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6<sup>th</sup> June 2019

Dear Sir/madam,

In January 2018, we made a submission to the Secretary of State in response to the FTIR. We suggested that the prevailing regulatory framework, with its lack of certainty, short duration and associated risks meant that the conditions were not suitable for wide scale roll out of FTTP in the UK. Since then, the change to a longer regulatory cycle is welcome, and there are a number of aspects within the Ofcom Consultation that we view as positive. Namely:

- (1) Regulation for inflation adjusted pricing on the 40/10 FTTC product and freedom from regulation at faster speeds is welcome as it provides a stable reference price against which FTTP products can be compared. A longer term commitment to this, beyond the five year review period would be a further positive step.
- (2) Allowing a switchover from copper to fibre on an exchange by exchange basis, lifting the regulation on copper will allow Openreach to incentivise transition onto the full fibre network in a timely manner. We welcome Ofcom's position that FTTP will be a superior service to FTTC and therefore should come at a moderately higher price. We agree that this should help incentivise investment in FTTP.
- (3) The fair bet principle is better protected with a longer regulatory cycle. We are also aware of the Ofcom presentation from July 2018 which showed the ability to earn a cumulative return of 12-14% on the FTTC investment. This clarity was welcome when looking ahead to the fair bet on FTTP.

#### **Geographic pricing**

We are concerned about the prohibition on geographic pricing. While we recognise that Ofcom is worried that Openreach could be incentivised to lower prices as new local networks enter the investment stage, we also understand that competition law would prohibit this anti-competitive behaviour.

Ofcom's starting premise that a region is potentially competitive should mean that the returns available from investment are suitable and sustainable at a reasonable penetration rate. As the return is made up by both revenue and cost, with the revenue being made up by both price and volume, Ofcom's prohibition on different geographic pricing presupposes that the cost of deploying FTTP is similar throughout these potentially competitive areas. Here we disagree.

If Openreach is forced to offer the same price for FTTP throughout the potentially competitive areas, there would be significant impacts on its incentives to invest. Where the cost to deploy FTTP is particularly low, competing networks, free to price how they see fit, would be able to undercut Openreach and therefore benefit from the higher penetration this would derive. Meanwhile, in those areas where deployment costs were high, BT would be forced to take lower returns, or risk no positive return at all. In both these scenarios the level of risk for shareholders increases substantially.

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There is also a risk that Virgin Media could adopt geographically different prices as it begins to face competition from differently priced networks. As an example, Hyperoptic is currently advertising £38 per month for a year of 900Mbps speeds, while Gigaclear costs £75 per month for the same service. These two providers have grown in two very distinct niches, Hyperoptic in blocks of flats where the cost to roll out FTTP is relatively low, while Gigaclear serves less dense areas requiring more investment. These businesses models could pick off customers in the arbitrage of a single national Openreach price.

Potentially competitive areas could be around 20m UK premises (70% of total) and yet City Fibre and Hyperoptic are targeting 5m by mid 2020s and TalkTalk is targeting just 3m premises in the same time frame. Targeting numbers that are significantly less than 20m reinforces the point that there are different business models which are likely to be fulfilled at rather different prices.

#### **RAB**

We are not opposed to the use of RAB based regulation for the areas of the country deemed to be non-competitive, but we think there needs to be a much clearer articulation of the details before we can fully understand the risks of this type of regime. This would include the risk around how Ofcom would set an appropriate return and how this might change with the assessment of the Openreach cost of capital over time.

RAB based regulation used in utilities such as water, power transmission and airports offer protection for customers against monopolies at the same time conferring upon the operator and its shareholders appropriate returns for the risks undertaken in investing in the infrastructure. Unlike these utilities, we are concerned that there may be some ambiguity when defining areas that qualify as non-competitive. This is made even more ambiguous by the proposals to force Openreach to provide network access to dark fibre.

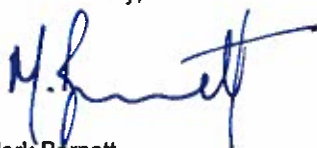
We are concerned that while defining an area as non-competitive, but then forcing Openreach to give dark fibre access to its competitors, could lead to alternative networks picking off potentially competitive locations within non-competitive areas. In regulated monopolies, consumers and customers have no choice but to use the water supplies, the transmission network or the monopoly airport. But Openreach's customers could choose options other than full fibre, including 5G which is served by back haul delivered through dark fibre access, or simply sitting on the copper network.

The USO considers fixed wireless access to be appropriate for some areas of the UK and therefore access to dark fibre could potentially make it more likely that competitive networks deploy this technology to compete with Openreach.

We find the logic of paragraph 3.36 to be rather difficult to follow. It begins by suggesting the primary concern of regulating dark fibre access is that it could weaken incentives for rivals to invest in networks. But then says that there is limited potential for investment as these areas have been defined as non-competitive. By opening up dark fibre to competing networks, Ofcom is at risk of undermining non-competitive nature of the area and the RAB regime designed for it.

In summary, we welcome the various elements in the consultation which we see as supportive of investment in FTTP. But we have concerns that the prohibition of geographic pricing could disincentivise Openreach to invest in competitive areas, while dark fibre access could allow Openreach to be picked off by niche operators in non-competitive areas. We would also welcome more clarity on the RAB regime.

Yours faithfully,



Mark Barnett  
Head of UK Equities

## Your response

Question	Your response
<p>Question 2.1: Do you agree with our overall approach to regulation in potentially competitive areas?</p>	<p>In January 2018, we made a submission to the Secretary of State in response to the FTIR. We suggested that the prevailing regulatory framework, with its lack of certainty, short duration and associated risks meant that the conditions were not suitable for wide scale roll out of FTTP in the UK. Since then, the change to a longer regulatory cycle is welcome, and there are a number of aspects within the Ofcom Consultation that we view as positive. Namely:</p> <p>(1) Regulation for inflation adjusted pricing on the 40/10 FTTC product and freedom from regulation at faster speeds is welcome as it provides a stable reference price against which FTTP products can be compared. A longer term commitment to this, beyond the five year review period would be a further positive step.</p> <p>(2) Allowing a switchover from copper to fibre on an exchange by exchange basis, lifting the regulation on copper will allow Openreach to incentivise transition onto the full fibre network in a timely manner. We welcome Ofcom's position that FTTP will be a superior service to FTTC and therefore should come at a moderately higher price. We agree that this should help incentivise investment in FTTP.</p> <p>(3) The fair bet principle is better protected with a longer regulatory cycle. We are also aware of the Ofcom presentation from July 2018 which showed the ability to earn a cumulative return of 12-14% on the FTTC investment. This clarity was welcome when looking ahead to the fair bet on FTTP.</p>
<p>Question 2.2: What is your view of our access and charge control proposals for wholesale local access services in potentially competitive areas?</p>	<p>We are concerned about the prohibition on geographic pricing. While we recognise that Ofcom is worried that Openreach could be incentivised to lower prices as new local networks enter the investment stage, we also understand that competition law would prohibit this anti-competitive behaviour.</p> <p>Ofcom's starting premise that a region is potentially competitive should mean that the returns available from investment are suitable</p>

and sustainable at a reasonable penetration rate. As the return is made up by both revenue and cost, with the revenue being made up by both price and volume, Ofcom's prohibition on different geographic pricing presupposes that the cost of deploying FTTP is similar throughout these potentially competitive areas. Here we disagree.

If Openreach is forced to offer the same price for FTTP throughout the potentially competitive areas, there would be significant impacts on its incentives to invest. Where the cost to deploy FTTP is particularly low, competing networks, free to price how they see fit, would be able to undercut Openreach and therefore benefit from the higher penetration this would derive. Meanwhile, in those areas where deployment costs were high, BT would be forced to take lower returns, or risk no positive return at all. In both these scenarios the level of risk for shareholders increases substantially.

There is also a risk that Virgin Media could adopt geographically different prices as it begins to face competition from differently priced networks. As an example, Hyperoptic are currently advertising £38 per month for a year of 900Mbps speeds, while Gigaclear costs £75 per month for the same service. These two providers have grown in two very distinct niches, Hyperoptic in blocks of flats where the cost to roll out FTTP is relatively low, while Gigaclear serves less dense areas requiring more investment. These businesses models could pick off customers in the arbitrage of a single national Openreach price.

Potentially competitive areas could be around 20m UK premises (70% of total) and yet City Fibre and Hyperoptic are targeting 5m by mid 2020s and TalkTalk is targeting just 3m premises in the same time frame. Targeting numbers that are significantly less than 20m reinforces the point that there are different business models which are likely to be fulfilled at rather different prices.

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

Confidential? – Y / N

<p>Question 3.1: Do you agree with our overall proposed approach to regulation in non-competitive areas?</p>	<p>We have written on two issues below: clarification on the details of the RAB regime and regulation of dark fibre.</p>
<p>Question 3.2: Do you agree that a RAB charge control framework is appropriate for non-competitive areas? If not, please explain why you think an alternative is more appropriate.</p>	<p>We are not opposed to the use of RAB based regulation for the areas of the country deemed to be non-competitive, but we think there needs to be a much clearer articulation of the details before we can fully understand the risks of this type of regime. This would include the risk around how Ofcom would set an appropriate return and how this might change with the assessment of the Openreach cost of capital over time.</p> <p>RAB based regulation used in utilities such as water, power transmission and airports offer protection for customers against monopolies at the same time conferring upon the operator and its shareholders appropriate returns for the risks undertaken in investing in the infrastructure. Unlike these utilities, we are concerned that there may be some ambiguity when defining areas that qualify as non-competitive. This is made even more ambiguous by the proposals to force Openreach to provide network access to dark fibre.</p>
<p>Question 3.3: Do you have any comments on the design of a RAB charge control for non-competitive areas?</p>	<p>No.</p>
<p>Question 3.4: Do you agree with our proposal to introduce dark fibre in non-competitive areas?</p>	<p>We are concerned that while defining an area as non-competitive, but then forcing Openreach to give dark fibre access to its competitors, could lead to alternative networks picking off potentially competitive locations within non-competitive areas. In regulated monopolies, consumers and customers have no choice but to use the water supplies, the transmission network or the monopoly airport. But Openreach's customers could choose options other than full fibre, including 5G which is served by back haul delivered through dark fibre access, or simply sitting on the copper network.</p> <p>The USO considers fixed wireless access to be appropriate for some areas of the UK and therefore access to dark fibre could potentially make it more likely that competitive networks</p>

	<p>deploy this technology to compete with Openreach.</p> <p>We find the logic of paragraph 3.36 to be rather difficult to follow. It begins by suggesting the primary concern of regulating dark fibre access is that it could weaken incentives for rivals to invest in networks. But then says that there is limited potential for investment as these areas have been defined as non-competitive. By opening up dark fibre to competing networks, Ofcom is at risk of undermining non-competitive nature of the area and the RAB regime designed for it.</p>
<p>Question 4.1: Do you agree with our proposed overall approach to QoS?</p>	<p>Confidential? – Y / N</p>
<p>Question 5.1: Do you agree with our overall approach to transitioning regulation as BT deploys its new fibre network?</p>	<p>Confidential? – Y / N</p>
<p>Question 5.2: Do you agree with our proposal not to require BT to offer new forms of wholesale access to its copper network?</p>	<p>Confidential? – Y / N</p>

Please complete this form in full and return to [approachtoremedies@ofcom.org.uk](mailto:approachtoremedies@ofcom.org.uk) or:

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