Wholesale Fixed Telecoms Market Review 2021-26

Further consultation on certain proposed remedies

Virgin Media response

January 2021

Non-confidential Response

SUMMARY

Virgin Media welcomes the opportunity to comment further on the Wholesale Fixed Telecoms Market Review ('**WFTMR**'), through this latest consultation[1] ('**the consultation**').

We continue to support Ofcom's overarching WFTMR objectives. In response to this consultation, we support Ofcom's proposals on: SOGEA pricing refinements, pragmatic revisions to DFA implementation timelines and PIA basis of charge clarifications. We have no material comments on proposed DFA pricing changes.

However, we do not agree with Ofcom's proposed changes to PIA rental pricing.

We acknowledge PIA rental pricing is a complex issue with long-term implications and numerous second-order effects and it is a topic where Ofcom needs to apply its regulatory judgement. There is the potential for long-lasting impacts to stakeholders if prices are set too high or too low. Openreach could enjoy excessive returns and PIA-based network rollout might be dampened. Equally, PIA CPs could underpay for infrastructure access, to the detriment of Openreach. These potential impacts are difficult to predict given use of PIA remains relatively modest, albeit accelerating.

Equally, longer-term price trends, whether increasing or decreasing, could also create or reinforce inefficient outcomes across stakeholders if they are set incorrectly. Openreach's incentives to create capacity after its network rollout could be dampened, or conversely, PIA CPs may not be incentivised to make efficient use of capacity that currently exists.

In our view, changes to the level and evolution of PIA rental prices should be fully considered and debated by industry stakeholders. More time should be taken, and evidence adduced, before material changes are introduced. Ofcom should revert to its previous proposals in January 2020 and engage all stakeholders throughout 2021-26 to consider what, if any, changes need to be made to PIA rental pricing methodologies for future reviews.

In our view, Ofcom's proposals will disincentivise the use of PIA. The proposed last-minute changes to PIA prices create price volatility, undermine long-term regulatory certainty and clash with Ofcom's broader policy objectives under the WFTMR. Fundamentally, the consequences of what Ofcom is proposing will have a detrimental effect on both Government's and Ofcom's aspirations for more

[1] https://www.ofcom.org.uk/__data/assets/pdf_file/0023/206960/wftmr-further-consultation-proposed-remedies.pdf

extensive and faster infrastructure deployment. In this consultation Ofcom notes it has aimed to alleviate these specific concerns. In our response we provide some brief comments on why we do not think Ofcom's proposals achieve this, and why we think this topic requires a fuller opportunity for stakeholders to consider these issues further.

1. PIA PRICING

In this section we provide brief comments on Ofcom's PIA rental pricing proposals. In addition, we comment on two related topics that have arisen as part of our review of pricing methodologies prompted by this consultation.

PIA rental proposals

We support Ofcom's aims for price stability, longer term certainty and simplification. In our view Ofcom's proposals do not achieve these aims. PIA price control remedies are a key factor in the viability of PIA as a remedy and we believe more time and evidence is required to fully consider the framework for pricing PIA.

Therefore, we do not believe the proposed changes should be made and, for now, Ofcom's previous proposals set out in January 2020 should be implemented instead.

We recognise this is a complex issue that has potential long-term implications for Openreach's efficient cost recovery as well as shorter-term decisions on whether potential new entrants' business cases will be approved. We think proceeding with the changes proposed in the consultation would introduce price-volatility and risks creating additional uncertainty that could undermine PIA. In short, we do not think these proposals are helpful for existing PIA users, prospective PIA users or ultimately Openreach.

Ofcom's proposals reduce our prospective use of PIA for rollout further from our existing network

Ofcom's proposals introduce short-term price volatility. In the case of 3+ bore Ofcom's proposals increase prices by c.30% by 2026 when compared to PIA CP expectations derived from Ofcom's January 2020 proposals.

Based on our analysis, this would have a material impact on the cost of our potential trunk build. This is a key factor in assessing the viability of expanding our network reach. Were these changes to be implemented, it would have the potential to make prospective deployment to Area 2 and Area 3 locations unviable and therefore constrain our ability to deploy further from our existing footprint than under Ofcom's previous proposals.

Ofcom's proposals may lead to specific planned build locations not being approved as the commercial case no longer makes sense, however Ofcom's proposals also create uncertainty for longer-term considerations of deployment via PIA.

The consultation notes these changes to PIA pricing are intended to avoid the potential risk of a step-change in prices in the future. However, Ofcom does not give any corresponding indication that this change is a one-off recalibration that is expected to result in long-term price stability and certainty, i.e., that stakeholders should expect a CPI-0% or CPI-CPI control to be in place over subsequent reviews as a result of these proposals.

To the contrary, Ofcom does not indicate it is proposing a one-off methodology change after which stakeholders should expect pricing to be broadly consistent in real or nominal terms, instead, it emphasises it was not its intention that stakeholders should expect prices to fall in the future.[2] Furthermore, Ofcom's reference to level playing fields and references to PIA CPs' revenue generating ability further muddy the waters for what may happen to PIA rental prices in future reviews.

This new uncertainty complicates longer-term decision making on our use of PIA, as we need to account for the potential that PIA prices will rise (potentially materially and consistently) above inflation throughout future decades, when deciding whether to build new infrastructure or use PIA for our network expansion.

Below we provide some further specific comments on why we believe the current methodology is not a strong foundation for setting PIA prices in the long-term and therefore why we believe Ofcom should revert to its previous proposals for this charge control period to permit a period of industry engagement to find a longer-term sustainable solution. We also highlight a peculiarity in the structure of PIA pricing: the lack of some form of inflation adjustment in the Network Adjustment fund.

There is a disconnect between the basis of cost recovery and the license of permitted occupancy

Ofcom's proposals are to adjust and simplify the assumptions used on the share of use and share of cost associated with various duct bore counts. These adjustments overlook an underlying

[2] For example, para 3.14 and 3.15. In both cases Ofcom is clear its intent was not for price reductions to be anticipated in the future, but the same symmetric reassurance on avoiding price rises is not provided.

inconsistency between the share of cost recovered through PIA prices and the space granted under a PIA licence. Ofcom's proposals make this disconnect even more apparent and so it is difficult to conclude this methodology will endure in the long-term.

Under the terms of the product, PIA CPs are permitted to deploy network in duct using up to 25mm diameter of spine duct space per licence. Regardless of the bore count, the space allowed is far lower than the proportion of costs a CP is paying Openreach to recover.

Below we illustrate the space used by a PIA CP, both if it were to make use of the full 25mm space allowance as well as where smaller, more efficient usage is considered.

Figure 1: Illustration of maximum licensed space vs cost recovery contribution

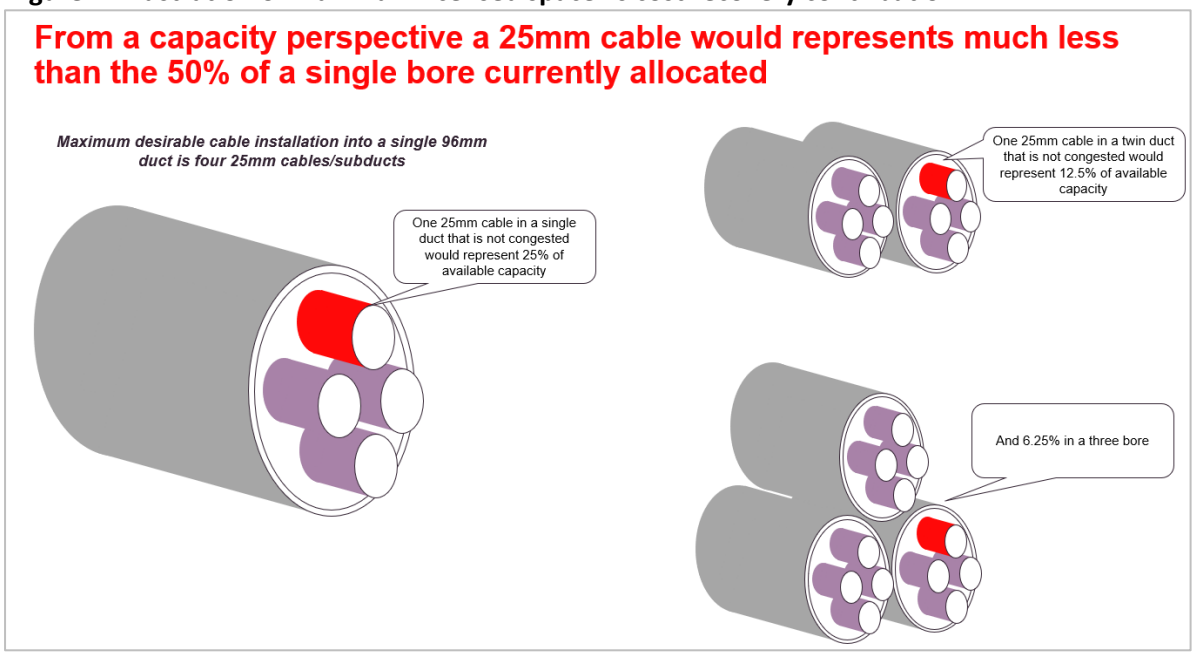
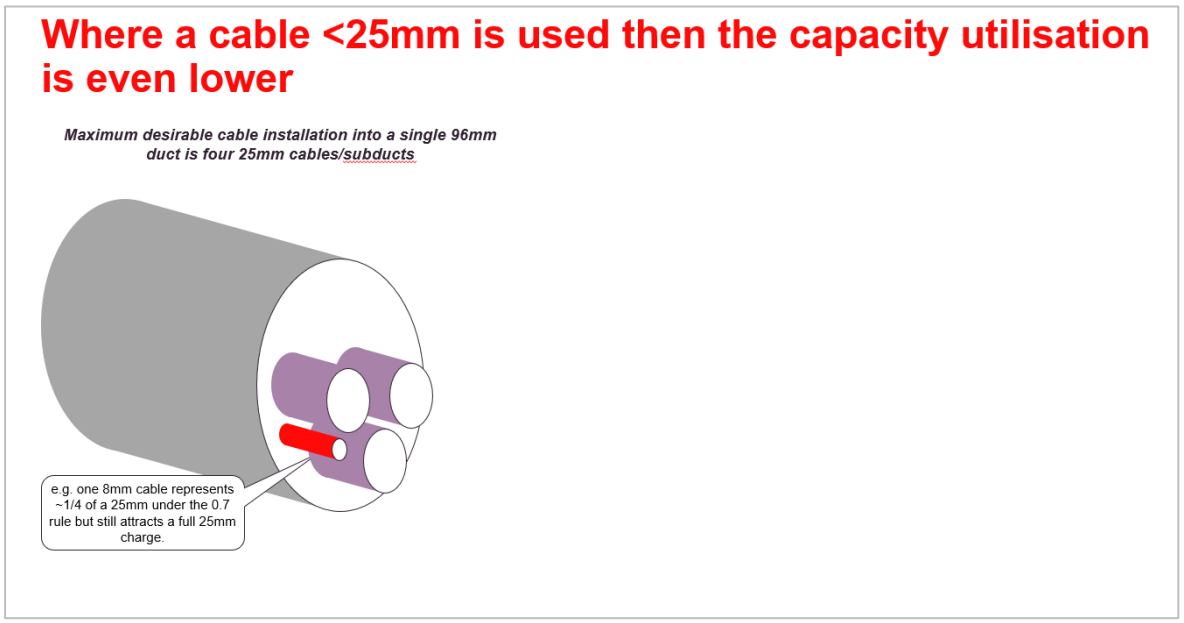


Figure 2: Illustration of common PIA CP utilisation vs cost recovery contribution



In our view this disconnect between utilisation and contribution to cost recovery is not sustainable long-term. We also do not think severing the link between utilisation and pricing entirely is the right solution as it does not incentivise efficiency and it further undermines cost causality as the basis of charges.

Ofcom's rationale does not reflect the likely evolution of PIA usage or market dynamics

Ofcom justifies its approach to cost attribution, in part, by reference to assumed market shares that PIA CPs might compete for using the archetype of a 100% PIA MSN CP.

Although we recognise Ofcom is seeking to implement a simplified approach and needs to place significant weight on its regulatory judgement for reasons noted, we do not think this reflects current or likely future usage of PIA, based on the approach adopted by current material users of PIA:

- **Virgin Media:** given our existing network footprint, we anticipate our use of PIA will lead to a hybrid deployment approach across most use cases i.e., our network deployment would be delivered through a mixture of PIA and continued new infrastructure investment. While the relative mix of these approaches might vary by location and over time, it would not be reasonable to expect that our use of a given segment of, say, a 2-bore duct would enable us to compete for 50% of customers served by that duct route. In many cases we would use PIA

for 'in-fill' i.e. serving a subset of premises that were uneconomic to deploy to during historical cable rollout or to homes built after cable networks were originally deployed. Our coverage may already be substantial in an area we decide to deploy using PIA. It would seem unreasonable to determine the basis of charges for PIA on the assumption we would now compete for 50% of homes, if in reality our PIA deployment increased Virgin Media's serviceable homes in the area by, say, 5%.

- **Business PIA CPs:** some PIA CPs are likely to deploy network for the sole purpose of providing business connectivity, or mobile backhaul. While this may raise complexities for Openreach cost recovery and how to price the product, we do not believe an assumption that 50% of premises are now subjective to competitive pressures is logical. This issue is compounded when a specialised business connectivity PIA CP and a mass-market FTTP PIA CP build in the same location. Both would have been assumed to compete for 50% of the market and each contribute to Openreach's costs accordingly under Ofcom's pricing approach.
- **Targeted PIA CP business strategies:** CPs such as Hyperoptic may disproportionately target certain segments of the market (e.g. MDUs, social housing or business parks). Again, there is little justification for assuming that use of a particular duct segment would indicate largescale competition for the premises served and therefore a greater perceived risk to Openreach's cost recovery.
- **PIA CPs that only deploy underground:** Based on our understanding from industry discussions, some PIA CPs may only operate using underground assets and avoid aerial network deployments. Given PIA Openreach's network is a mixture of overhead and underground it would be unlikely an underground-only CP deploying in a given area could target 50% of serviceable homes if overhead deployment is ruled out.

In effect, Ofcom's methodology is predicated on the expectation that all PIA CPs are effectively smaller, carbon copies of Openreach. In our view this assumption is not consistent with CPs' use of PIA today and it overstates the potential threat to Openreach's cost recovery through network competition and at the same time makes it likely costs will be over-recovered.

Declining PIA prices during this and subsequent reviews is pro-competitive, particularly as it is immaterial to Openreach's cost recovery

Ofcom explains the rationale for breaking the current link between prices and utilisation is to avoid short-term and longer-term price instability. Openreach is building out its gigabit-capable network at

scale and at pace and as a result its overall space utilisation within its duct network is growing relative to PIA CPs deploying in its network. As a result, the relative size of PIA CPs occupancy rate is declining. It is probable that this trend will continue across subsequent market reviews as Openreach's buildout progresses throughout the 2020s.

In its regular shareholder update communications Openreach frequently notes that it considers it has a scale, speed and cost advantage over competing network builders. It is also clear that the success or failure of network investment business cases being planned or acted on now will determine whether Ofcom's objectives for PIA (and competition in the market more broadly) are met. Given these factors, and the relative immateriality of PIA to Openreach's ability to recover efficient costs, it is not clear to us this change is necessary. Even if this change were necessary, it is not clear they are needed now or even in the next market review.

To the contrary, a reduction in PIA unit prices over this period, which only arise as a result of Openreach making more progress on network build than its competitors, seems to be logical and potentially beneficial to the long-term viability of competitors entering the market today. Spurring investment during this period (rather than dampening it, which Ofcom's proposals would be expected to do at the margin) would appear to be a helpful counterbalance.

Maintaining a link to actual utilisation provides an incentive for copper recovery. Severing this link removes this incentive to free up capacity

Ofcom explains that a benefit of its proposed approach is to avoid future potential price instability in the event that Openreach recovers copper assets once it completes its legacy network switchover. Copper recovery would increase the relative proportion of occupancy by Openreach's and PIA CPs' gigabit capable networks and this would flow through to PIA pricing.

A number of factors will feed into the timing and extent of any copper recovery programme Openreach might undertake. The prevailing price of copper for resale, Openreach's own need to utilise the space it would create and the risk of network damage or interruption of service that could result[3] will all be relevant factors. However, given the timeframes involved in copper switch-off and the timeframes involved in Openreach's recent consultation on local exchange closures, it is clear that any material copper recovery programme, if it were to occur, is likely a decade or more away.

[3] Given Openreach's and PIA CPs' network will invariably lie on top of any legacy network, we anticipate this would be a material consideration in all circumstances.

Given the sequencing involved, Openreach would look to undertake this work after its network rollout is substantially complete in a given area and given the timeframes involved in customer migration this may occur only after material (perhaps even the large majority) of PIA CP network rollout has taken place.[4]

As a result, it is not clear to us how extensive any copper recovery programme might be. If demand for capacity is relatively low, the risks and liabilities associated with disrupting networks are high then the cost-benefit analysis of leaving legacy assets in situ may not justify a major programme of recovery. In other words, the potential PIA price increases that Openreach presented to Ofcom may not materialise. Even if a recovery programme is undertaken it may be of modest scale compared with what is theoretically possible. In these cases, PIA CPs will have paid a materially higher price during this market review to avoid higher prices in future reviews that were only theoretical.

If a scale copper recovery were to be considered, in our view, the potential pricing impact on PIA would act as an incentive for Openreach to undertake this work. While it would not benefit builders today, this would provide more duct capacity for new entrants in the future, or easier maintenance or expansion for current PIA CPs. Ofcom's proposals would remove this potential incentive for Openreach and so makes that hypothesised cost-benefit analysis less likely to stack up, as Openreach will have benefited from the price increase today without even removing a single cable.

Therefore, given the substantial uncertainties inherent in making a decision at this stage, we believe it would be pragmatic to maintain the January 2020 proposals as previously stated and to consider reform of PIA pricing at a future market review, where PIA usage is more mature and greater clarity on potential copper recovery programmes are understood.

Other specific pricing consideration

How are micro-duct, direct-buried or other routes inaccessible to PIA CPs accounted for?

We would welcome clarification from Ofcom on the regulatory accounting approach to infrastructure assets that do not enable PIA CP usage. From WFTMR consultation documentation we

[4] Therefore, for example, Openreach may receive comparatively fewer requests for Network Adjustments, such as for removal of redundant cables, to create capacity for new network build.

have reviewed, it is not clear to us whether direct-buried and other civils techniques are included or excluded from the cost base in Ofcom's PIA price modelling.

Are these assets included in 'single bore' asset groups and therefore PIA CPs are contributing to the cost recovery of assets they have no practical ability to access, or are these assets and corresponding homes served excluded from Ofcom's analysis?

Network Adjustment fund indexation

Since the relaunch of PIA, the Network Adjustment fund has been set at £4,750/km of spine and this has been held flat in nominal terms. In the WFTMR Ofcom continues to maintain this funding cap flat at £4,750.

Given Openreach's various ancillary charges have some form of indexation and CPs' own unit costs (in the event they self-provide network adjustments) will have grown[5] between 2018-2026, we believe there is merit in indexing the Network Adjustment fund so that its value does not erode during this charge control period.

[5] These are likely to have tracked general wage inflation, given network adjustment costs are substantially labour costs.

2. CONSULTATION QUESTION RESPONSES

Question 3.1: Do you agree with our revised proposals relating to calculating the shares of unit costs to be reflected in PIA rental charges? Please set out your reasons and supporting evidence for your response.

We do not agree with these proposed changes. Ofcom should revert to its previous proposals and plan to engage ahead of the next market review once more information is available on the use of PIA, the impact on Openreach is better understood and its plans for augmenting infrastructure capacity through copper recovery programmes are more advanced.

Question 4.1: Do you agree with our revised proposals relating to dark fibre pricing? Please set out your reasons and supporting evidence for your response.

We do not have any material comments on these proposals at this time.

Question 5.1: Do you agree with our revised proposals relating to DFA implementation? Please set out your reasons and supporting evidence for your response.

Yes, we agree a longer and phased implementation for DFA is appropriate. We agree that a one-month implementation period is likely to be insufficient and could risk Openreach designing and implementing key aspects of the product in isolation and without feedback from prospective customers.

Perversely, a short implementation period may have raised the risk that Openreach presented its approach as a fait accompli, with its hands tied by an imminent deadline to maintain compliance. In our view Ofcom's new proposals allow time for stakeholders to review and discuss Openreach's approach and, where necessary, consider alternative approaches that may make the remedy more effective.

We also agree that a phased soft-/-full launch approach is sensible. This approach would avoid unnecessary delays to product launch, ensure stakeholders are focused on core product details during the initial period and enable all parties to consider suitable approaches to 'non-essential' features once the foundations of the product have been set out.

Overall, while Ofcom's proposed approach continues to set ambitious implementation timeframes, we believe it strikes a pragmatic balance for all stakeholders.

Question 6.1: Do you agree with our proposal that the maximum charge for the SOGEA 40/10 service should be equal equivalent to the maximum MPF charge plus the maximum VULA 40/10 charge? Please set out your reasons and supporting evidence for your response.

We continue to support Ofcom's proposal to define an anchor product for the purpose of its remedies and to identify 40/10 services as the appropriate anchor product.

Ofcom's proposal, to explicitly link the SOGEA-based FTTC price cap to the equivalent MPF + VULA charges, is appropriate and will provide more certainty to SOGEA customers and more clarity to Openreach.

Question 7.1: Do you agree with our proposed interpretation of the basis of charges obligations for PIA ancillaries related to network adjustments and other PIA ancillaries and contractor ECCs?

Ofcom proposes to interpret the basis of charges obligation for PIA ancillary services (whether related to network adjustments or directly chargeable to the CP) as being cost oriented and consistent with FAC. Ofcom proposes to maintain a similar approach to contractor ECCs; with direct external charges paid by BT being marked up for common costs as well as direct internal incremental costs, such as costs associated with wayleaves.[6]

We support these proposals and agree that this approach is more appropriate than considering DLRIC and DSAC.

Question 7.2: Do you agree with our proposed changes to the legal conditions related to PIA ancillaries related to network adjustments and other PIA ancillaries?

Yes.

[6] In Annex 1 we discuss wayleaves further, in particular, the appropriateness of Openreach charging for access to this information as an ancillary service, given we would expect costs associated with recording and organising wayleaves is already captured in relevant regulatory charges.

Question 7.3: Do you agree with our proposal to require BT to provide us with cost information on i) PIA ancillaries related to network adjustments and other PIA ancillaries and ii) contractor ECCs as part of its regulatory reporting requirements?

Yes.

ANNEX 1: PIA LEGAL INSTRUMENTS CLARIFICATIONS

Below we set out two points of clarification related to the current and future interpretation of the scope of the Legal Instruments associated with PIA.

In particular, whether various information that may be held by Openreach for the purpose of maintaining and expanding its network, ought to be considered in scope of the definition of "PIA Database Access" and if it should be made available in a readily accessible format, without charge.

Post-2017 wayleaves

Under the Electronic Communications Code, wayleaves agreed after December 2017 provide the automatic right for operators to share of upgrade apparatus. As a result, a wayleave agreed by BT after this date would enable a PIA CP to utilise this agreement avoid a duplicative administration (provided any other necessary access rights beyond the wayleave are secured with the landowner).[7]

Openreach currently provides a chargeable (per hour and uncapped) ancillary service on request to confirm whether it holds a post-2017 wayleave for a given property. This process is not suitable for scale use and comparing the applicable charge to the typical CPP of deploying network, it is clearly cost prohibitive to use.

Given this information is already collated and readily available, we believe this information should be provided by Openreach as core information in scope of the "PIA Database Access". Whether or not a piece of infrastructure is subject to a pre-existing ability to share is an important piece of information to a PIA CP when considering deploying network in that infrastructure, in the same way that the estimated spare capacity is a relevant factor.

We would welcome clarification by Ofcom on whether Openreach should incorporate post-2017 wayleave status into the information it provides PIA CPs by default (i.e. as a frequently updated flatfile or directly applied to PIA mapping data in some form) and without cost, to enable effective sharing of these agreement rights.

Geographically disaggregated duct blockage propensity data

[7] Openreach WFTMR consultation response, https://www.ofcom.org.uk/__data/assets/pdf_file/0025/199213/Openreach.pdf, para 6.148.

[✂]

Figure 3: [✂]

[✂]

The usefulness of blockage propensity data is a function of its geographic specificity. Currently, PIA CPs are aware that **[✂]** blockages per km of duct length is the rule of thumb for Openreach's network nationwide. Clearly this national average has limited practical application in all but the highest level of analysis of network rollout planning. Conversely, highly granular data on the likelihood of encountering a blockage could provide benefits to both forecasting and planning.

We have a helpful parallel within the PIA today. Openreach presents approximate duct capacity information in the form of an estimated RAG status for each duct segment based on various information such as its existing cable records and PIA CP usage. **[✂]**

[✂]. Therefore, although it appears this specific information is not available, we would welcome clarity from Ofcom on whether Openreach should be required to collate and provide ready access to information comparable to this scenario, which Openreach may generate as part of its use of its infrastructure, during the course of its gigabit-capable network rollout. **[✂]**.