

UKB Networks

Response from UKB Networks to Ofcom's BCMR consultation on Leased Lines Charge Controls and Dark Fibre Pricing

Non-Confidential Version

Introduction

UKB Networks Limited ("UKBN") welcomes the opportunity to comment on this further consultation on leased lines charge controls, as part of Ofcom's review of the Business Connectivity Market.

UKBN is a wholly owned subsidiary of HKT, Hong Kong's premier telecommunications network and service provider. HKT is listed and headquartered in Hong Kong with a market cap of approximately \$9bn. The investment of HKT and its parent company PCCW in the UK to date amounts to more than [X].

[X]

In this response UKBN repeats, to some extent, comments it has made in response to Ofcom's BCMR consultation of May 2015. We have limited our response to the question concerning dark fibre pricing.

The Importance of Dark Fibre Backhaul

In paragraph 8.10, Ofcom states:

".... We note that our Dark Fibre Access remedy is intended to provide the opportunity for CPs to purchase a dark fibre input to create their own active leased line solutions. Our policy intention is for this to happen when it is efficient for CPs to provide their own alternative solution. This should be either when the CP wishes to employ different active components, to those provided by BT, to provide the preferred customer solution, or when the CP is able to provide an equivalent service at lower cost than BT."

This statement seems to overlook the importance of dark fibre for operators to use for their own backhaul solutions.

UKBN will largely rely on third party network providers to backhaul traffic from its hub sites to its core network. UKBN will increasingly rely on BT, as the only operator with fairly ubiquitous network reach, for backhaul circuits, particularly as we deploy networks in more rural areas.

There are many other broadband providers that provide services to businesses, local authorities and, increasingly, local communities that require access to backhaul. Government policy is now to encourage these network providers to help resolve the "not-spot" issues in both city and rural areas however they can only do so if they have access to timely and sufficient backhaul.

The market for backhaul is constrained by the location and availability of capacity in existing fibre networks. In some cases cell sites and towers may be located at a considerable distance from existing alternative network infrastructure while all locations are within reach of BT's ubiquitous network infrastructure. Alternative network operators will require network extensions or need to build new fibre.

BT's extensive network infrastructure and its broad geographic coverage gives it an inherent competitive advantage over any rivals in providing extensions and fibre backhaul at lower marginal cost than available to others except perhaps in a limited range of urban locations.

It is vital that backhaul circuits provide sufficient capacity to carry the data requirements of the end users, not only for current demand, but also to cope with growth in the number of users and growth in the data usage levels of end users. The ability to burst and to increase capacity rapidly to meet demand are vital in order to meet customer expectations and provide a high quality user experience.

Dark fibre has the following benefits over active products:

- It enables the operator to provide "bursts" of traffic over and above the day to day data requirements of its end users.
- It enables an operator to scale up its backhaul capacity to meet growing customer demand more quickly and more economically, thus preventing a capacity bottleneck which would diminish customer experience.
- It enables an operator to expand its access network without relying on a third party backhaul provider to increase backhaul capacity.
- It enables rapid diagnosis and repair of network faults, thus enabling service quality differentiation.

- It encourages a competitive market for dark fibre to develop based on new infrastructure investment where new entrants can see an opportunity to compete with BT based on a more efficient model.
- Dark Fibre is technology neutral and is therefore useful for providing services to enterprises and government – operators can separate and isolate individual wavelengths using different frequencies of light and thus provide more secure private networks as well as public internet access on the same optical path.

In general, enabling a more fluid, flexible and efficient approach to access network build (as the availability of dark fibre backhaul would), would enable and encourage service innovation and increase customer choice.

Ofcom's approach to dark fibre pricing

We believe that Ofcom has placed undue weight on its desire to avoid inefficient market entry caused by arbitrage opportunities. We note Ofcom's comment in footnote 202: *"We note that, in seeking to avoid creating arbitrage opportunities, our goal is not necessarily to protect all aspects of the current pricing structure of BT's active products, but rather to avoid incentivising inefficient entry based solely on arbitrage between incompatible pricing structures."*

BT's current pricing structure should not dictate regulatory policy. Nor should Ofcom be overly concerned to prevent inefficient market entry – this should be purely for the market to decide.

We do not believe that Ofcom should give material weight to the risk of active tariff rebalancing, especially as it appears that returns on BT's regulated services have been consistently above the rate required to compensate investors¹. We do not believe there is any overall benefit in the business sector continuing to subsidise other user groups, if indeed that would be the outcome. Alternatively, the outcome might be that BT simply becomes more efficient and/or ceases to over-recover its costs.

These risks should be set against the benefits of encouraging investment in network build on the part of users of dark fibre, for example encouraging investment in wireless and fibre access networks.

We disagree with the proposal to adopt active-minus pricing and favour instead cost-based pricing (which would likely therefore be distance-based), as explained in more detail below.

¹ Frontier Economics, The Profitability of BT's Regulated Services: a report prepared for Vodafone, November 2013: <https://www.frontier-economics.com/documents/2013/11/the-profitability-of-btsregulated-services-frontier-report.pdf>

Question 8.1: Do you agree with our proposals regarding dark fibre pricing? If not, what alternative would you propose and why?

We disagree with Ofcom's approach to pricing of the dark fibre product. Ofcom proposes that dark fibre products should be priced by reference to the EAD/EAD Local Access 1Gbit/s active products, with dark fibre variants of both EAD and EAD Local Access, and with the same charge structure in respect of circuit length as their corresponding active products.

UKBN urges Ofcom to adopt a cost-plus pricing model. Pricing and contractual terms should reflect the infrastructure nature of the remedy; dark fibre pricing should be bandwidth-neutral. Both BT and its competitors will have to invest significantly in capacity and fibre reach over the coming years and appropriate cost regulation is critical both to providing appropriate incentives and returns for BT, and to providing a satisfactory investment environment for others.

If an active-minus model is adopted, we are not convinced that the 1Gbit/s EAD products are the correct benchmarks to use and consider that there would be a strong case for the 100 Mbit/s products to be used.

We do not believe that cost-plus pricing will discourage network investment on the part of potential alternative providers of dark fibre. Dark fibre providers tend to invest in metropolitan areas and/or on intercity routes². There is no prospect of alternative providers gaining sufficient presence to act as a constraint to, or compete with, BT within the period of this review. Eventually these networks could change the competitive dynamic in, for example, "Central Business Districts"³ which might result in a deregulation of these areas following future market reviews.

In relation to the design of the dark fibre product, we note that Ofcom proposes to model the product on the EAD and EAD LA products. We note that the EAD products are designed to route into and out of BT exchanges⁴. This is arguably not the most efficient routing methodology and could lead to unnecessarily high charges where charges (either active-minus or cost-plus) are distance based. However, such inefficient routing could incentivise market entry of alternative network providers who are able to provide service more efficiently than BT, to the benefit of customers.

Services requiring two fibres

Ofcom proposes that that, where the Dark Fibre Service is based on access to more than one optical fibre, BT may calculate the charge by multiplying the charge for a single fibre 1Gbit/s EAD service or 1Gbit/s EAD LA service by the number of optical fibres, adjusted to reflect any incremental cost savings of providing network access to more than one optical fibre at the same time.

² For example, <http://www.cityfibre.com/news/2014/11/12/cityfibre-signs-dark-fibre-deals-with-ee-and-three-to-enhance-mobile-networks>

³ Ofcom BCMR consultation, paragraph 4.87 and footnote 103

⁴ [X]

We disagree with this pricing approach as it would force operators who would otherwise choose to use a fibre pair for operational reasons to use a single fibre instead. It would make the cost of a pair of fibres almost double the price of a single fibre, even though the marginal cost of an additional fibre on the same route is very low.

If the fibres were priced so that jointly the two dark fibres provided BT with a financial contribution equivalent to that of a single fibre, Ofcom posits in paragraph 8.83: "It might be that this approach would result in access seeking operators in most cases seeking a pair of fibres. It could be argued that this would then mean the dark fibre service being provided, using a pair of fibres, would be significantly different from the, single fibre, EAD service being used to provide the access pricing benchmark, and therefore would be incompatible with the benchmark."

Ofcom goes on to say in paragraph 8.85: "Adopting the [approach of doubling the price for the provision of two fibres] would still allow dark fibre to be commercially viable compared to the current active product set."

Ofcom's comments illustrate the illogicality of using a BT product as a benchmark for pricing, when it is not relevant to the way in which many or most operators will use the dark fibre. Only cost based pricing will ensure that the market does not continue to be distorted by constraining the way in which operators access the incumbent's network infrastructure.

UKB Networks Ltd
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