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Dear Lindsey and Dave,

Ofcom's proposed approach to regulating Openreach's copper retirement

I write further to CityFibre's consultation response of 8 December 2020.

In that response, CityFibre explained that there is a material likelihood that the three proposed stages of copper retirement ("stop-sell", removal of the copper price cap, and forced migration of remaining copper customers) – each of which is expressly designed to support Openreach's fibre investment case – will have the effect of dampening the investment incentives of network rivals such as CityFibre by enabling Openreach to leverage its incumbency advantage and critically reduce the pool of addressable consumers. This effect will be exacerbated by the fact that the period of the market review (2021-26) is critical for rivals seeking to achieve efficient scale. Ofcom's approach risks undermining investment by alternative operators and thereby reducing the competition which Openreach will face.

As CityFibre observed[1], while Ofcom's stated objective is to strengthen network competition, to date Ofcom does not appear to have undertaken any detailed assessment of the potential for its copper switchover proposals to undermine rivals' ability to compete with Openreach.

In the context of the concerns which CityFibre has previously identified, the purposes of this letter are:

a) to highlight the fact that the use of the exchange footprint as the relevant geographic unit against which deregulation will be assessed introduces an additional competition concern that has not been recognised by Ofcom. This approach is liable to incentivise and facilitate Openreach to roll out its fibre network in a targeted manner designed to undermine the investment cases of other operators and thereby deter them from achieving sufficient scale in their own full fibre network builds to then be able to act as effective competitors to Openreach;

b) in light of Openreach's recently announced Handover Exchanges, to identify a limited amendment to Ofcom's proposals that would reduce the risk – namely, that Openreach Handover Exchanges, rather than individual exchange footprints, be used as the relevant geographic unit; and

c) to reiterate the urgent need for Ofcom to undertake a detailed assessment of the potential for its copper switchover proposals to restrict network competition. It is CityFibre's position that the proposals in their current form entail a disproportionate risk to competition, and that to implement them without further assessment of that risk would be unreasonable, and contrary to Ofcom's own stated objectives, its statutory duties, and its public law duty of sufficient enquiry.

[1] 1.25(i)

Risks associated with the use of exchange footprints

As set out in its consultation documents of January 2020[2] and October 2020[3], Ofcom proposes to adopt a 3-stage approach to the removal of regulation on Openreach copper services. In summary:

- Phase 1 – Where Openreach has achieved 75% ultrafast coverage, it will no longer be required to provide copper products to new or upgrade customers in that exchange ("Stop-sell").
- Phase 2 – At the later of (i) 2 years from the Phase 1 stop sell date or (ii) the date on which Openreach has achieved full ultrafast coverage in an exchange, the copper price caps will be lifted in that exchange, thus allowing Openreach to raise copper prices to incentivise migration to FTTP products.
- Phase 3 – Where Openreach has achieved full ultrafast coverage in an exchange and less than 10% of customers remain on copper products, Openreach can notify Ofcom of this and, two years thereafter, may forcibly migrate existing copper customers onto its fibre network.

We understand that Openreach has to date notified Ofcom of 220 exchanges in respect of which it expects to provide ultrafast services to 75% of premises by 2022. If Ofcom's proposals in the January and October Consultations are implemented, Openreach will soon be able to stop selling copper services to new customers in those exchanges and, where coverage reaches 100%, will be able to increase prices for copper services in those exchanges from 2023. The October Consultation proposals would then allow Openreach forcibly to migrate all customers in the exchange area to fibre services where take up of fibre services exceeds 90% in those exchange areas.[4]

CityFibre has already highlighted the risk that the effect of these measures will be to foreclose investment from rivals to Openreach.[5] Specifically, in locations where Openreach does or could face direct competition from rival full fibre builders, the current proposals would provide them with the ability to undermine rivals' network deployments, potentially foreclosing them in that location. That is because the proposals will allow Openreach simply to leverage its existing customer base, and further entrench its dominant position.
The additional point which CityFibre now wishes to highlight is that the risk of such anti-competitive foreclosure is exacerbated unnecessarily by Ofcom's use of the exchange footprint as the geographical unit with respect to which the proposed measures will apply.

As Ofcom has recognised[6], large-scale network investment is risky and time consuming. The necessary level of investment can only be justified where there are sufficient guarantees of take up of services over that network some way into the future. Alternative networks are committing at least £10 billion of investment to building fibre services for the benefit of consumers and changes to expected levels of take up, particularly in selective geographies, can have a significant effect on the business case for roll out.

CityFibre has a stated ambition of deploying full fibre services to up to 8 million UK premises, at a cost of approximately £4 billion. CityFibre's network build strategy is based on deploying full fibre across large contiguous areas, specifically across entire towns and cities. CityFibre has to date announced deployments in more than 60 towns/cities covering over 5 million premises. The average number of premises across our planned towns/cities is over 80,000.

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[2] *Promoting competition and investment in fibre networks: Wholesale Fixed Telecoms Market Review 2021-2026*, Ofcom, 8 January 2020 ("**the January Consultation**")
[3] *Consultation: Copper Retirement – conditions under which copper regulation could be completely withdrawn in ultrafast exchanges*, Ofcom, 15 October 2020 ("**the October Consultation**")
[4] Openreach has notified Ofcom of a further 51 exchanges which will be eligible for stop-sell in 2022 (see this ISP Review article).
[5] See responses to the January and October Consultations
[6] *Regulatory certainty to support investment in full-fibre broadband*, Ofcom, 24 July 2018 ("**July 2018 Policy Document**")

Our network deployment architecture is based around fibre exchange (‘FEX’) locations, which have the capacity to serve up to 50,000 premises. Owing to the size of the towns/cities where we are deploying network, we on average deploy two FEXs per town/city. However, in larger cities there can be many more FEXs, for example we have plans in some cities to have more than five FEXs. Our network topology is independent of the topology of the Openreach network.

Even seemingly modest targeted changes to the expected level of take up can seriously undermine the business case for rolling out to individual zones. For example, if CityFibre were to lose 10% of penetration, relative to expectations as established in our business plan, then [✂] of our planned [✂] cities would fall below our investment threshold representing [✂] of our planned 8 million footprint. There is also a knock-on effect to contiguous area. If the number of contiguous zones in which investment is feasible is reduced, CityFibre’s business plan comes under threat. Given that we would not look to grow a fragmented footprint, our intentions to grow our footprint beyond the 8 million, for example, as a result of the outside in programme, would be at risk.

As they stand, Ofcom’s proposed measures for copper switchover will enable and incentivise Openreach to target its fibre rollout at individual exchanges within zones where alternative networks have announced their own plans for rollout. This could have a critical impact on competitors. For an alternative network whose business case is based on zones of around 50,000 premises, Openreach rollout to a single exchange in a zone reduces the addressable number of premises by around 10% (the average exchange serves only 5,000-6,000 premises) and the possible available revenue by substantially more, assuming the most attractive exchange areas are targeted. In other words, a limited investment by Openreach may have a disproportionately large effect on the feasibility of a rival’s rollout.

Openreach will be able easily to target individual exchanges on the basis of alternative networks’ publicly announced plans and it is, therefore, plainly not unrealistic to envisage such conduct. Ofcom itself has hypothesised that Openreach could seek to deploy fibre selectively in *sub*-exchange areas to deter competitor investment, giving rise to a competition concern[7]. Ofcom’s proposals seek to address that concern by using exchange areas (rather than sub-exchange areas) as the geographical unit with respect to which the proposals will apply. However, as explained above, Ofcom has failed to appreciate that an equivalent concern arises on its proposed approach as well.

Indeed, Ofcom’s proposals facilitate such behaviour by Openreach. The removal of regulation and forced fibre migration will reduce Openreach’s costs in those exchanges by allowing Openreach to avoid the costs of operating copper and fibre networks in parallel, as Ofcom itself recognises[8]. Openreach is therefore incentivised to target its rollout program not only at those exchanges in which it can reduce costs most effectively but also at those in which it can increase revenues most effectively. The most effective means for Openreach to increase its revenues will be to target its rollout at exchanges where this will undermine alternative network investment and so reduce competitive pressures on Openreach.

A limited amendment to address these risks

On 3 December 2020, Openreach launched a consultation on Openreach’s Future Handover Architecture and Exchange Footprint. Under those proposals, Openreach is planning to reduce the number of exchanges employed in its network from around 5,600 to just 960 Openreach Handover Points. If implemented, the number of premises in a given area would increase to around 50,000, in keeping with the zonal approach adopted by alternative network operators.

[7] October Consultation, footnote 24.
[8] October Consultation, paragraph 3.20

We believe that Ofcom's stated objectives would be better achieved, with less risk to network competition, if Ofcom were to amend its proposals so that the geographical unit used for the purposes of the Copper Switchover proposals is based on the Openreach Handover Point rather than the exchange. Indeed, Openreach's proposals themselves provide an indication that a division of geographical areas into zones comprising 50,000+ premises would better reflect the economic realities of fibre rollout. An amendment of this sort to Ofcom's proposals would significantly reduce the potential for Openreach to engage in targeted behaviour of the sort described above. Given the scale of investment required to rollout to each of these larger areas, Openreach would be more circumspect in adopting a targeted approach since the expected returns of doing so would be align more with normal commercial returns, rather than reflecting the prospect of reduced competition. Such an approach would therefore support network competition in accordance with Ofcom's stated objectives as well as its statutory duties.

The need for a detailed competition assessment

We note that, surprisingly, Ofcom's January and October Consultations contained no assessment of the impact of its copper switchover proposals on competitors' incentives to rollout their networks. In both consultations, Ofcom appears only to have considered the impact of its proposals on Openreach's own incentives to rollout fibre. The effects on network competition are addressed in a single paragraph of the October consultation (3.73), which itself refers back to a single paragraph in Volume 3 of the January consultation (2.31). Both of these paragraphs simply record Ofcom's proposal to use the exchange footprint (rather than sub-exchange areas) as the relevant geographical unit to prevent Openreach from targeting strategic overbuild where alternative providers are currently building network. However, as explained above, this measure is not sufficient to prevent strategic conduct by Openreach that could critically undermine competitors' investment incentives in relevant zones.

In circumstances where CityFibre has identified a credible risk of anti-competitive conduct by Openreach; where this concern is consonant with a concern identified by Ofcom itself; and where Ofcom is committed, as a matter of both policy and statutory duty, to safeguarding competition, it is imperative that Ofcom now conducts a full assessment of the potential impact of its copper switchover proposals on competitors' incentives, taking into account the concerns CityFibre has articulated.

This is particularly so given that the period of this market review (2021-26) is critical for alternative networks seeking to achieve efficient scale and therefore exercise a competitive constraint on Openreach. As CityFibre set out in its response to the October Consultation[9], delivery of alternative networks' plans is highly contingent on the right regulatory environment being in place. If Ofcom cannot be certain that its proposals will not have the effect of deterring investment, it should delay those proposals until such time as alternative networks have had the opportunity to advance their rollout plans, as CityFibre explained in meetings with Ofcom in January 2021, we think the timetable would need to be pushed out to beyond 2028.

If the impact of Ofcom's proposals is to deter investment by alternative networks, it will not be possible to resolve the issue by subsequent changes to regulation in the next market review period. It is therefore critical that Ofcom has satisfied itself that any regulation put in place during this review will not have a detrimental impact upon the investment plans of alternative operators.

With best regards,

Polly Weitzman
Senior General Counsel

cc: Alex Blowers

[9] CityFibre response to October Consultation, paragraph 1.9