Cover sheet for response to an Ofcom consultation

BASIC DETAILS

Consultation title: Promoting competition and investment in fibre networks - Initial proposals – Approach to remedies

To (Ofcom contact): Competition Group

Name of respondent: Lee Turner

Representing (self or organisation/s): Gamma Telecom Holdings Limited

Address (if not received by email):

Kings House, Kings Avenue West, Newbury, Berkshire, RG14 5BY

CONFIDENTIALITY

Please tick below what part of your response you consider is confidential, giving your reasons why

Nothing	☐	Name/contact details/job title	X
Whole response	☐	Organisation	☐
Part of the response	☐	If there is no separate annex, which parts?	

If you want part of your response, your name or your organisation not to be published, can Ofcom still publish a reference to the contents of your response (including, for any confidential parts, a general summary that does not disclose the specific information or enable you to be identified)?

DECLARATION

I confirm that the correspondence supplied with this cover sheet is a formal consultation response that Ofcom can publish. However, in supplying this response, I understand that Ofcom may need to publish all responses, including those which are marked as confidential, in order to meet legal obligations. If I have sent my response by email, Ofcom can disregard any standard e-mail text about not disclosing email contents and attachments.

Ofcom seeks to publish responses on receipt. If your response is non-confidential (in whole or in part), and you would prefer us to publish your response only once the consultation has ended, please tick here. ☐

Name Signed (if hard copy)

Clear. Creative. Communications.

Competition Group
Office of Communications
Riverside House
2A Southwark Bridge Road
LONDON
SE1 9HA

7th June 2019

By e-mail

Reference: **Promoting competition and investment in fibre networks - Initial proposals – Approach to remedies (the "Consultation")**

Dear Sirs,

Gamma Telecom Holdings Limited ("**Gamma**") welcomes the opportunity to respond to the Consultation published on 29 March 2019; our response is appended.

Introduction

Gamma is a Public Electronic Communications Network that provides wholesale fixed and mobile telephony and data services, to some 1,100 resellers. Two of these resellers are wholly owned subsidiaries and represent themselves over 20% of our business. In all cases, our partners and subsidiaries sell almost exclusively to businesses throughout the UK and increasingly to various European Union member states. Gamma has a turnover c£245m per annum and is ultimately owned by Gamma Communications plc, a company listed on the Alternative Investment Market with a market capitalisation of *one billion* pounds.

This consultation response relates to Gamma Telecom Holdings Limited and its subsidiaries.

Any conflict between the implied position of Gamma in any UK Competitive Telecommunications Association (UKCTA), Internet Telephony Services Providers Association (ITSPA) or Federation of Communication Services (FCS) responses or that of any other association in which Gamma is involved, is accidental and we consider that our views in this response should prevail.

Gamma trusts that this response addresses the questions posed by the Office of Communications ("**Ofcom**") and would welcome the opportunity to elaborate on any points in more detail if required.

General Comments

Gamma has a few concerns arising from the Consultation and we expand on these issues below. We are not responding to the individual questions asked in the Consultation, but instead have group our comments into the relevant areas of concern

Due Process

The Consultation relates to remedies in as yet undefined product markets and geographic markets that Ofcom have consulted upon (and Gamma was, to some extent, critical of).

Gamma considers that the cart is well ahead of the horse. Of course, there is nothing wrong with Ofcom consulting upon potential remedies, and in this case we consider the Consultation to be a narrow call for inputs on the subject, however, we respectfully submit that it would be a far more effective use of public funds and CP effort to follow the well-established market review principle;

1. Define Geographic and Product Markets
2. Consider the extent of competition in the relevant markets
3. Impose the minimum remedies required to secure the desired objectives.

We have had consultations and a Statement on the 2019-2021 Business Connectivity Market Review, a consultation (but no statement nor analysis from Ofcom) on geographic markets[1], but we are missing an essential piece before talking about remedies, which is a debate on the product market(s).

For now, we have to take the lists in Tables 1 and 2 of the Consultation as being those markets, but this is highly unsatisfactory. We discuss some of the reasoning behind our concern herein, however, at a summary level, there has been no consideration of the potential interaction of the new Fibre to the Premise ("**FTTP**") broadband product from BT, especially given the likely merger of residentially focussed local access market review and the business connectivity market review, with the existing product set.

This situation makes consideration of remedies, other than in general and academic "product agnostic efficacy of remedy" terms somewhat tricky. However, we note that Ofcom's pro-active approach to the 2021 period, with early and wide-ranging consultations, is a positive step. Our criticism should be taken of the sequencing and not the underlying intent.

Importance of Considering Business and Residential Premises Separately

It is easy to read sections of the document, notably §1.9 and §1.10, and think that Ofcom is planning to adopt a set of regulations that are neutral to the type of premises. In other words, the bringing together of the Business Connectivity Market Reviews and Local Access Reviews into a single market may have significant, negative, consequences if not approached with due care.

Depending on the product market definition, then whether there are separate markets for business and residential users is a significant issue. While we note that Ofcom has previously consulted at a high level of geographic and product definitions, there was not a substantial (and we would say insufficient) focus on this matter. It is premature to start to consider market power remedies before proper analysis and debate has occurred on the market definitions – and the jump to this latest Consultation, given the criticisms in the BCMR Appeals2 of the product market definition from 2016, leaves Gamma considering that the process is progressing too rapidly to be effective.

[1] Noting that in the BCMR Appeals ([2017] CAT 25 *British Telecommunications plc v Office of Communications)*, that the geographic market definition was criticised.
[2] CAT Judgement of 18 September 2008 – Neutral citation [2008] CAT 22.

To illustrate our thinking, if the product to which remedies are going to be applied is dark fibre, then there is less difference between residential and business premises. In more niche cases, there is the relevance of different types of fibre cable; with some commanding a premium for lower signal loss and lower latency characteristics which may be more suited for applications such as financial services over a residential household. However, the main differentiator is the fault-fix and installation remedies imposed far more than the physical product itself, with businesses placing a far greater weight on the certainty of installation date and rapid fault resolution compared to weight on shorter lead times more prevalent in the residential market.

However, the moment that the circuit has any form of active electronics in the defined product, there becomes a veritable chasm between the needs of residential and business users.

A residential deployment may use optical splitting technology to contend a trunk fibre to multiple premises; providing the residential premises don't require a bandwidth that exceeds a single wavelength then this is a pragmatic approach to delivering a service at a cost-effective price. However, a business is likely to place value on being able to scale bandwidth on demand, including dynamically consuming more wavelengths, which means the use of optical splitters becomes problematic.

Additionally, the termination unit needs to be able to support this, unlike the artificial limit imposed by BT which traditionally deployed ADVA electronics that could not handle an increase above 100Mb/s. It is far more likely a residential user will tolerate a bandwidth fixed for their maximum 2-year contract, compared to a business on the typical three years found for data services deployments in that market.

To that end, we welcome the product distinctions in (for example) Table 1 of the Consultation where there is a natural residential/business split, which is to say that we would not expect there to be any standard residential use cases involving leased lines that need consideration on an *ex-ante* remedies basis.

Gamma has previously made representations that business broadband (i.e. ADSL 2.0+ and Fibre to the Cabinet ("**FTTC**") based broadband) have different characteristics to residential (notably in previous Wholesale Broadband Access reviews). While we disagree with Ofcom's conclusions, the market is moving on, and it would be an increasingly academic exercise to re-run those debates looking at 2021-2026. Furthermore, with the upcoming changes to regulation regarding end of contract notifications, and the different treatments thereof between business and consumer services, it is highly plausible (and logical) that operators currently providing residential-type broadband to businesses will seek to position the product more towards a business market so as to avoid the more burdensome treatment of the notifications falling upon consumer customers. This ought to mean business broadband customers get a better service as a result.

Where we have substantial concern is in the emerging area of FTTP broadband where there is a significant potential overlap between business and residential.

At present, whether there are Ethernet applications over FTTP broadband, or whether FTTP broadband will become a substitute for EAD, EFM or other leased line technologies, is yet to be seen.

However, Ofcom's "wait and see" approach by not setting *ex-ante* conditions even in non-competitive areas, represents a "Sophie's choice" between two of Ofcom's statutory objectives. We recognise and support the general principle of light-touch regulation, but as has been noted to Ofcom in several responses by various parties in various markets[3] care must be taken when applying this largely successful approach from stable markets to new, or rapidly changing markets.

One of the most important outcomes that Ofcom should seek to achieve is to create an environment conducive to investment. In turn, this means creating an eco-system where there is some certainty that investment will produce an economic rent. We do not seek that Ofcom guarantees us a living, however, when considering million-pound investments in consuming Ethernet Access Direct ("**EAD**") directly from Openreach, the spectre of BT's downstream divisions making that investment a white elephant through margin squeezes or other uses of an FTTP broadband product in the business sector is something adds to the risk column in that investment decision.

For example, we know from previous market reviews and economic theory that different flavours of broadband are a competitive constraint on other flavours, limiting the need for regulation on them all. Equally, we knew that various types of leased line act in a similar way.

What we don't know is to the extent at which, on a forward-looking basis in 2021, the new products will interact with the existing products in economic terms. We would hope, that by the publication of the formal consultation for the regime from 2021, some of the uncertainty gets addressed in time. However, for now, the critical point is that it is challenging to discuss an approach to remedies absent the definition of the product markets for which they may apply.

[3] We note that this has become a theme in the discourse around the all-IP migration scenarios in the Narrowband Market Review.

To that end, instinctively, given the potential for FTTP broadband to be disruptive, we would say that equivalence of inputs (not just non-discrimination) is vital. Furthermore, if a charge control is not implemented then serious consideration should be given to cost-orientation obligations.

We also note that the Consultation appears silent on the Openreach Optical Spectrum Access ("**OSA**") product; this is a player in the market and a competitive constraint on abuse of dominance, especially on leased lines. The lack of such consideration reinforces our view that the Consultation is premature absent a proper consideration of the product markets.

Quality of Service

There does appear to be somewhat of a contradiction in Ofcom's position on Quality of Service ("**QoS**") in the Consultation as compared to the 2019 BCMR Draft Statement[4]. The Consultation notes that where BT has SMP it could have "the ability and incentive to provide sub-optimal QoS" and concludes that QoS remedies are likely to be necessary to promote competition and provide customer benefits[5].

The effectiveness of strong QoS remedies in the Leased Line Market is acknowledged in the Consultation[6], with Ofcom stating that broadly the same remedies were proposed in the 2018 BCMR Consultation[7], with some further incremental performance increases in some cases.

However, the 2019 BCMR Draft Statement states that Ofcom are not imposing QoS standards in the Metro Areas or other High Network Reach areas[8], even though Ofcom have concluded that BT have SMP in the High Network Reach areas[9].

We would expect consistency across the market sector reviews. Industry has recently experienced, and is still recovering from, a serious planning resource issue in the provision of EAD. The removal of QoS remedies in the largest of our market sectors, the High Network Reach areas, coupled with potential changes to Service Level

[4] Promoting competition and investment in fibre networks: review of the physical infrastructure and business connectivity markets Volume 2: market analysis, SMP findings, and remedies for the Business Connectivity Market Review (BCMR) – Published 24 May 2019
[5] 4.3 and 4.4 of the Consultation
[6] 4.7 of the Consultation
[7] Ofcom, 2018. *BCMR Consultation*, 15.24-5.
[8] 15.8 of the 2019 BCMR Draft Statement
[9] 6.2 of the 2019 BCMR Draft Statement

Guarantee payments[10] does give cause for concern. To this end, we agree with Ofcom's concerns on sub-optimal QoS presented in the Consultation.

Indeed, we foresee an increasing convergence in higher speed fibre to the premise services and the lower bandwidth Ethernet leased line services. In an all IP world, business connectivity will be sold as a component part of a complete business solution. The nomenclature of Ethernet, FTTP etc. will not be important; for instance, we may deliver value added Ethernet type services over FTTP technology if it fits the solutions requirements.

Charge Controls

Ofcom will be well aware of Gamma's position regarding the cost of capital used in charge control modelling. We have long considered it too high for the following reasons;

1. BT's credit rating is lower than expected from an infrastructure monopoly
2. BT's beta of equity is higher than expected from an infrastructure monopoly

While these are both actual, market defined, figures and are currently used in the cost of capital calculations, the regulatory cost of capital should be that of the actual business unit in question.

If BT were reduced to being just a monopolist for the products being charged controlled, then we would suggest that the cost of capital would be significantly lower than is used by Ofcom. An entity backed by a multi-billion-pound physical infrastructure asset would have a lower cost of borrowing, and its equity beta would represent a value closer to a risk-free asset expected from a ubiquitous monopoly.

BT's foray into wholly unrelated business areas, such as mobile and sports rights, should not be funded by its competitors. But by allowing charge controls to be calculated by reference to a cost of capital calculation that inherits the market risk associated with those business units, then that is precisely what Ofcom is doing.

It's not just that Gamma (and by extension its business customers) are paying for BT's diversification into consumer focused content, other BT management decisions, such as its historical approach to its pension contributions, all affect the key metrics that flow into the cost of capital.

[10] 15.273 of the 2019 BCMR Draft Statement

Given that Ofcom is consulting so far in advance on the subject of remedies, there is sufficient time to create a more robust framework for the cost of capital calculation which does not act as a cross-subsidy funding BT's diversification.

At the very least, there is ample time for Ofcom to lay out in detail why the current methodology does not (or does so immaterially) provide a benefit to BT.