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Gigaclear Response to Ofcom Consultation: Promoting competition and investment in fibre networks – Pricing wholesale local access services in Geographic Area 3 with a BT Commitment to deploy a fibre network.

Introduction

Gigaclear welcomes Ofcom's proposed adoption of the forecast RAB mechanism.

As the UK's largest exclusively rural fibre to the premises (FTTP) network operator, our business model focuses on delivering full fibre connectivity to geographic areas that are unlikely to sustain multiple 'Very High Capacity Networks' (VHCN). We then take a keen interest in both the designation and regulation of Area 3, as it encapsulates the geographic market segment that we seek to invest in.

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Gigaclear has recently secured access to £525 million debt financing to fund expanding that footprint to over 500,000 premises within the timeframe of this market review.¹ The vast majority of this network investment (current and planned) falls within Ofcom's current assessment of Area 3, which Ofcom defines as 'where there is unlikely to be material commercial deployment by rival networks to Openreach' and within which Ofcom's stated intention was to 'encourage [the] BT investment case over that of alternative operators'.

In our previous WFTMR submission, we then argued that Gigaclear's current network footprint evidences 'material commercial deployment' and so propose that Area 3 should not then capture the current Gigaclear network footprint where appropriate postcode sector 'scale' was evidenced.

We also proposed that restrictions should be placed on where BT Openreach can allocate Area 3 build costs under a forecast model, in order to prohibit BT Openreach from allocating Area 3 build where pre-existing state aid contracts are operational and where non-incumbent network operators are likely to deliver commercial build in Area 3. We also stressed that through compelling BT Openreach to declare where it intends to deliver its rollout commitment under a forecast model, the data gathered can be shared with BDUK and used to inform where state aid is allocated, thereby mitigating the risk of state aid crowding out commercial investment. It could also be used to inform future commercial investment of other operators, if made public through the operation of the EECC transparency mechanism. We look forward to Ofcom addressing these proposals in its WFTMR draft decision.

¹ <https://www.ispreview.co.uk/index.php/2020/04/rural-isp-gigaclear-signs-525m-long-term-funding-strategy.html>

In making these arguments, we proposed that if the 'variable k'² RAB model is applied to what Ofcom currently defines as Area 3 (so includes the Gigaclear network footprint), it will deter, rather encourage investment in VHCNs in the parts of Area 3 that BT elects to not deliver full fibre, through reducing the wholesale cost of a substitutional product in these areas (that being copper based, superfast connectivity). The remedy would then risk being in contravention of Article 74 of the EECC.

In developing the forecast model in light of BT's commitment, we then welcome Ofcom's ambition to align Area 3 pricing regulation with that proposed for Area 2. This goes some way to addressing the danger of alt-net full fibre investment in Area 3 being deterred through a lower cost substitutional product. However, further consideration should be given to how this danger can be avoided should BT fail to deliver its forecast build plan and Ofcom amend future pricing regulation to address this.

We also welcome Ofcom's consideration of expanding the prohibition on geographic price discounting to apply to full fibre in Area 3, although encourage Ofcom to provide more information on how the consent mechanism would function, as well as to ensure that networks that may be detrimented by the proposed discount can be notified of such a request.

Background

Based in rural Oxfordshire, Gigaclear was established in 2012 to address demand from rural homes and businesses for access to fast, reliable internet connectivity. These issues originated from the very long lengths of copper cable being used to deliver broadband in rural areas and other network operators prioritising network investment in cities and towns with higher population densities.

This environment created the opportunity to use new FTTP network technology, where distance has effectively no impact on performance, to deliver a multi-gigabit capable, future proofed service. Whilst our initial network builds were purely commercial, Gigaclear subsequently secured and delivered BDUK contracts in Essex, Berkshire and Gloucestershire; the first wholly full-fibre contracts secured under the BDUK programme.

Gigaclear currently operates 15 BDUK contracts delivering full fibre connectivity across the South of England. The most of any operator after BT Openreach.

Question 3.1: Do you agree with our approach to assessing the BT Commitment and proposals for pricing WLA services in Geographic Area 3?

Gigaclear supports Ofcom's general preference for a 'forecast' approach, as well Ofcom's ambition to align the pricing regulation of Area 3 with that of Area 2.

Regarding Ofcom's preference for a forecast approach, we agree that this approach offers greater simplicity and transparency to that of the 'variable k' model, for the reasons Ofcom sets out in 3.27.

Beyond these factors, we also believe that the forecast model is preferable, as the alternative 'variable k' approach risks being in contravention of Article 74 of the EECC. This article obliges Ofcom to encourage investment in VHCNs. Gigaclear's current scale and secured funding is material evidence of investment into non-incumbent VHCNs in Area 3 and to introduce the variable k model would see copper product prices fall in the areas that BT Openreach does not deliver full fibre network.

In Ofcom's initial WFTMR consultation, it rightly highlights that copper based superfast connectivity is a substitutional product to full fibre, this would then function to deter such investment in non-BT Openreach VHCN connectivity in Area 3. In light of this concern, we then welcome Ofcom's proposal of 'having a consistent pricing approach in Area 3 as in Area 2 in order to be supportive of network investment'.

² For clarity, this is what Ofcom labels as 'post-build'.

In order to achieve this consistent pricing approach, we agree that it is appropriate to explore whether a build commitment from BT can be secured and whether such a commitment can align to be within the expected cost thresholds of the regulated price glidepath (CPI+0%) initially proposed for Area 2.

A core challenge of this approach is ensuring consistency between forecast and actual build; Ofcom is right to stress that if BT Openreach fail to meet their forecast, prices would have been set at a level higher than required, resulting in unnecessary consumer harm. We discuss these dangers further in response to Q4.1.

Regarding BT's commitment to deliver 3.2 million premises within Area 3, we then support Ofcom's goal of 'determining a reasonable range of cost recovery profiles that are consistent with an expectation of cost recovery over the lifetime of the fibre and copper network' and 'whether a forecast approach set at the level of CPI-0 in the period of the market review' will provide a reasonable expectation of cost recovery for the build commitment.

Geographic Discounts

We warmly welcome Ofcom's support for restricting BT Openreach's geographic pricing flexibility on FTTP rental charges in Area 3. To justify this, Ofcom rightly point to a number of providers having indicated that they have ambitions to build in Area 3, with 'some rival investment taking place today as evidence'. The most pertinent example of this is Gigaclear's current scale and we hope that our recent securing of £525 million debt funding offers further evidence to support this position.

BT has both capability and incentive to use regional price reductions to limit competition, across both legacy and FTTP infrastructure. Even highly geographically targeted price reductions could be disastrous to new networks emerging in Area 3; Openreach's scale and national presence grants it an ability to absorb costs that would be unbearable to new entrants. As alt-net investment in Area 3 increases throughout the period of the market review, the opportunity for this to occur will then increase. It is then appropriate to introduce this measure.

With that said, we note that Ofcom states that 'Openreach will be able to use the consent process discussed in our January 2020 Consultation to request use of discounts where they are objectively justified and consistent with our policy objectives'. In light of the above considerations regarding the potential for detriment to competition should targeting pricing occur, it would be appropriate for network operators within the postcode sector area (and neighbouring postcode sectors) where BT Openreach is seeking consent for price reduction, be informed of the request and permitted to present their consideration of how such an action may impact competition. With this information, Ofcom can come to a more informed assessment than without it.

Post 2026

Given that the cost recovery of BT Openreach's commitment extends beyond the length of the market review period considered here, it is reasonable to anticipate that implementation of the forecast RAB model will extend into future charge control period consideration.

Question 4.1: Do you agree with our proposals for basket design and implementation of a forecast-RAB?

As Ofcom is no longer pursuing the post-build (variable k) RAB model, Ofcom no longer requires a basket control for GEA rentals across all bandwidths.

We also agree that a separate control for MPF rentals will provide better customer protection to standard broadband customers, as it will ensure that BT does not raise MPF prices as customers transition to higher speed services. We then support the introduction of a charge control for MPF and GEA 40/10 FTTC separately.

Compliance with build commitment

Ofcom should not look to amending future market review pricing as the only means of addressing BT failing to meet its proposal to deliver 3.2 million premises within Area 3.³ This is because this information will inform both the allocation of state aid and investment decisions of alternative network operators.

Should BT Openreach's build plan be made public (as we expect it would in some form in line with the EECC transparency mechanism), it will inform the network investment decisions of other operators, most notably those in Area 3 seeking to avoid BT Openreach full fibre rollout. It would also allow BDUK (should this data be shared with them) to avoid allocating state aid to areas where BT Openreach has already committed to delivering commercially. As Area 3 is defined by the limited potential for competition, the introduction of such public transparency measures then addresses the 'hold up' problems identified within the Future Telecoms Infrastructure Review (FTIR).⁴

Failure for BT Openreach to meet its commitment does not then simply create a problem regarding consumer harm through higher than required prices. In addition, their commitment will have functioned to deter other networks investing in the areas they declare as part of the build plan. Indeed, the crowding out of this investment and the consequential absence of gigabit capable connectivity in these areas may constitute a greater consumer harm.

To address this problem, it is appropriate for Ofcom to consider enforcement of the BT Openreach offer. Of course, such enforcement should reflect the variable nature of forecasting build in rural areas and permit the impact of events beyond BT Openreach's reasonable control. However, forecasting of build in rural areas to a reasonable accuracy is part of BT Openreach's pre-existing operations in executing their BDUK state aid contracts. It is then something they are well equipped to do. It would then be reasonable and proportionate for Ofcom to consider enforcement of the BT Openreach commitment.

If this is not done, it is arguable that BT Openreach is incentivised to fail to meet the 3.2 million commitment, as the only detriment they see will be cost recovery through movement in the future pricing glide path. This may then be worth the opportunity to materially mislead the investment decisions of competitor networks in Area 3.

Question 5.1: Do you agree with our proposals for reporting requirements?

In light of Ofcom moving to a forecast RAB approach and the consequential changes to the proposed controls discussed above, it is appropriate for Ofcom to revise its reporting proposals for BT Openreach within Area 3 in the manner that it has set out.

Further, where Ofcom maintains its 'proposal for BT to provide us with information on FTTP homes passed in both Area 2 and Area 3, split by those funded commercially and those funded by government subsidies or other grants', we advise that this data is also split across Area 2 and Area 3, as this will aid wider transparency of BT Openreach's investment in Area 3.

³ We note that Ofcom states that is 'confident that BT has the resources and incentives to meet that commitment. In May 2020, BT announced an ambition to deploy a fibre network to 20m premises by the mid to late 2020s. The BT Commitment to commercially deploy to 3.2m premises sits within that broader ambition'. This is an odd point to use as evidence. The purpose of regulation in Area 3 is to encourage the incumbent to invest, as absent regulation, the incumbent faces little incentive to do so. The 3.2 million should then be build that BT Openreach would not have delivered otherwise.

⁴ <https://www.gov.uk/government/publications/future-telecoms-infrastructure-review> paragraph 26, page 24