

October 7th 2016

David Michels
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London, SE1 9HA

Sent by email

Letter in response to Ofcom's proposal for strengthening Openreach's strategic and operational independence

Dear David,

CityFibre welcomes the opportunity to respond to Ofcom's proposals for strengthening Openreach's strategic and operational independence.

We share Ofcom's and other Communications Providers' view that the governance of BT Openreach needs to be significantly strengthened. CityFibre's position in the market is however very different to the majority of other CPs in the UK, in that CityFibre is a direct competitor to BT Openreach, rather than to BT's downstream retail businesses. In this response therefore, we focus on some specific issues that are relevant to our particular business model. These of course are also relevant to the achievement of Ofcom's longer term goal of ensuring there are at least three competing networks in 40% of the country.

CityFibre has historically never purchased access to BT's network, instead we have constructed our own all-fibre networks to serve both the business connectivity and the fixed access markets. Recently, however, CityFibre has started trialling the use of access to BT's ducts and poles, namely in Southend and Bristol. Despite now using BT ducts, CityFibre does not consider itself a downstream customer of BT Openreach, nor a downstream competitor to BT. We are a competitor to Openreach as we do not offer retail services to end users, but only wholesale connectivity to CPs and aggregators, not a downstream competitor but a competitor at the same level as BT Openreach.

Clarifying where CityFibre sits in the overall value-chain of the provision of high-speed connectivity networks and services is important in the context of Ofcom's proposals because we consider that the proposals put very little emphasis on growing competition at the deep infrastructure level at which both Openreach and CityFibre operate. Ofcom's proposals appear to be carefully considered in the context of furthering strong downstream competition, but downstream competition based on continued reliance upon BT Openreach. In this letter we highlight the risks arising from Ofcom's current focus on downstream competition and present our views and suggestions on how this be better balanced. This is specifically important in light of Ofcom's findings in the Digital Communications Review (DCR) that the UK electronic communications market should become less dependent on Openreach and that the UK needs investment in fibre networks to compete with the Openreach hybrid copper-fibre network.

The broader regulatory context

CityFibre recognises that there may be both the opportunity and the incentives for BT to favour its own downstream businesses through the services and charges offered by Openreach. We also acknowledge that there may be opportunities for BT to direct profits from Openreach to other parts of BT, where BT faces stronger competition, and the resulting risk of market distortion. We note that Ofcom's proposals do

not appear to address the second issue mentioned above. It would be helpful for Ofcom to state how it plans to prevent the recycling of super-normal returns from Openreach to anti-competitive effect.

Recognising the issues as set out above, means that CityFibre agrees with Ofcom that it would be beneficial to the overall UK electronic communications market that Openreach become more independent. In fact, we believe that a more independent Openreach could also be beneficial at the infrastructure level as an independent Openreach should have the following consequences:

- Openreach will make stand-alone commercial investment decisions, not driven by BT's downstream retail businesses. This could create a transparent and competitive infrastructure market, which we consider a positive development, and
- Greater separation of Openreach from BT Group could make BT's downstream business more independent as well. This could open up new business opportunities for companies like CityFibre, building state-of-the art fibre networks.

It is however absolutely critical that the overall regulatory context, in which the changes to Openreach's status and governance are made, is one that encourages investment in competing infrastructure, rather than embedding Openreach as the single monopolistic infrastructure that all other providers use. Ofcom's strategic objectives of investment in competing fibre networks and a reduced reliance on Openreach cannot be achieved unless the overall regulatory framework is designed accordingly.

A more independent Openreach will not assist in achieving these objectives in and of itself, and could even make the achievements of those objectives less likely unless care is taken to shape the wider regulatory framework. Ofcom itself notes that a more independent Openreach (or even a structurally separated Openreach) is not a magic bullet to address the key competition problems in the UK electronic communications markets. Those problems can only be addressed through encouraging competition at the highest level feasible and thus subjecting Openreach to competitive pressure. Ofcom state on several occasions in their proposals that "*network competition is the most effective spur for continued investment in high quality fibre-based networks*"¹

An example of where the wider regulatory framework is not designed to support the investment in competing fibre infrastructures is Ofcom's BCMR decision in April this year, in which Ofcom concluded that there are no or little benefits of competing fibre infrastructure to serve the business connectivity market. As a consequence of that conclusion, Ofcom then proceed to regulate BT's wholesale prices down to a level that is exclusionary for any provider that does not have the same economies of scale and scope as BT. Naturally, it is physically impossible for any other provider to match BT's economies of scale and scope as BT's market shares (at the wholesale infrastructure level) are around 70%.

Whilst CityFibre does not offer detailed comments on Ofcom's proposals for furthering Openreach's independence, we urge Ofcom to ensure that any decisions regarding Openreach are in the context of the achievement of the Objectives stated in the DCR statement in February this year.

Scope for discrimination within Openreach

The original intention when Openreach was created was that it should provide the key, non-replicable wholesale products that were, in the jargon of the time, 'enduring economic bottlenecks'. Ofcom is well aware that the nature of what is or is not such an enduring economic bottleneck changes over time with the advent of new technology. Indeed, Ofcom's strategy in the DCR recognises that there is now greater scope for new competitive infrastructure deployment than was hitherto the case.

The consultation document is silent on the question of what the future product set of Openreach should be, and where the boundary between Openreach and the rest of BT should lie, now and in the future when (as we hope) the strategic goals set out by Ofcom in the DCR have begun to be achieved.

At present, Openreach offers a range of active and passive products some of which can be inputs to each other. Whilst the document recognises the scope for discrimination where wholesale and retail markets are vertically related, it does not explicitly recognise that the same risk applies in relation to active and

¹ One instance of this point being made in Ofcom's proposals in in section 1.4.

passive wholesale products where the latter may be an input to the former. Moreover, whereas the provision of a wholesale product to BT Retail from Openreach will occur across a business boundary thus providing a degree of transparency, the same need not be true where a passive product or input is provided to another product within the Openreach product family.

These issues require careful regulatory design to address. Two broad approaches which can be followed are periodic reassessment of the products that should be provided by Openreach rather than by BT Wholesale, and specific regulatory requirements in relation to the pricing, terms and conditions of input products to ensure that BT is not incentivised to undermine the desirability of using certain input products. The latter will be particularly important, in our view, in relation to future Duct and Pole Access.

Ofcom's focus on co-investment

One specific aspect of Ofcom's proposals which causes CityFibre concern is Ofcom's apparent focus on co-investment between Openreach and downstream retail businesses. Whilst co-investment or anchor tenancy arrangements are well-known and recognised in the infrastructure and property sectors, Ofcom should exercise extreme caution in recommending or appearing to grant some form of regulatory waiver to co-investment between Openreach and independent downstream CPs.

Given that Openreach already has a very large anchor tenant in BT's downstream retail businesses, co-investment between Openreach and other downstream CPs could effectively squeeze out competing infrastructure builders. This is because there would be little or no scope for the competing providers to secure anchor tenancy or co-investment agreements with downstream CPs if they were already engaged with Openreach. In other words, such agreements could be used tactically by Openreach to exclusionary effect. CityFibre would consider such a move to be potentially anti-competitive and urges Ofcom to exercise extreme caution in advocating this type of arrangement.

Co-investment by Openreach in itself, however, is not necessarily anti-competitive. It could for example be envisaged that Openreach would co-invest with other competing infrastructure providers in new duct and pole facilities that are suitable for supporting all-fibre networks that can serve both the business connectivity and fixed access markets. Given that the costs of the civil infrastructure represent the largest cost for network operators, it may be that co-investment in new fit-for-purpose duct infrastructure between Openreach and other builders of fibre networks is the most efficient approach to the challenge of rolling out fibre networks to private users, business and the public sector in the UK as quickly and efficiently as possible.

CityFibre is aware that in Spain different providers build duct infrastructure² in different locations and then provide each reciprocal access to that infrastructure. Models like that could be an efficient means of addressing the significant investment challenges facing all builders of the ducting infrastructure to support new fibre networks.

Summary

CityFibre agrees with Ofcom that measures to increase the independence of Openreach could be a useful component of the full set of tools to overcome the combination of downstream competition problems and lack of investment in fit-for-purpose fibre infrastructure by Openreach. It is, however, critical that Ofcom consider carefully the overall regulatory framework and context and that any changes to Openreach's status and governance are dovetailed with other regulatory measures that are specifically targeted at achieving Ofcom's DCR objectives of reducing the country's reliance on Openreach and fostering increased investment in sustainable infrastructure competition.

CityFibre is particularly concerned about Ofcom's focus on encouraging co-investment between Openreach and downstream competitive CPs. If this were to happen, it would likely further entrench Openreach as the single national infrastructure provider, simply because tying in one or more large competing Communications Providers to use the Openreach networks. This would substantially undermine the financial viability of a competing infrastructure provider.

² In combination with using existing duct infrastructure.

Ofcom should instead consider encouraging co-investment between Openreach and competing infrastructure builders to speed up the roll out of the civil infrastructure to support new all-fibre networks to deliver the connectivity required for the next many years.

Yours sincerely.

A handwritten signature in black ink, appearing to be 'A. Blowers', written on a light background.

Alex Blowers
Head of Regulatory Affairs