Response to Ofcom Approach to Geographic Markets Consultation

Version 1.0

16 April 2019

Hyperoptic Introduction

Hyperoptic is a Code Power operator founded in 2011 by Dana Tobak and Boris Ivanovic. Hyperoptic is the largest provider of 1 Gb residential broadband in the UK and currently use a Fibre to the Building infrastructure operating across 28 cities with ambition to service significantly more. We have installed or are in the process of installing to over 400k residential homes and over 10k business units.

Hyperoptic was founded to bring the UK's broadband infrastructure to the next level creating a new full fibre infrastructure, offering 1 Gb services and raising the level of expectations on the role of connectivity in British households and businesses. Customers get the wired speeds they expect, and we have over 95 percent customer satisfaction rating consistently on our quarterly surveys.

To date, we have been expanding our network 100 percent year on year, and having recently secured 100m in debt funding. Our plans are to reach 2m homes passed by 2022 and 5m homes passed by 2025.

Currently, 50 percent of our footprint would, without Hyperoptic, be fibre-free with its residents only able to use ADSL often below 10Mbps – we are a key deliverer to whitespace areas and often target these areas having been neglected by other operators and network builders.

Response summary

Hyperoptic welcome the opportunity to respond to the Ofcom Physical Infrastructure Market Review consultation.

We note that there is some difficulty with commenting on an approach to differentiation across geographic markets without a clear view as to how remedies will be applied across geographies, as the two elements are linked. We agree with the proposal to include as much as possible in the prospectively competitive areas, but there needs to be recognition that the conditions need to be correct to actually facilitate competition.

However, as is set out in detail of this response we disagree with the focus on the mere presence of rival infrastructure as the main factor determining the prevailing conditions of competition in a given location. We are concerned that Ofcom's proposal gives rise to a potential for a perverse incentive when viewed in light of the overarching policy objective set out in the FTIR and the strategic policy position respectively: to maximise FTTP availability by using infrastructure competition as a stimulus. The targets for this are 15 million premises to be connected by 2025 and coverage across all parts of the country by 2033. Hyperoptic is embarking on a significant investment programme to roll out its own fibre network to five million homes by 2024 and is deploying substantial capital to the achievement of that goal. Deregulation in advance of actual substitutability in the market will place upward pressure on pricing. This will incentivise Hyperoptic to allocate its capital to in such a way that there would be a reduction in additionality of FTTP deployment overall, putting at risk Government's fibre coverage targets of 15 million premises connected by 2025 and ubiquitous coverage by 2033.

Approach to geographic markets

We agree with the three categories that Ofcom have set out in respect of the different competitive conditions that exist within geographic areas. However, we believe that further consideration needs to be given to the elements that Ofcom propose to use to assign any given area to one of the three categories. We would also welcome additional clarity about the impact of potential regulatory forbearance on co-investment by OR on the designation of a geographic area as competitive or otherwise.

Competitive areas

Ofcom set out that they would effectively use two criteria to establish whether a geographic area is competitive and where this is the case, they would not regulate. The criteria are the presence of at least two networks (in addition to Openreach) supplying ultrafast broadband and leased line services; and looking at the market share data of these networks to determine whether these networks make the area effectively competitive.

We strongly disagree with the focus on the mere presence of rival infrastructure as the main factor determining the prevailing conditions of competition in a given location. At para 2.20 Ofcom set out that "*Even where two alternative networks are deployed, the result may not be one of effective competition. Where two networks in addition to Openreach are present, we would also need to look at other metrics (such as market share and potential for future competition) to ensure there is sufficient competition*" Our experience of actual competition in the market today substantiates a view that the presence of rival infrastructure alone has not led to an exertion of competitive pressure on the incumbent and cannot be relied upon to constrain its behaviour in a deregulated environment. There are additional factors beyond the mere presence of rival infrastructure that have prohibited switching to date that should be given due consideration in determining the prevailing conditions of competition within a geography. We are also concerned that the effects of deregulation cannot be isolated to a specific geographic market and that the risk of bleed across into other areas is significant.

In para 6.42 of the BCMR Ofcom asserts, that countervailing buyer power (and hence competitive pressure) is predicated on a credible threat to switch supplier (or to self-supply). Examining the presence of a network or their market share does not demonstrate causation between that presence, its market share and link them to competitive pressure on the incumbent. For example, the evidence set out in para 6.120 of the BCMR of lower effective prices in the CLA than in regulated areas, and intensity of competition in those areas where Ofcom recognises that this could reflect other factors such as lower average costs in these areas arising from higher business density. This suggests that although there is significant presence of competing infrastructure, there is no evidence to demonstrate that this has a constraining effect on OR. We would urge Ofcom to undertake more detailed study on the constraining impact of the mere presence rival networks on OR with a view to making an evidence-based assessment at the next Review. Given that the CLA is effectively the test case for geographic deregulation, the learnings from in-depth, evidence-based analysis would help to inform debate as regulation transitions to a new geographic approach.

An absence of real substitutability in competing supply means that the only option for Hyperoptic to obtain countervailing power in a deregulated environment is to allocate capital to replacing existing EAD lines with our own connections. The opportunity cost of deregulating before the emergence of actual substitutability is therefore a reduction in Hyperoptic's contribution to overall FTTP coverage. Given the scale of our publicly stated ambition, this would constitute a meaningful constraint on the achievement of Government's 2025 coverage goal. As Ofcom move towards the more holistic approach outlined in the consultation, it is essential to consider the impacts of individual policies against the wider policy objective.

In the BCMR when defining a single market for CI Access services at all bandwidths Ofcom also mentions the ability to switch seamlessly between bandwidths, inferring that it is the actual event of switching that informs its view of competitiveness. Our experience shows that whilst there is a theoretical option to switch, there are a number of factors make effective switching unviable today, thus removing it as a constraining effect on the incumbent. These barriers to switching can occur from different scenarios: economic; operational; and customer impact.

The cumulative effect of these factors is that Hyperoptic faces material disincentive to switching to another provider which would need to be offset by a substantial price differential that is simply not available in the market today. Even if this were possible on a case by case basis it would be much harder to achieve savings that would justify the additional costs to the business of setting up and managing additional suppliers. Ultimately it would come down to a choice of using available funding to grow the footprint in keeping with Government's targets or using available capital to change the way current customers are already served.

We agree with Ofcom that networks providing only leased lines should be discounted from the network presence assessment given that they do not supply residential services. We also believe that this logic needs to be extended to discount any network that does not meet the characteristics necessary to support scale roll out of residential services within an area.

Throughout this consultation Ofcom refer to a threshold of 65% of premises being covered to determine whether a network is deemed present in an area. The reasoning for this is that it was used in the 2018 BCMR Consultation as well as the 2008 and 2018 WBA Statements. We question this line of reasoning; firstly the 2016 BCMR used 90% as a threshold with no justification for reducing the threshold to 65%. Additionally, the economic logic from the business market – where Ofcom accepted that even within the CLA, other networks are still likely to have to undertake additional deployment in order to reach a premise – is that the rental from leased-line type services will make despite this additional cost justifiable. This is clearly not the case for residentially focused networks. Therefore, a higher % threshold should higher. 65% means that 35% of the market in that geographic area is only addressable by the incumbent.

In the PIMR Ofcom recognised that a ubiquitous telecoms physical infrastructure (both in terms of the overall coverage it provides, and the contiguity of that coverage within a particular area) is highly important. It brings the ability to connect to as many residential premises or business sites within a deployment area as possible, and the flexibility and certainty to be able to provide any connection in the future quickly and without significant additional connection cost.

Based on our own experience of building an infrastructure strategy to reach the highest levels of customers in the most efficient way, we believe that Ofcom must include ubiquity as one of the factors that are a basic requirement when grouping geographies into homogeneous areas.

Potentially competitive areas

Absent detail at this point about remedies it is hard to give a detailed response to how Ofcom view this section of the market. Our assumption is that Ofcom will set remedies within these areas that will be designed in order to facilitate competition, in other words to create conditions that will allow areas to move from potentially competitive to being actually competitive in so far as is possible. Within this context, it will be important to ensure that the incumbent is not able to leverage their reach in order to structure price incentives to remain with them. Bulk discounts or minimum terms offers for instance could result from deregulated areas could bleed across into potentially competitive geographies, resulting in customer lock-in on the OR network in areas where the level of competing infrastructure suggests that there should be the potential for competitive pressure on OR.

The methodology that Ofcom set out for assessing this second category could depend significantly on how the second and third planks of the assessment are carried out. It therefore creates a grey area of uncertain overlap between areas that are potentially competitive and areas that are deemed non-competitive. Whilst we believe it is important that the potentially competitive areas are sufficiently wide so as to give competition the opportunity to develop, it is also important that areas are not put in this category too soon as this could result in unintended consequences.

Ofcom set out at para 2.21 that areas could fall into the potentially competitive category where:

- An alternative ultrafast network or networks is/are present; and/or
- Alternative providers have sufficiently specific plans to build in the area; and/or

- Ofcom consider there is a possibility of network build.

Aside from Ofcom's assumption at para 3.32 that all networks from the Connected Nations report are capable of supporting other services such as leased lines. the first bullet is relatively straight forward to assess. Ofcom has not provided any evidence that underpins this assumption, and we believe that apart from the capability aspect, Ofcom must also take into account signals from network owners as to which market segments they will be serving. Failing to do so could result in an inaccurate suggestion of competition in the leased-line type market.

We have the following comments about the remaining two bullets.

Operator plans to deploy – As we move to a five-year review period Ofcom have stated at para 3.35 that "*an important feature of our market analysis will be to take account of network roll out by operators over a longer term. We therefore propose to take into account operators' future network rollout plans for the purposes of assessing competitive conditions.*" What isn't clear from the Consultation is the weighting that Ofcom will ascribe to the remaining two bullets set out above nor whether or how remedies based on this analysis will be phased through the review period.

In respect of the assessment of competitive areas, Ofcom state at para 2.19 that "*even where a telecoms provider has a committed plan to deploy a network, there is likely to be some uncertainty, e.g. in terms of the timescale of deployment; the final extent of rollout; and the take-up of services.*" This factor must also be considered in respect of the assessment for potentially competitive areas as well, but Ofcom have not set out at this point how this uncertainty will be factored in to a forward view of competitiveness, nor whether there is an intention to sense check assumptions based on this analysis through a review period. We would welcome this further level detail in the future Statements and Consultation that Ofcom undertake on this new approach to regulation.

Ofcom also discuss how to account for differing levels of certainty about operator's build plans. In terms of mapping network plans, where a network plan identifies areas at a more granular level than Ofcom's chosen unit, Ofcom plan to map the planned footprint and apply the 65% threshold to assess whether they should consider the plan covers a sufficient proportion of the geographic unit in which is it is planned to be deployed) – our previous comments about this threshold are equally valid here.

However, Ofcom state at para 3.43 that where a plan is at a higher level, they would assume that it covers all premises with that town/city and include all geographic units that have a sufficient proportion of its premises within the boundary of the town/city. Ofcom do not give a view as to the foundation of this assumption, or whether there has there been a statistically valid sample of plans that suggest that this is accurate? We also believe that an assumption along these lines should carry much less weight than fully documented network build plans.

Potential future rollout plans – Ofcom set out at para 3.45 that "*We also need to consider how to determine those areas where we might expect potential future network rollout beyond operators' existing plans, as we wish to capture all possible locations for commercial scale rollout of new networks within our potentially competitive areas.*" Ofcom then go on to set out how they will identify areas where network build might be economic based on identifying geographic areas of sufficient size and density of premises. However this does not explain how Ofcom would weight this element. Above in para 3.47 Ofcom state that it is hard to use the input from operators (as to what factors they use to determine whether a build is economically viable) to make a model. The alternative is much less detailed and is likely to give far less accurate a view as to what builds are economic, therefore we believe it should that Ofcom should apply weighting to the various factors and this element should carry the least weight. This is particularly the case since it would be concerning an area where no operator had signalled to Ofcom that they have an intention to build there. So even if it is potentially economic to do so, there is little likelihood of such a build occurring within the review period. A potential way to utilise this analysis would be to use it to create as large an area as possible within which remedies should encourage competition. But no assumptions about competitive conditions should be made from this element of the analysis. We would also like to see Ofcom include some metrics that would be used to test the assumptions reached by the model throughout a review period, to allow for adjustments where the model is proven incorrect.

Conclusion

As set out above, we have significant concerns that premature deregulation (i.e. without demonstrable competitive constraints on OR) will result in upward pressure on pricing that will disincentivise Hyperoptic from our own fibre build. The opportunity cost is in the diversion of capital from the exercise of adding to the UK's overall availability of FTTP connections. We therefore urge Ofcom to implement additional metrics or KPIs that would serve to demonstrate the presence of competitive pressure on OR and only move towards deregulation if actual competition is clearly and reliably achieved.