



Non-domestic rates and the price for Dark Fibre

Response submitted by CityFibre Infrastructure Holdings PLC

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CityFibre's response to Ofcom's consultation on Non-domestic rates and the price of regulated dark fibre

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1 Introduction

1.1 About CityFibre

1.1.1 CityFibre provides fibre connectivity services through designing, building, owning, and operating fibre optic network infrastructure. The Group is a wholesale operator of fibre networks in towns and cities outside London which provide open access, shared fibre infrastructure that enables gigabit-capable connectivity for Channel Partners and mobile network operators, who in-turn deliver digital connectivity solutions to their end customers spanning the public sector, business, mobile operator and residential markets.

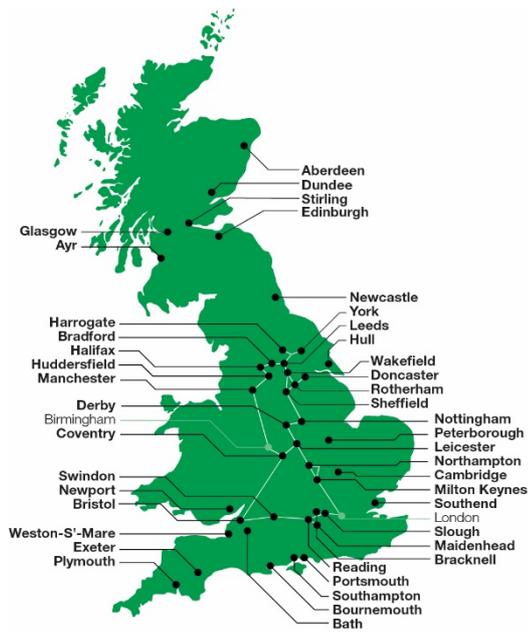
1.1.2 CityFibre operates across the UK, and currently has full fibre optic metropolitan area networks in 42 towns and cities including: Aberdeen, Bristol, Coventry, Edinburgh, Glasgow, Manchester, Milton Keynes, Peterborough, and York. Furthermore, the Company owns and operates a long-distance fibre-optic network that interconnects 24 of its current towns and cities.

1.1.3 CityFibre is a provider of 'full fibre' infrastructure, meaning there is no copper or co-axial cable used for the provision of data connectivity services in CityFibre's networks. This sets it apart from other infrastructure competitors, who rely heavily on legacy copper and co-axial cables connecting to premises on all but a small percentage of their networks.

1.1.4 CityFibre's network is constructed to provide high capacity fibre infrastructure that serves four primary market verticals:

- Public sector – fibre connectivity to council buildings, schools, hospitals, CCTV;
- Business – fibre connections to enterprises and SMEs;
- Mobile operators – fibre connections to mobile base stations and small cells for 4G and future 5G mobile services; and
- Consumers – fibre connections to homes.

1.1.5 As at 31 December 2016, CityFibre operated 2,244 kilometres of metro local access duct and fibre networks across 42 towns and cities, as well as a 1,139 kilometres national long distance network connecting 22 towns and cities to data centres in London and the UK regions, as illustrated in the map below.



1.2 The structure of this response

1.2.1 Ofcom has only posed a single question in this consultation which is very broad. The entirety of this response should therefore be considered a response to that single question.

1.2.2 The response is structured as set out below:

Section 2: Executive Summary

Section 3: CityFibre's comments on the scope of the NDR consultation

Section 4: CityFibre's response to Ofcom's proposals in the NDR consultation

2 Executive Summary

- 2.1.1 CityFibre welcomes the opportunity to respond to Ofcom's consultation on non-domestic rates and the pricing for regulated Dark Fibre (the NDR consultation), although it is disappointed at the narrow focus and the brevity of that consultation.
- 2.1.2 CityFibre does not object to the introduction of a DFA remedy but does consider that the pricing of that remedy and the broader impact on competition (in particular, infrastructure-based competition) should have been more thoroughly assessed in the BCMR. This consultation is a missed opportunity to rectify this error. We are very disappointed that this opportunity has not been taken.

Ofcom has failed to take into account the full scope of the Competition and Markets Authority's Final Determination

- 2.1.3 CityFibre has reviewed the Competition and Markets Authority's (CMA's) Final Determination (FD) carefully and finds that the NDR consultation fails to implement the FD in accordance with the directions therein. The FD is a single determination covering both the appeal filed by CityFibre and the appeal filed by TalkTalk and the CMA made significant findings in both appeals which are of direct relevance to the NDR consultation and its scope.

Ofcom's proposals are arbitrary, not supported by facts and analyses, and would cause distortion of competition

- 2.1.4 The role of the non-domestic rate (NDR) in setting the pricing for the regulated dark fibre access remedy (DFA) is significant, and the way it is reflected in Ofcom's chosen pricing methodology for the DFA will determine (to a significant extent) the level of take-up of the DFA remedy in this charge control period and beyond. CityFibre considers that:
- (1) Ofcom's proposed 'active-minus' pricing methodology is flawed and is the underlying cause of the NDR differential problem and TTG's successful challenge of Ofcom's DFA pricing decision;
 - (2) Ofcom's approach of setting a single 'representative' NDR level, to be included into the formula BT should apply when calculating the active-minus DFA price, ignores how the networks and DFA requirements of CPs vary. Applying a simple average (if indeed Ofcom's approach uses an average¹) is inappropriate;
 - (3) Ofcom's proposed NDR adjustment will create arbitrary winners and losers and result in an unjustifiable distortion of competition.
 - (4) The assumptions Ofcom has made in arriving at that representative NDR, will not achieve the projected levels of take-up of DFA assumed in Ofcom's cost-benefit analyses for the DFA remedy (and the justification for mandating DFA and not duct and pole access (DPA) as well as

¹ Ofcom states that the 1.9km length it has assumed is an average, but has presented no data to support this. The other assumptions made by Ofcom are clearly not averages (e.g. the size of existing contiguous network and the number of new circuits that will be directly connected to the existing contiguous network of the CP).

or instead of DFA). Ofcom therefore needs to redo its cost benefit analyses for both the DFA and the DPA remedy;

- (5) Further, Ofcom's assumptions of DFA take-up are part of its financial models underlying the setting of the CPI-X charge control for active wholesale leased lines. The small adjustment to the 'X' value in the final year of the LLCC is therefore not sufficient to reflect the impact of the proposed NDR adjustment to the DFA pricing formula.

3 Ofcom has failed to take into account the full scope of the CMA's Final Determination

3.1.1 CityFibre has reviewed the CMA's FD carefully and finds that the NDR consultation fails to implement the DF in accordance with the directions therein. The FD is a single determination covering both the appeal filed by CityFibre and the appeal filed by TalkTalk and the CMA made significant findings in both appeals which are of direct relevance to the NDR consultation and its scope.

3.1.2 CityFibre notes that Ofcom has communicated to the CMA that the NDR consultation is intended to address the FD findings in their entirety, but, having reviewed the scope of the NDR consultation it is clear to CityFibre that that is not case.

3.1.3 In particular, Ofcom has failed to take into account that the CMA found that it [redacted]². This is very significant as a further reduction in the DFA price, as proposed in the NDR consultation, would increase the impact on infrastructure competition. Ofcom therefore has a duty to present its analysis of that impact as part of its justification of the proposed remedy.

3.1.4 Additionally, the CMA found that Ofcom's assumptions of the take-up of the DFA product were predicated on [redacted]those assumptions were no longer applicable. It is therefore incumbent on Ofcom to demonstrate that its adjustment to the DFA pricing formula overcomes this problem. Ofcom has however presented no such analysis and the fact that Ofcom's adjustment to the DFA formula is [redacted], suggests that the impact on Ofcom's take-up assumptions for the DFA remedy is unlikely to be neutral.

3.1.5 Further, the CMA directed Ofcom to amend its pricing methodology to comply with its regulatory objectives, not simply make an arbitrary adjustment and not present analysis of how that adjustment was arrived at, nor what the expected impact of the adjustment would be.

3.1.6 With regards to Ofcom taking into account the full scope of the FD, the CMA stated the following [redacted]

[redacted]

[redacted]

4 CityFibre's comments on Ofcom's proposals

4.1 Ofcom's use of the active minus pricing method for DFA

² [redacted]

- 4.1.1 In the BCMR consultation, issued in May 2015, Ofcom set out a number of different possible approaches to the pricing of the (then) proposed DFA remedy. The active-minus pricing approach was selected as Ofcom concluded it would pose the lowest level of risk to BT's active leased lines price gradient and also reduce arbitrage opportunities which could (according to Ofcom) result in under-recovery by BT of its common costs.³
- 4.1.2 Ofcom selected the active-minus pricing approach, despite having identified the issues relating to the different levels of NDRs payable by different CPs and acknowledging that BT's Cumulo payments are different from the NDRs payable by any other CPs⁴. The NDR differential would not have been an issue, had Ofcom chosen a different pricing approach for the DFA remedy.
- 4.1.3 Having recognised the NDR differential issues arising from using the active-minus pricing approach, Ofcom made what we now know to have been an unfounded assumption that the Government would change the NDR legislation to change the definition of rateable occupation (but only for regulated DFA provided by BT) from the party lighting the fibre (e.g. the CP purchasing the DFA) to it being BT. Ofcom proceeded to assume that there would be no NDR differential once the DFA remedy was launched.
- 4.1.4 Choosing the active-minus pricing approach, despite the risks of there being no legislation change, resulted in the appeal by TalkTalk (TTG)⁵ and the CMA FD conclusion that, in the absence of a change to the legislation, Ofcom was wrong in how it treated the NDR differential in the active-minus pricing formula (i.e. in deducting BT's Cumulo rate), [X]⁶.
- 4.1.5 Until either the legislation changes, or the Valuation Office Agency changes its methodology within the existing legislation, it is therefore clear that under the active-minus pricing approach, the DFA prices need to be calculated using a different measure of NDR than BT's Cumulo rate. Ofcom's proposals as set out in the NDR consultation (and discussed in some detail below) are however yet another attempt at an inadequate 'quick fix' that will without doubt lead to the creating of winners of losers amongst the CP community in the UK.
- 4.1.6 It seems clear, therefore, that to implement the CMA Determination, Ofcom should consider the most appropriate pricing of the DFA remedy to achieve the objectives it set out in the BCMR consultation in May 2015, not just apply a 'fudge factor' NDR rate to rescue a clearly inferior pricing approach.
- 4.1.7 The underlying problem remains the choice of an active-minus pricing method. This is partially because of the NDR differential issues as heard during the CMA process, but also very significantly because the active-minus pricing makes the DFA remedy incompatible with a cost-based DPA remedy.
- 4.1.8 In the currently ongoing WLAMR consultation, and the associated consultation on duct and pole access remedies (the DPA consultation), Ofcom sets out clearly that its preference is to

³ BCMR Final Statement, paragraph 7.41.

⁴ Even from the NDRs payable by Virgin Media and KCom, both of which are subject to an expense and receipt (E&R) NDR calculation rule, not the standard NDR 'tone table' applied to all other CPs.

⁵ In which CityFibre was an intervener in support of TTG.

⁶ [X]

apply a DPA remedy without any restrictions on the downstream use of DPA⁷. The active-minus pricing for DFA was quoted by Ofcom in the BCMR as one of the main reasons for not implementing DPA together with DFA. Ofcom now has the opportunity to correct that inconsistency in pricing and costing approach between the DFA and DPA remedies. It would then be possible to introduce an unrestricted form of DPA that created a seamless remedy applying across both the BCM and WLAM, side-stepping the legal concerns which appear to preclude Ofcom introducing unrestricted DPA in the WLAM.

4.1.9 Ofcom should embrace the overall sentiment of the CMA Determination, namely that “*Ofcom should determine an amended DFA pricing methodology in accordance with its regulatory objectives*” [emphasis added]. The CMA’s Determination did not state that Ofcom should revise the amount to be deducted from BT’s active wholesale leased lines prices, but that it should determine an amended pricing methodology.

4.1.10 CityFibre does not consider that the active-minus pricing methodology is appropriate for the market conditions and it is clearly inconsistent with Ofcom’s preferred way forward in relation to the application of the DPA remedy without downstream usage restrictions.

4.2 Ofcom’s approach to setting the ‘representative NDR’ for the active-minus DFA price calculation creates winners and losers

4.2.1 Ofcom is making a number of significant assumptions when arriving at its proposed representative NDR rate for calculating the DFA price. Whilst CityFibre understands that any solution adopted for the value representing the NDR component would need to be practicable, it seems clear that in its focus on simplicity of implementation (and on its argument that, with a minimum change to the NDR component, it does not have to revisit other parts of its BCMR remedies decisions), it has developed a proposal that could have a destabilising effect on a number of currently competitive markets in electronic communications in the UK.

4.2.2 Ofcom’s assumptions fall into two categories:

- (1) The size of the access seeking CP’s existing contiguous network, to which a DFA line would be connected, and
- (2) The average distance of DFA lines required by access seeking CPs.

The characteristics of the access seeking CPs’ existing contiguous networks and DFA link requirements

4.2.3 When setting the proposed representative NDR value, Ofcom has assumed that access seeking CPs will have an existing contiguous network of >1000km.

4.2.4 Ofcom further appears to assume that all DFA lines required by CPs will be connected to that existing contiguous network.

4.2.5 And, lastly, Ofcom assumes that those who do not have their own existing contiguous network at the moment, likely have a network made up from active leased lines (which does not qualify

⁷ DPA consultation Paragraph 4.72 “*As Explained above, our preference would be to impose a general PIA obligation (i.e. one that does not include any usage restrictions) given the risk of regulatory failure of imposing such restrictions*”.

as the CP's network in the NDR tone table calculations), which can easily be converted to DFA and thus form part of the CPs own network (as the CP will be lighting the fibre) so that the CP can reduce its NDR liabilities to the level assumed by Ofcom.

The size of the CPs contiguous network

- 4.2.6 [§<]For those CPs that do not have a contiguous network of >1000km, the DFA price resulting from Ofcom's proposal will be such that it is unlikely to be economical to use DFA. This will thus create a division of CPs into those who can profitably use DFA and those who cannot.
- 4.2.7 The consequence of Ofcom's proposal for a representative NDR will therefore be that larger and more established CPs will have a significantly lower cost burden in using DFA than their smaller rivals. This is not a simple reflection of economies of scale, but an artificial differentiation caused by Ofcom's approach to DFA pricing methodology (active minus) and Ofcom's decision to apply a single representative NDR based on its selected assumptions. Ofcom's proposal will therefore cause competition distortion.
- 4.2.8 Further, Ofcom's assumption that all DFA lines will be connected directly to an existing contiguous network operated by the access seeking CP appears to be similarly flawed. It is not uncommon for CPs to purchase end-to-end leased lines (and therefore DFA in the future) to serve customers where the CP itself does not have physical presence. This would particularly be the case in situations where a CP bids for business from larger multi-site businesses and relies on BT for connectivity in areas where the CPs itself does not have network presence. At the very least, a proportion of DFA circuits would not be connected to an existing contiguous network, and Ofcom needs to investigate what that proportion is.

Conversion of leased lines networks to DFA networks

- 4.2.9 Lastly, Ofcom's assumption that a CP without its own network can simply and easily convert an existing network to DFA, in order to qualify for the >1000 km NDR rate, is also flawed. BT's draft DFA reference offer sets out the terms for converting active leased lines to DFA connections⁸. The costs of converting a 1000 km network (of average 1.9km length as assumed by Ofcom) would be in excess of £700k. Additionally, it would take a minimum of 6 months, to convert that number of active leased lines to DFA circuits as BT has applied maximum limits to the number of circuits that can be converted by a CP each calendar month.

The average distance of DFA links

- 4.2.10 Ofcom has calculated the representative NDR value using an average distance of 1.9km⁹. In CityFibre's experience, the distance of dark fibre links required by CPs varies considerably. Different types of CPs also have different average link distances – for example, CPs using dark fibre to connect end customers only, will vary from CPs using dark fibre to connect their own points of presence.
- 4.2.11 Ofcom therefore not only risks significantly favouring CPs that have a lower than average link distance, but it also risks making DFA accessible to some types of CPs but not others.

⁸ <https://www.openreach.co.uk/orpg/home/products/darkfibreaccess/darkfibreaccess.do>

⁹ With an allowance for main link distance by the meter, where applicable.

Summary

- 4.2.12 CityFibre's experience suggests that Ofcom's proposed use of a representative NDR in the active-minus price calculation for DFA will create winners and losers amongst CPs in the UK and could cause significant competitive disruption, potentially resulting in stranded investments for smaller CPs that would be subject to substantially higher NDRs than the representative NDR developed by Ofcom. Ofcom should consider very carefully whether, for example, its proposal will artificially bifurcate the MNO market based on the contiguous network size and average link lengths of the four MNOs.
- 4.2.13 [§<]¹⁰, [§<]but we believe strongly that Ofcom cannot assume that smaller CPs will necessarily understand the importance of this consultation and therefore submit the data required for Ofcom to make this assessment. Ofcom should therefore request specific information from CPs¹¹ of different kinds and of different sizes and undertake an impact analysis. Only if such an analysis shows that the proposed representative NDR will not cause harm to competition and investors in smaller CPs, should it rate be used to calculate the active-minus DFA pricing.

Ofcom needs to review its cost-benefit analyses of all remedies in the BCMR and the charge control

- 4.2.14 As described above, there is no doubt that Ofcom's proposed response to the CMA's Determination will result in a reduction in demand for the DFA remedy. CPs that have smaller contiguous networks that Ofcom's assumed > 1000 km, have longer than 1.9km average links, need links that are not directly connected to their existing contiguous network, or have active leased lines networks rather than own operated fibres, will all find the revised DFA price unviable, when compared with BT's active 1Gbps active leased line service.
- 4.2.15 A reduction in demand for the DFA remedy necessitates a review of Ofcom's cost-benefit analysis for the introduction of the DFA remedy in the first place, and of the cost-benefit analysis of alternative remedies which Ofcom decided to not introduce, including the DPA remedy.
- 4.2.16 In paragraphs 2.52 – 2.62 in the NDR consultation, Ofcom describes how it considers that the introduction of the proposed representative NDR into the DFA pricing formula would be unlikely to have any significant impact on the incentives to use the DFA remedy, and thus on the demand and take-up of DFA.
- 4.2.17 CityFibre fundamentally disagrees with this conclusion. Ofcom relies on over-simplified analysis, for example stating that the increased NDR reduction to the DFA price will be off-set by the higher NDRs payable by the CPs¹², but that is assuming that the averaged/representative rate makes DFA attractive to the same number of CPs as if the price were to reflect the level of NDRs faced by each specific CP. That is clearly not the case.
- 4.2.18 Without detailed information about the network sizes, types and average (and distribution of) circuits length for a large number of CPs, Ofcom cannot know how the DFA demand will be impacted by its NDR proposal. The only thing that is certain is that demand will be lower than

¹⁰ [§<]

¹¹ Using its s.135 powers.

¹² NDR Consultation, paragraph 2.59.

that originally modelled by Ofcom (which assumed no NDR differential, i.e. the change in the definition of rateable party), which had aggressive assumptions of cannibalisation of almost all new 1Gbps and 10Gbps circuits from the day the DFA is introduced.

- 4.2.19 In paragraph 2.62.1 Ofcom says that its proposal is objectively justifiable because it “*seeks to address the differences in exposure to NDR*”, but Ofcom does not in any way objectively demonstrate that its proposal achieves that objective and the proposal therefore cannot be considered objectively justified.
- 4.2.20 Further, in paragraph 2.62.2, Ofcom states that it also does not consider that the proposal will have a material impact on the case for DPA. The reason given for that is that Ofcom has maintained the active-minus pricing approach, which it considers incompatible with a cost-oriented DPA remedy.
- 4.2.21 CityFibre disagrees with this. If the demand for DFA is reduced (due to the NDR proposal), then it is very possible that the DPA remedy would now prove overall more beneficial than the DFA remedy. Ofcom therefore cannot use its choice of flawed pricing methodology for DFA as the rationale for not reviewing the impact of its proposal on the full suite of potential remedies.
- 4.2.22 Further, as set out above, the proposed amendment to the active minus pricing formula has made the active-minus pricing approach even less appropriate and defensible as a suitable and proportionate remedy. The maintenance of that pricing approach should therefore not be given as justification for not reviewing the cost-benefit analyses of the DPA remedy. On the contrary, that pricing methodology should be reviewed as part of implementing the CMA’s direction to amend the pricing methodology for the DFA remedy.

Summary

- 4.2.23 Ofcom has not provided any actual objective evidence to demonstrate that its proposal does not impact the cost-benefit justification for the DFA remedy. The objective analysis presented in the earlier sections of this response demonstrate without doubt that the demand for DFA will be substantially reduced. The cost-benefit balance of the DFA remedy must also be affected.
- 4.2.24 The DPA remedy was rejected by Ofcom as a remedy alongside the DFA remedy due to the pricing methodology incompatibility, and as a stand-alone alternative remedy to the DFA because Ofcom considered the benefits of the DFA remedy would be significant. It is clear that the latter of those two parameters would change as a consequence of Ofcom’s NDR proposal, thus making a review of its cost-benefit analysis for both DFA and DPA necessary.