Response to Ofcom's further consultation on proposed remedies

Wholesale Fixed Telecoms Market Review 2021-26

Joint submission by Colt and TalkTalk (the 'Passive Access Group')

Submitted to Ofcom: December 2020

1. Summary

1.1. The Passive Access Group ("PAG")[1] provides this response in relation to Ofcom's *Wholesale Fixed Telecoms Market Review 2021-26 Further consultation on certain proposed remedies* (the "remedies consultation").[2] The PAG members are some of the largest investors in network infrastructure and purchasers of access products in the UK. Although each has their own individual strategy, they share the common goal of encouraging Ofcom to impose passive remedies on BT/Openreach to enable them to provide customers with faster, higher quality, more diverse choice and affordable communications services.

1.2. The PAG is disappointed that the proposals to change the methodology for calculating some PIA charges result in increased charges overall. But more importantly, Ofcom's justifications for this - maintaining stable wholesale prices – notwithstanding that it delivers very little benefit to consumers in practice, subverts the well-established principle that prices be cost based and are based on evidence. The justification Ofcom gives for the increases in overall DFA/DFX charges is that BT has revised its approach to cost allocations which, to the surprise of no-one, increases the rent Openreach would receive from its competitors deploying fibre networks. This is in conflict with Ofcom's overall objectives of ensuring a level playing field between Openreach and altnets.[3] Ofcom simply accepting as given BT's views on cost allocation risks being seen as an abdication by Ofcom of its responsibilities, undermining confidence and creating further uncertainty for the outlook for wholesale prices.

1.3. Ofcom's proposals to depart from its well established cost-based pricing approach for setting prices of services subject to SMP remedies hands BT the ability and incentive to game the system by inflating its prices and profits.

1.4. The PAG is also concerned with Ofcom's proposal to delay DFA implementation, QoS requirements and SLA/SLGs in line with Openreach's demands, particularly when Openreach openly opposes the implementation of the DFA remedy. Ofcom's efforts to appease Openreach undermines CPs confidence in Ofcom's willingness to regulate Openreach rigorously and in the implementation of the DFA remedy.

1.5. The remainder of this document sets out these concerns in more detail.

2. Passive Infrastructure Access ("PIA") pricing

2.1. Ofcom has significantly altered its methodology for setting the PIA price caps in an effort to achieve what seems to be a primary objective of 'stable prices'. However, it is not clear what the fundamental link is between stable prices and its principal objectives and

[1] Comprising of Colt and TalkTalk.
[2] https://www.ofcom.org.uk/__data/assets/pdf_file/0023/206960/wftmr-further-consultation-proposed-remedies.pdf
[3] Remedies consultation, paragraphs 3.2 and 3.18.

duties, in particular *vis a vis* regulatory certainty and predictability - which are commonly accepted to encourage investment.[4]

2.2. Ofcom links its change of approach to the concern that the utilisation approach it previously applied may raise an expectation that PIA prices will fall in subsequent review periods. However, Ofcom's chain of logic for changing its approach throws the baby out with the bathwater. On the contrary, 'price stability' is not sufficient in and of itself to achieve Ofcom's principal objectives and discharge its duties and therefore should not be its overriding objective:

2.2.1. There is nothing implicit in the utilisation approach about the level of future prices. In fact, it is clear that the opposite is inherent in the methodology – prices may change based on utilisation which does not equate to prices going up <u>or down, it equates to them changing.</u>

2.2.2. If still in doubt, Ofcom can address any expectation concerns by simply stating there should be no expectation of lower prices.

2.2.3. Dealing with price instability/changes is not actually an issue for altnets in practice. Rather price changes (instability) is what altnets have come to reasonably expect under the regulatory framework and so are very experienced in dealing with it. In fact this is what their systems and processes have been developed to accommodate over the past 20 or so years in relation to Ofcom's cost based charge controls that it is well understood and expected to impose.

2.2.4. Pricing predictability and certainty is far more important to altnets and <u>is</u> consistent with Ofcom discharging its duties. This is because pricing predictability and certainty arises from a robust methodology and setting prices by reference to a cost basis for the regulated wholesale prices, with suitable transparency for all parties which encourages competition where it is possible. This is what altnets have come to expect yet this is currently absent from Ofcom's change in approach.

2.3. Instead, Ofcom's proposed changed method is based on arbitrary assumptions which in practice only BT will have the data available to challenge. What is worse is if the data that Openreach has would enable it to justify a lower price – Openreach has every incentive to remain silent. Therefore, allowing Openreach to detail to Ofcom what its reasonably incurred costs are without a mechanism for objective scrutiny risks CPs paying a higher percentage where Ofcom has underestimated its usage assumptions. Ofcom's change in approach is therefore likely to have the opposite effect to predictability and certainty. Openreach has every incentive to remain quiet when its data indicates that prices should be lower, and conversely, every incentive to challenge an existing price when its data indicates the price should be higher. Far from being 'fair' Ofcom is handing Openreach more of a *one way* bet.

[4] The 2010 and 2013 *EC Recommendations* (https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:251:0035:0048:EN:PDF) (*https://eurlex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:251:0013:0032:En:PDF*)

2.4. The PAG's view is that a price that is lower at the start of the review period and higher towards the end of the review period would be more appropriate. The issue of copper retirement and its impact on the loading of ducts should be addressed directly rather than fudged. BT's reorganising of its legacy networks should not lead to a cost penalty for competitors deploying fibre network. Ofcom has failed to justify how its 'stability based' approach meets its objectives to ensure a level playing field for altnets and cost recovery for Openreach. The only justification it gives is that the new method is 'appropriate'. This is plainly insufficient and is contrary to its principal duties, in particular, to promote competition and investment, and is in direct conflict with the 2010 and 2013 EC Recommendations clearly require cost-orientation for duct access.[5]

3. Dark Fibre Access ("DFA")/Dark Fibre X ("DFX") pricing

3.1. The proposed price changes are materially higher access rental charges[6] and lower main link prices,[7] the net impact of which appears to be an overall increase in prices (given the mix of rental vs main link).

3.2. The change appears driven by changes in attribution as discussed in section 2, in particular:

3.2.1. Access fibre allocation;

3.2.2. Inter-exchange fibre allocation; and

3.2.3. Access fibre usage factors.

3.3. It appears to be the growing wholesale products which are seeing an increase in cost and capital employed allocations, and those that are either contracting or that benefit from a stable price control, that are seeing a fall.

3.4. The PAGs view is that - absent visibility of the data – which is only available to BT it is difficult to understand why pricing has risen so much in this consultation compared to the pricing proposed in its initial consultation.[8] What does seem clear is that the changes in cost allocations in BT's most recent Regulatory Financial Statements[9] is an important contributing factor.

3.5. At a high level it is possible to compare like for like BT's newly restated figures for financial year 2018/19 with those previously released under the old allocations, including by drawing from the tables showing the changes for operating costs and mean capital employed.[10] It is not possible to compare figures for 2019/20 like for like as the old

[5] Please see the 2010 EC Recommendation https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:251:0035:0048:EN:PDF and 2013 EC Recommendation https://eurlex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2013:251:0013:0032:En:PDF

[6] Nov 20 Table 4.1 and Jan 20 volume 4 Table 3.1.

[7] Nov 20 Table 4.1 and Jan 20 Table A19.1.

[8] Promoting competition and investment in fibre networks: Wholesale Fixed Telecoms Market Review 2021-26, published January 2020.

[9] for the year to March 2020 with restatements for the previous financial year.

[10] Appendices 4.2 and 4.3 to BT's 2019/20 Regulatory Financial Statements.

approach was not replicated. In 2018/19 however, the restatement had the following effects which are likely to be relevant:

3.5.1. The Physical Infrastructure Access Market category was created from scratch and absorbed 7% of Openreach's opex and as much as 35% of its mean capital employed;

3.5.2. Contemporary Interface Access (leased lines) has also seen a big increase, gaining 14% of Openreach's opex and 8% of its MCE;

3.5.3. Wholesale Local Access by contrast saw 14% of Openreach's MCE transferred to other categories;

3.5.4. Wholesale Fixed Analogue Exchange lines lost 15% of Openreach's MCE; and

3.5.5. Low bandwidth leased lines saw 12% of Openreach's opex and 14% of its MCE transferred to other categories.

3.6. Clearly it is the growing wholesale products which are seeing an increase in cost and capital employed allocations, and those that are either contracting or that benefit from a stable price control, that are seeing a fall. This is a substantial change to happen at BT's behest in a single restatement given the profound long term implications for competition.

3.7. The changes in BT's cost allocations are based on BT's own judgement and appear to have been simply accepted by Ofcom. We would be grateful if Ofcom could please confirm what level of scrutiny Ofcom has in fact undertaken of these changes in cost allocation. This lack of transparency is even more concerning given that Ofcom is choosing to depart from its usual approach of ensuring cost-based prices for most products giving BT's scope to game the cost allocation to increase its profits by shifting costs from products whose prices are not based on cost (e.g. all WLA products in Area 2 including FTTC40) to ones that are (e.g. some LLA/IEC). This is classic BT behaviour of 10 years ago which Ofcom and industry (and the courts) worked very hard to disincentivise, yet here Ofcom appears to be actively (re)encouraging this type of behaviour by simply taking what BT says at face value and providing no visibility of the data relied upon.

3.8. The PAG's view is that Ofcom needs to properly scrutinise these allocations given that BT's best justification for these changes is its own judgement.[11]

3.9. There is also a fundamental flaw in Ofcom's analysis of the attribution of more cost to the LLA/IEC. Given that WLA costs are lower, this will mean that the excessive profits arising from its CPI+0% indexation will be even higher for WLA products. It comes at the price of even more excessive wholesale prices - Ofcom has not demonstrated how or why it has assessed these conflicting interests under its <u>principal duty</u> to further the interests of <u>all</u> citizens and consumers. This is also true of Ofcom's proposals to shift from CPI-CPI to CPI+0% for the dark fibre ancillary charge price cap. Ofcom's primary duty to consumers cannot be overridden by a change in its policy.

[11] Charge control notice 3.25, 3.26 and 3.27.

3.10. We would therefore be grateful for a more detailed explanation from Ofcom of how it has weighed its duties and come to the conclusion to promote one type of investment at the cost of others.

4. DFA implementation timing

4.1. The PAG is concerned with Ofcom's proposals to push back the implementation for DFA. Previously Ofcom required Openreach to launch DFA within one month of publication, however now this has changed to 4.5 months for a soft launch and 14 months for a hard launch. This is following Openreach's response, which states that one month is insufficient, and it is unable to reuse its 2016 refence offer[12] - however the reasons for this are marked as confidential in the consultation. Openreach has asked for a delay until June 2022 for the DFA product launch[13] - and Ofcom has accepted this – without giving stakeholders any sufficient explanation.[14] Given this - what assurances can stakeholders have that Openreach/ Ofcom will not simply push back these proposals again in August 2021/ June 2022?

4.2. There is also no compelling justification for Ofcom's proposals to delay implementing SLA/SLGs. Given the importance of the circuits, end customers expect SLA/SLGs – therefore CPs must offer them to end customers. However, CPs cannot be expected to offer SLAs/SLGs without any corresponding SLAs/SLGs from Openreach. The current proposals make the DFA remedy unattractive to CPs by expecting them to fill the gaps which arise due to Openreach's poor service quality. Ofcom should therefore ensure that SLAs/SLGs and QoS obligations are offered at the soft launch stage.

4.3. Openreach has failed to provide any convincing reason to proceed with no manual launch, beyond that it would result in pushing out the soft/hard launch by 4 months.[15] Again, there is no apparent justification for this delay, particularly given that Openreach has recently implemented DFX, which is a similar product to DFA.

4.4. Ofcom also states that its proposals are consistent with the BEREC common positions on wholesale leased lines[16] - specifically, BR16b, on requiring operators to publish a reference offer within a reasonable time. However, Ofcom should also take account of the competition issue which arises frequently according to BEREC that '*SMP operators may delay provision of the RO to alternative operators. Doing so would, in turn, delay access to their networks*.'[17] Therefore Ofcom should ensure that it is appropriately evaluating the harm that a delay to the publication of the reference offer would cause CPs.

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[12] Openreach response to the January 2020 Consultation, paragraphs 1.23(c)(iii) and 7.185-7.251
[13] Para 1.23 c iii Openreach's response
[14] Openreach marked its reasons for the delay as confidential in the Remedies consultation.
[15] Openreach response to the January 2020 Consultation, paragraph 7.247
[16] Para 5.22 of the Consultation
[17] BEREC common position page 8