch Openreach resources, divert operational resources that should be better focussed on fibre roll-out, would demand increased investment in largely legacy assets and there is a risk that those investments would become stranded once the market transitions from copper to fibre. However, it is not clear that all those investments would be stranded – for example, increased capital maintenance of a duct – and this approach does not adequately protect consumers who may remain on these products for many years to come.

This next market review period represents a critical inflexion point in Ofcom's and the Government's ambition to roll out gigabit-capable networks. A key determinant

[29] Paragraph 1.2, Ofcom, 'Quality of Service for WLR, MPF and GEA: Statement on quality of service remedies' (2018).
[30] Ibid, paragraph 3.68, citing: slide 36, Jigsaw Research 'Automatic compensation: Consumer experience of provisioning delays, loss of service and missed appointments, Presentation of Quantitative Findings' (March 2017).

of whether this will be a success is the pace and scale at which retailers can migrate customers onto the new services. Poor quality of service on existing copper-based services will undermine confidence in the market generally which will have a knock-on effect of reducing the incentives on consumers to migrate to new, gigabit-capable services.

Ofcom should put in place new MSLs on FTTP

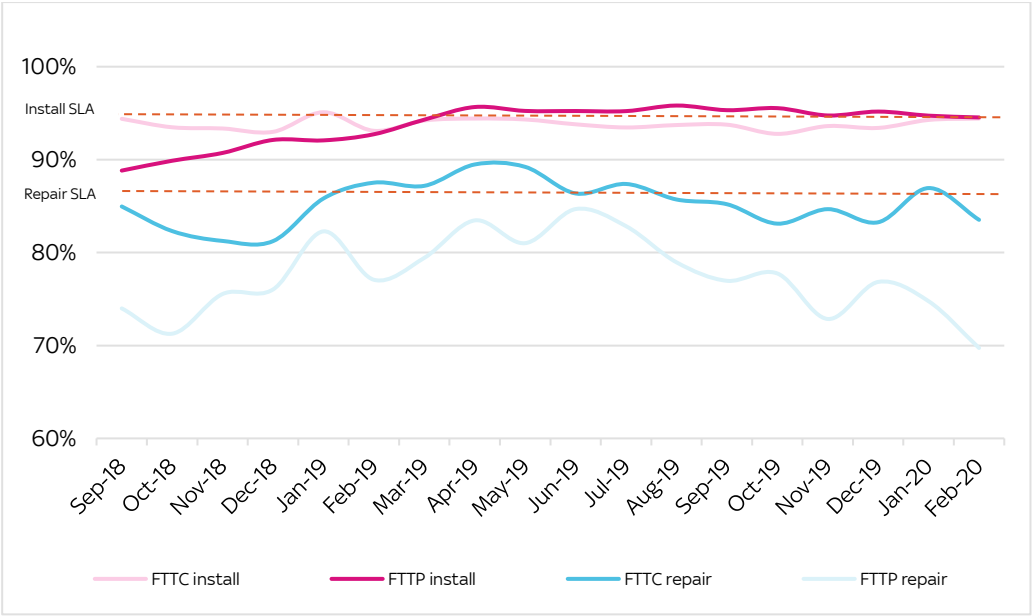
The transition to gigabit-capable networks over the next decade will create a period of considerable disruption and costs to consumers (for example, they may have to take annual leave to be at home for an engineer appointment, have physical work to their house or garden and adapt to use the new technology). Therefore, it is critical that throughout (and in the lead up to) this process, consumers retain confidence in the broadband market, its suppliers and network operators.

More broadly, in the absence of regulation, Openreach may dedicate significant resources to rolling out FTTP as quickly as possible in order to hit roll-out targets. There is a clear risk, therefore, that Openreach could prioritise the pace and scale of its build over the quality of that build (e.g. by re-deploying engineers to FTTP without ensuring that they are trained properly). Poor quality FTTP provisioning, faults and repair could seriously undermine the widescale take-up of gigabit-capable broadband.

Ofcom argues that: (i) it is not in a position at this time to determine what service standards it could set on FTTP; and (ii) in any event, existing FTTC standards may not be an appropriate measure of quality. This is disappointing given that Ofcom considers that FTTP offers significantly improved performance (for example, lower fault rates) and it has even attempted to quantify that 'service uplift' (by proposing that Openreach can charge a £1.50 to £1.85 per month pricing uplift to reflect FTTP's higher quality). Given that Ofcom expects consumers to pay for FTTP's premium service quality, Ofcom should stand behind that and regulate the minimum level that FTTP service quality should be.

As a starting point, we suggest that Ofcom adopt the MSLs it has in place for FTTC and apply them to FTTP. As set out in Figure 2, Openreach is already performing well in relation to repairing FTTP faults on time and, in early-to-mid 2019, was not far off the level achieved by FTTC in relation to installing FTTP on time.

Openreach repair on time* and install on time (FTTC and FTTP comparison)**[31]



* Percentage repair completion (Service Maintenance Level 2).
** Percentage order completion (by the Committed Date).

In any event, if Ofcom is correct that service quality should be higher for FTTP than FTTC[32], we consider that the existing MSLs will (at least) be a reasonable starting point and that setting levels too low is much better than not setting them at all.

Sky **June 2020**

[31] Source: Openreach data.
[32] Ofcom suggests that *"... evidence from France and Spain indicates that a bedded-in fibre service suffers from lower fault rates than copper-based services. Furthermore, we would expect that the value of uninterrupted services to customers will be higher by the end of the control period as customer demands from their broadband services increase."* (Paragraph A22.11, Annex 22, WFTMR consultation).