Ofcom July 2020 Wholesale Fixed Telecoms Market Review Consultation

Response from Fern Trading Limited

29 September 2020

Introduction

1. The UK's full-fibre footprint is expanding rapidly. Thanks to major investment in the altnet sector over the past year, commercial engineering workforces have expanded and upskilled. Competitors now find it easier to access BT's ducts and poles to deploy their networks.

2. Commercial providers naturally focus on areas which offer the easiest returns, while BT's current record of fibre investment is almost non-existent in rural areas. So, to help expand fibre, the Government has committed £5bn to help fund gigabit-capable deployment in rural locations. The regulatory framework must now follow suit.

3. Ofcom has sought to do this by setting regulated prices which incentivise BT in these locations. However, as demonstrated by BT's recent Area 3 commitment, its incentives actually encourage build in places already earmarked for deployment by altnets, and force those on slow copper - who won't be upgraded - to pay for this.

4. This approach does nothing to increase the UK's fibre footprint. Ofcom must find ways to incentivise BT to go deeper into rural areas, where nobody else has plans to build, or else leave that to the BDUK process.

Ofcom's Area 3 strategy

5. In its January Wholesale Fixed Telecoms Market Review consultation ('WFTMR1'), Ofcom defined geographic markets for wholesale local access ('WLA') services according to the level of competition they could sustain. It identified three levels of competition, each constituting a different market: "*competitive*"; "*potentially competitive*" ('Area 2'); and "*non-competitive*" ('Area 3')[1].

6. Ofcom considered that Area 3 contained 9.2m premises, i.e. these were places where there was "*unlikely to be material commercial deployment* [of fibre] *by rival networks to BT*". It said: "*In the less profitable parts of the country, where competing networks are not sustainable, our strategy is to set regulatory prices that support investment by Openreach.*"[2]

7. To incentivise BT under this strategy, Ofcom offered to allow it to set prices for its wholesale local access ('WLA') services using forecast regulatory asset base (RAB) pricing, provided it committed to build fibre on "sufficient scale" in Area 3.

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[1] WFTMR1 p3.

[2] Ibid.

8. Under this approach, BT would be allowed to add Ofcom's estimates of the costs of deploying fibre to Area 3 to its UK-wide asset base, and then recover this investment from all of its UK customers, both fibre and copper, by applying a higher (and uniform) price for its services[3].

9. In its July WFTMR consultation ('WFTMR2'), Ofcom announced that BT had formally committed to extend its fibre network to 3.2 million premises in Area 3, provided Ofcom applied its proposed price control. Ofcom considered that BT's offer met its sufficiency requirement, and is now therefore proposing to apply the control.

Impact of Ofcom's proposal

10. In order to comment on the forecast RAB price control, it is necessary to consider Ofcom's Area 3 definition, and assess the extent to which its proposals:

    1. further consumer interests by incentivising BT to extend its fibre footprint in Area 3; and

    2. promote open competition and investment from full-fibre providers.

11. We examine these issues in this response, because, unfortunately, Ofcom failed to conduct an Impact Assessment for WFTMR2. It cannot rely for this on its WFTMR1 Impact Assessment, because this did not assess the impacts of the *specific* commitment which BT has now made.

12. Impacts will vary according to the nature of the commitment. For example, had BT offered to build 1-2m premises in rural areas which could only support one operator, then Ofcom's proposal may very well have furthered consumer interests without significantly harming competition. By contrast, BT's commitment, and extra funding sourced by Ofcom from BT's copper network customers, to build 3.2m in towns and villages where commercial providers are already planning to go, does not extend the UK's fibre footprint[4], and unfairly undermines its competitors. Same price control; different commitment; different impact.

13. It is also unclear how much the forecast RAB approach really incentivises BT in Area 3 compared to the do-nothing option. We understand from conversations with Ofcom that BT's commitment includes at least 500,000 premises that it has *already* built *without* the need for any additional incentive. It would almost certainly have built a significant proportion of the remainder under its 'Fibre First' or rural villages programmes, even without the benefit of the price control.

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[3] Ofcom says that these costs are recovered "*over all customers, fibre-based and copper-based, in Area 3*". In fact, because the price is uniform across the UK, Area 2 customers pay for the Area 3 investment as well. Ibid p3.

[4] In fact, Ofcom proposals will probably lead to a reduction of already-planned Area 3 investment by altnets. Providers who might otherwise have contributed to more than the 3.2m in Area 3 are likely to find finance harder to come by, and business plans damaged, as a result of BT's presence.

Problems with Ofcom's strategy

14. Ofcom's strategy to encourage build in parts of the country where it believes competing networks are not sustainable ('Area 3') by incentivising BT to build there fails on almost every level.

    a. Ofcom has misidentified which areas can support competing fibre networks.

        i. It should model commercial viability and validate this with operator plans.

        ii. It has underestimated the level of MSN deployment in Area 3.

        iii. It has underestimated the level of "broadband-only" deployment in Area 3.

    b. Ofcom's proposals give regulatory support to the parts which need it least; 6m people in Area 3 on slow copper will fund full fibre for the lucky 3.2m.

    c. Ofcom wrongly believes that BT has a lower cost base, and can therefore build in places in rural Area 3 that no other operator can.

    d. Ofcom openly favours BT in Area 3 above other operators, and thereby risks damaging full-fibre businesses already active there who are reliant on fair competition, and reducing their contribution to building a gigabit-capable nation.

    e. Ofcom's proposals do not expand the UK fibre footprint; instead they promote network overbuild and competition, rather than coverage.

    f. Why do we and other altnets want to have our build plans classified as Area 2 and not Area 3? Because Ofcom is proposing to incentivise BT to build past 3.2m properties in the most commercially attractive parts of Area 3, which is exactly where we and other altnets have built, are building or have plans to build. Logically, a lot of the fully commercial build plans from these alternative operators will no longer make economic sense, as BT is being handed the funds to overbuild them and to do so quickly. Ofcom is effectively giving the 3.2m properties to BT on a platter and removing from the sector what would be perfectly viable commercial investment from the large infrastructure funds backing the altnet operators. If we are going to achieve a fully gigabit capable UK by 2025, Ofcom needs to be encouraging commercial investment, not hindering it.

    g. There are simple alternative approaches available which would expand the Area 3 fibre footprint further than the 3.2m under Ofcom's proposals.

15. We now consider each of these points in turn.

(a) Ofcom has misidentified which areas can support competing networks

16. Ofcom's WFTMR1 identified 9.2m premises where it considers material deployment by networks other than BT is unlikely. DCMS identified[5] 3.1m premises which would require public subsidy for fibre deployment, and a further 3.1m which are commercially viable but at

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[5] Future Telecoms Infrastructure Review.

risk of no investment[6]. This means there are 3m premises which DCMS considers to be both commercially viable and investible, and which Ofcom believes are only viable for BT.

17. Area 3 includes large towns, some of them county towns such as Dorchester, Taunton and Lewes. These are not rural locations, nor are they non-competitive. Commercial providers are already building there without subsidy, or have clear and funded near-term plans to do so. This *proves* their commercial viability. BT needs no regulatory incentive to build here; it can do so on the same basis as any other operator.

(i) It should use its own modelling on commercial viability, validated by operator build plans

18. The only way to assess the commercial viability of fibre build (and therefore the boundaries of Areas 2 and 3) six years out is through modelling, as DCMS has done for its F20 programme. However, Ofcom rejected its previously proposed cluster analysis approach for assessing potential for material MSN deployment, as being too "speculative"[7]. Instead, it decided to base its analysis on operator build plans.

19. At one level this makes a lot of sense. Most altnets use financial models that look 6-10 years ahead to justify their investment case. Many are now funded by top-tier infrastructure funds, imposing a level of rigour that should make their forecasts more acceptable to Ofcom.

20. Nevertheless, we see significant value in using a neutral central regulator-created model to provide a nationwide picture of commercial viability, using transparent and consistent assumptions. This should then be validated against operator plans. While in many parts of the country the results will probably be similar given the limited number of variables involved, modelling is likely to highlight some areas which are viable and where fibre is likely to be deployed by 2026, but which simply haven't yet been targeted in operator plans.

(ii) It has underestimated the level of MSN deployment in Area 3

21. Ofcom focused its WFTMR1 analysis on the existing and forecast fibre network coverage plans of "MSN"s from 2018. It defined these as networks which cover business and residential customers, have wide geographic availability, and provide a wide range of services[8]. Ofcom said there were three MSNs: Virgin Media, City Fibre, and its new acquisition, Fibre Nation. On the basis of their plans, Ofcom identified 70% of premises where it expected at least one MSN to deploy by 2026.

22. However, Ofcom said it would update its analysis if other MSNs appeared before its final statement[9]. Swish and Jurassic fulfil all the criteria set by Ofcom for MSNs.

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[6] Of this 6.2m, it identified 5m premises for intervention under its 'outside in' programme.

[7] WFTMR 7.34

[8] Ibid 1.19

[9] Ibid 7.21 "*Other networks may start rolling out prior to our final statement (for example, Axione229). In addition, some networks that we have considered to be broadband only networks may be able to provide leased lines if demand arises.* ***If such developments were to occur, we would need to consider updating the MSNs included in our analysis for our statement.***"

3. They are backed with £500m of funds from Fern Trading Limited, an entity managed by Octopus Investments Limited which has c.£9bn funds under management.

4. They have a large potential fibre footprint (the whole of the South West in Jurassic's case; the whole of the UK in Swish's case).

5. They have board-approved plans to pass over 750,000 homes within these footprints by 2026, and extension plans to go even further. They have so far passed around 25,000 homes.

6. They supply businesses as well as consumers.

7. They offer multiple products including leased lines (i.e. high-speed, high-quality, point-to-point uncontended data connections, targeted at businesses).

23. It should be clear from this that neither Swish nor Jurassic are examples of "*networks that provide broadband only services ... with a targeted business case, for example to serve MDUs or to target rural areas, perhaps using public funding or support from the local community*"[10].

24. Ofcom must therefore follow through with its WFTMR1 commitment to update its MSN analysis on the basis of new operator information. Locations where Swish and Jurassic plan to deploy will, by definition, include at least one MSN by 2026. Ofcom must categorise these locations as Area 2.

(iii) It has underestimated the level of other operator deployment in Area 3

25. Ofcom assessed whether the fibre coverage of "broadband-only networks" would change the conditions of competition in any area from those anticipated under its MSN assessment.

26. It included B4RN, CallFlow, Community Fibre, Gigaclear, Hyperoptic, IFNL, ITS, ZZoomm and Toob in this analysis. It found that their coverage plans did not materially alter the results of its MSN-based analysis. This was for one of three reasons:

   a. they didn't cover enough of a postcode sector to make a difference to the expected level of competition (Hyperoptic's Multiple Dwelling Units); or

   b. were focused on areas which could only support one network and therefore didn't constrain prices (Gigaclear); or

   c. were at too early a stage (or too non-specific) to inform a view on whether their presence might alter competitive conditions (other providers).

27. As with its MSN analysis, Ofcom acknowledged that new entrants might arrive, and operator plans might develop. It said it would review this ahead of its statement.

28. If Ofcom does not consider Swish or Jurassic to be an MSN (which we will contest), it must include us as a new entrant broadband-only network in this updated analysis. This means it must compare our forecast locations to those of MSNs to determine whether we are likely

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[10] Ibid 7.14

to expand the geography of areas where non-BT commercial deployment is likely. Where this is the case, our presence is likely to alter competitive conditions, because:

   a. we typically cover the majority of premises in any postcode sector we pass;

   b. our business plans assume that most areas we operate in will support a rival; and

   c. our plans are fully formed and audited, and reviewed by independent experts in the sector to a level of confidence which has persuaded a large commercial organisation to invest into such plans.

29. More broadly, Ofcom recently issued a s135 information request to operators regarding their fibre rollout plans, with the aim of using responses to update its analysis of wholesale fixed telecoms markets before issuing a statement.

30. We are unclear whether Ofcom has included all operators in this request, or only a selected few, as it did in WFTMR1. Nevertheless, s135 responses should improve the depth of Ofcom's fibre dataset, and bring it up to date. Where these show credible plans to cover postcode sectors Ofcom previously thought could only be covered by BT, it must reclassify these as Area 2, in line with the process it set out in WFTMR1.

31. If Ofcom decides to discount any of these s135 responses as speculative or non-specific, and if it has omitted any operators from the request, it must clearly state the reasons why, and explain why it considers plans from MSNs or BT to be any more credible. BT in particular appears to have little cash available with which to fund its 20m fibre premises ambition, unless it can find an investment partner.

32. Ofcom has been careful not to say how it will assess the "materiality" of operator build plans, when categorising locations as Area 2 or 3. We think Ofcom should reflect on whether this definitional reticence is appropriate in a public consultation process, given the significance of this term in its geographic market assessment.

33. For example, Ofcom has offered no explanation of why it included build locations from "broadband-only providers", and even some from the likes of City Fibre, in Area 3. This lack of transparency makes it difficult to respond to this consultation with constructive suggestions on how Ofcom's proposals might be changed to improve consumer outcomes.

34. However, on any natural reading of the term, Swish and Jurassic's proposed c.650k Area 3 premises alone are clearly of sufficient scale to be described as "material". This figure represents more than 20% of BT's proposed Area 3 coverage. Add in the proposed coverage of other altnets, and the proportion - and materiality - must grow significantly.

35. There can also be no argument that materiality is affected by lack of contiguity in commercial deployments. Jurassic plans to cover almost the entire South West of England in one continuous footprint; its presence will provide material competition, and constrain BT prices across this entire area. Swish will have a substantial presence in the Home Counties. It will cover whole towns, and in many cases the villages surrounding those towns.

(b) Ofcom's proposals give regulatory support to the parts of Area 3 which need it least; 6m people on slow copper in Area 3 will fund full fibre for the lucky 3.2m.

36. Ofcom rightfully seeks to incentivise fibre build in harder-to-reach areas. However, by allowing BT to cherry-pick the 3.2m premises in its Area 3 commitment, it fails to achieve this. Instead, it guarantees regulatory support for the easiest third of Area 3 to reach, i.e. those most likely to attract interest from full-fibre providers. Ofcom should not focus its regulatory support here; it should aim to incentivise build in more rural and economically challenging areas.

37. In doing so, Ofcom is distorting the competitive market it has helped create in the last few years. It is giving the incumbent an unnecessary advantage of £1.0-1.7bn of capital that it otherwise would not have, with which to build in towns where competitors are already building or have plans to build. We do not believe that such assistance is needed, or should be given to BT alone, while other firms are confident of building in those areas without any such advantages.

38. Ofcom's approach means that *all* of BT's customers will end up paying for its investment in fibring up the 3.2m most commercially attractive premises in Area 3, through a price hike. This includes customers who live in competitive or potentially competitive areas. But, most significantly, it also includes those in the 6m Area 3 homes on slow copper broadband products which will not be upgraded.

39. In theory, Ofcom might seek to rely on BDUK initiatives, such as the 'F20', to reach these people. However, Ofcom has made no attempt to link its proposals, or BT's commitment, to BDUK's plans. It has not linked the areas where it believes build incentives are needed, with those where BDUK believes subsidy may be required. It has not sought to assess how likely BDUK tenders are to be awarded and build completed before 2026.

(c) Ofcom wrongly believes that BT has a lower cost base, and can therefore build more deeply than other operators into rural Area 3 without subsidy.

40. By defining an Area 3 location as one "where there is unlikely to be commercial deployment by rival networks *other than Openreach*", it appears that Ofcom assumes BT can build more cheaply in Area 3 than its competitors, and can therefore deploy in more rural areas than they can, without subsidy.

41. It is critical that Ofcom understands that the opposite is often true. Thanks to PIA regulations, commercial providers can now reduce costs by using BT's infrastructure. In fact in both rural and urban areas they can often build more cheaply than BT, because:

    a. They are more modern and efficient, and operate without the costly burden and complexity of managing old copper networks and legacy IT systems.

    b. They don't carry BT's vast central overheads or pensions overhang.

    c. There are very few economies of scale involved in digging up roads and laying fibre. Indeed, there are often advantages of being a smaller, more nimble organisation, able to deal directly with local contractors.

42. In addition, full-fibre providers are likely to generate at least as many new customers as BT wherever they build, as they are not tarnished with the brush of being a 'slow broadband provider'. BT's brand is of little value when it comes to selling fibre. Furthermore, they can

invest to generate incremental revenue and margin, unlike BT, which suffers from the 'incumbency trap' of needing to invest largely to protect its existing revenue.

43. Thus, for both cost and revenue reasons, altnets are generally likely to be able to go more deeply into Area 3 than BT on a commercial basis.

44. Indeed, this is why full fibre providers have been so active to date in Area 3. They can build more cheaply and expect *at least* as great a conversion rate from copper as BT could achieve. BT, by contrast, has focused on Area 2 markets, particularly those already covered by Virgin, where it can make a return on its higher deployment costs.

45. This highlights that Ofcom's methodology for defining geographic markets is fundamentally flawed. To determine whether competitive conditions are significantly different in a given location, Ofcom should assess whether or not deployment is economically viable for *any provider* - BT or otherwise. DCMS recognised this: it assessed whether markets are "*viable for at least one operator*"[11], with no distinction between whether this is BT or anyone else.

(d) Ofcom openly favours BT in Area 3, and thereby risks damaging full-fibre businesses and their investors who have been attracted to the current UK regulatory environment, and hence reducing their contribution to building a gigabit-capable nation.

46. Ofcom uses price regulation to incentivise BT, rather than other operators, to build in Area 3. It does not say why. We can see four possible reasons:

   a. It believes that only BT has the scale to build in more rural locations. This overlooks the fact that even BT acknowledges other operators' plans to build at least 18.7m premises[12]; almost as much as its own 20m target, but with a higher proportion in harder-to-reach areas.

   b. It believes that BT is a more viable long-term concern than altnets. This overlooks:

      i. the current high, and growing, levels of investment in other operators;

      ii. the history of the cable industry, which shows that consumers did not experience service loss where providers suffered financial difficulties. (Ofcom could seek powers to appoint a provider of last resort if it is concerned on this point); and

      iii. BT's own clear financial difficulties: its share price has collapsed 80% since 2016, it has cut its dividend, and it was recently driven to increase retail prices by 3.9% in real terms to address its huge pensions overhang and lack of ability to raise external capital. It is far from clear that it has the resources to complete its ambitions.

   c. It believes that BT can deploy more cheaply than altnets, and is therefore a better bet for rural coverage. As described above, this simply isn't true.

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[11] Future Telecoms Infrastructure Review p5

[12] Openreach presentation to Passives Working Group.

d. It feels that the tools at its disposal are limited to regulating the prices of the dominant provider. We largely agree with this, but remedies should be targeted at driving the dominant provider much deeper into a correctly defined Area 3, where other operators are unlikely to build.

47. Ofcom has a duty not to discriminate in favour of any operator. If it has based its strategy of favouring BT on any of the first four reasons above, this would represent clear discrimination in favour of BT, and Ofcom could be subject to legal challenge on this basis.

48. Why, for example, did Ofcom not consider the alternative proposal by Fern Trading to fund a commitment by Jurassic to cover the *entire* South West of England if Ofcom removed it from Area 3? This would have led to *far* greater coverage of this area than BT proposes under its commitment. Similarly, why did it not try to encourage the altnet sector as a whole to offer a commitment to build in Area 3, in return for incentives for BT *not* to build there?

(e) Ofcom's proposals prioritise overbuild instead of expanding the UK fibre footprint.

49. Ofcom is proposing to allow BT to charge slow-copper customers more, so it can use the money to lay fibre where other people are already deploying or planning to deploy.

50. For example, Jurassic recently built a full-service, gigabit-capable fibre network, passing c.20,000 residential and businesses properties in Exmouth. Yet Exmouth is also included within BT's 3.2m Area 3 commitment. Under Ofcom's proposals, BT will fund this overbuild from price increases imposed on customers stuck on low-speed copper elsewhere.

51. This approach effectively prioritises network overbuild and competition in what should be Area 2, over coverage in what should be Area 3. Some full-fibre providers will withdraw where they see one of their target areas included within BT's Area 3 commitment. Customers who live in these areas will see little difference as a result; commercial build will simply be replaced by customer-subsidised BT build. And some affected providers will probably decide to re-deploy their resources to Area 2. But, while this may increase competition in what should Area 2, it will come at the expense of expanding the fibre footprint in what should be Area 3.

52. We cannot reach 100% UK gigabit capability by 2025 under a regime, which (a) incentivises BT to overbuild full-fibre providers where they have already built in Area 3; and (b) forces other operators to scale back Area 3 plans where they have not yet built. This guarantees that rural areas will be left behind, and charged more for copper. It means BT will put competitors out of business by overbuilding them with cash raised as a result of Ofcom support.

(f) Why do we want to have our planned build locations in Area 2 and not Area 3? Because any overbuild from BT (or any other operator) is only like to come if there is a commercial logic for it.

53. At a fundamental level, we want our proposed commercial build locations classified as Area 2, because, by Ofcom's own definition, this is how they must be classified.

54. Furthermore, we don't want to operate in an area where we are exposed to regulatory decisions which distort the market in favour of BT, and increase the risk that we are overbuilt.

55. Ofcom believes that for 21.3m UK premises there is already some material commercial deployment by rival networks to BT, or that this could be economic by 2026. But what Ofcom doesn't comment on is how many of these premises it believes *BT* will build to.

56. This clearly won't be 100%. BT has a public ambition to build to 20m premises by "mid to late 2020s". Assuming it can fund and resource this ambition (which seems unlikely), some of its deployment will almost certainly be in Area 3, and some will come after 2026. Even if this were wrong, i.e. even if *all* of BT's rollout was in Area 2 and completed by 2026, this would still leave 1.3m Area 2 premises unpassed by BT, according to its own ambition.

57. This is a further reason we want to be in Area 2; it means we expand the UK fibre footprint in the less attractive of the commercially viable locations. This maximises our chance of recovering our investment before fair competition arrives.

58. If Swish and Jurassic's build proposals are included in Area 2, which by Ofcom's definition and consultation process they must be as they are MSNs, we estimate that Area 2 would expand by around 0.65m to 21.95m (as we believe we have little overlap with Virgin or City Fibre's plans). Other commercial operator plans are likely to increase the Area 2 boundary even further. With every increase, the chance of BT's 20m ambition resulting in over-building us in Area 2 decreases. This is because it is committed to deploying to 3.2m of its 20m premises in Area 3 in return for a better price control outcome[13].

59. If Ofcom accepts BT's commitment and allows it to increase prices to build in Area 3, BT will almost certainly fulfil its Area 3 commitment. Ofcom will then be proved right that no other operators will build there. But this will only be because the incumbent has been handed an unfair advantage that distorts the market in its favour, and forces commercial competition, that would otherwise have built there, to flee[14].

60. We suspect that Ofcom is well aware that at least 3m of the Area 3 homes are in fact commercially viable. It has included them in Area 3 for precisely the reason we state above. It knows this encourages BT to prioritise building the least commercially attractive premises of what should be Area 2, rather than leaving these till last.

61. To be clear, we do not object to overbuild; we expect to see it eventually almost everywhere we deploy, by BT or another operator. But Ofcom's proposals incentivise BT to build in Area 3 locations which it might otherwise have left until later, possibly until after 2026. This threat of artificially front-loaded overbuild reduces the attractiveness of these areas for

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[13] It is unclear how much of BT's 3.2m Area 3 commitment is in addition to, or part of its 20m ambition. However, we know that at least 0.5m premises come from the 20m, because they have already been built. We suspect that a significant proportion of the remainder is similarly non-incremental. The more of BT's Area 3 commitment that comes from its 20m, the more it involves a transfer of premises from Area 2 to Area 3. Provided our plans are included within Area 2, this reduces the likelihood that BT overbuilds us.

[14] We are already hearing stories of altnet negotiations with local authorities breaking down, because local authorities believe that BT will build there, having seen its published list of 1.6m premises.

companies like us, who are well funded, and would otherwise specifically target areas like this.

(g) There are simple alternatives approaches available which would expand the Area 3 fibre footprint further than the 3.2m under Ofcom's proposals

62. If Ofcom persists with its Area 3 definition, it should reclassify as Area 2 any location where any operator other than BT actually builds (whether or not BT has built there first). These areas will have been proven to be economically viable to providers other than BT. (BT could still build in these locations if it wishes, but on the same commercial basis as other providers).

63. It is unclear whether BT's commitment commits it to building in *specific* Area 3 towns and villages, or whether it has discretion to shift its build to other locations if a commercial provider gets there first. We think BT should have this limited discretion, but only where another operator has already built.

64. Ofcom could then ensure that BT does not over-recover from its price increase by either:

- removing locations from BT's 3.2m commitment if another operator gets there first, and adjust the price control for subsequent years accordingly; or

- require BT to use the funds to build deeper into Area 3. As these locations would be more expensive to reach, it would not be fair to expect BT to commit to a one-for-one replacement. Ofcom should seek a replacement formula based on the cost of BT's Area 3 deployment, rather than the number of homes it passes.

Conclusion

65. In our view, the proposed price control and wider Area 2 / Area 3 regulatory regime has many flaws. In an ideal world, it would be subject to root and branch reform, with Ofcom using its own modelling, supported by operator build plans, to determine which areas should properly be the subject of regulatory support, and what fibre shortfall occurs as a result – or indeed using the same modelling used by DCMS in its F20 programme.

66. However, we are aware that Ofcom is running out to time to implement a regulatory regime before the start of the market review period. We therefore recognise the need to work as closely as possible with its current proposals. On this basis, we suggest the following changes to its current proposed position:

a. Ofcom should acknowledge Swish and Jurassic as MSNs, and include their rollout plans (along with updated plans from Virgin and City Fibre) within Area 2.

b. As per its WFTMR1 commitment, Ofcom should include credible build plans submitted by broadband-only operators in response to its s135 requests, within Area 2.

c. Anywhere that an operator builds on a commercial basis should by definition be classified as Area 2, whether or not this forms part of BT's 3.2mn commitment. This

would incentivise operators to build in rural areas, safe in the knowledge that BT will not be penalised if they "fail" to overbuild them.

d. Where commercial operators build in what Ofcom currently calls Area 3, it should either adjust the price control each year to ensure that this does not allow BT to over-recover, or require BT to use the funds to build to more costly rural premises located deeper in Area 3, where other operators are unlikely to build.