



MS3 Networks

A holistic overview of competition issues and regulatory requirements across Hull's fixed telecoms markets

MS3

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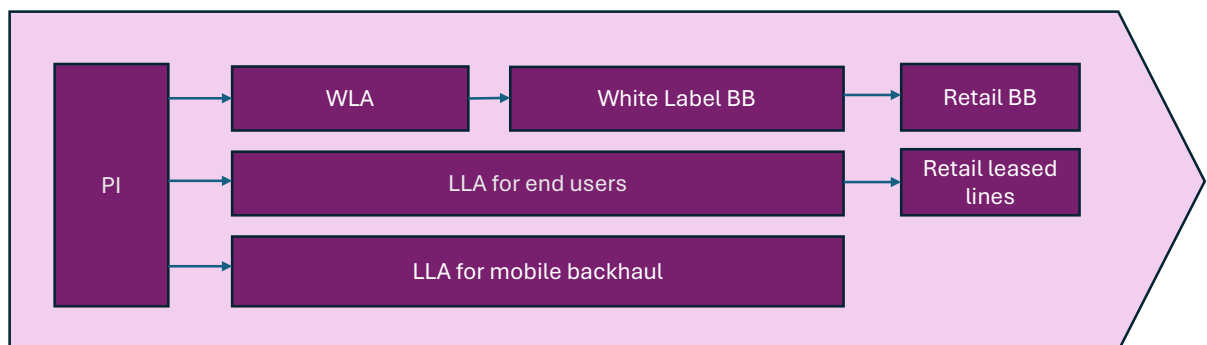
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Table of Contents

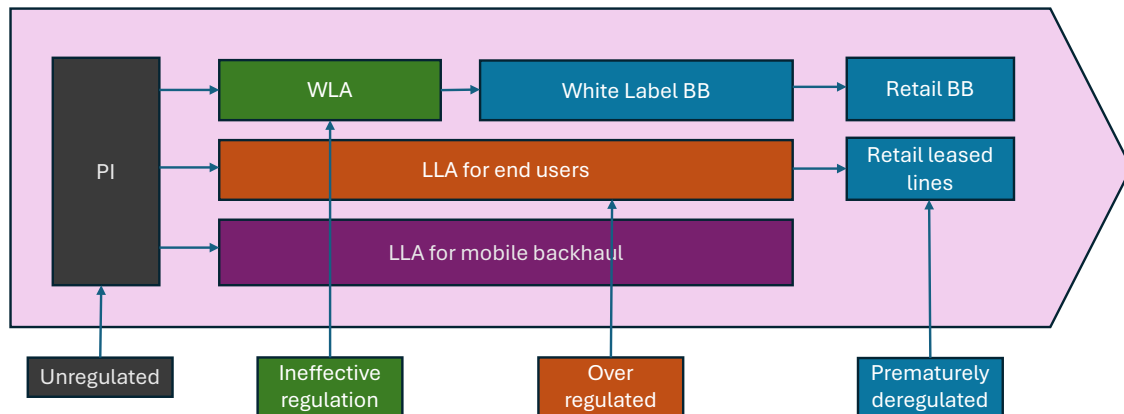
1	Executive summary	1
2	Introduction	2
3	Hull telecoms markets	3
3.1	The conventional regulatory approach has failed in Hull.....	3
4	The Hull TAR is an opportunity	5
4.1	The broadband markets	5
4.1.1	Network competition is part of the solution.....	6
4.1.2	The holistic solution	7
4.2	The leased lines markets	7
5	Conclusion.....	8

1 Executive summary

- 1 MS3 welcomes the opportunity to submit information and analysis to Ofcom while Ofcom is undertaking its market analysis in preparation for publishing its Hull TAR consultation. MS3 has submitted a number of separate papers addressing individual areas of concern. This paper seeks to bring them all together and provide Ofcom with a more holistic understanding of MS3’s concerns and how the different issues identified interrelate.
- 2 Due to the lack of impact of existing and past regulatory interventions by Ofcom in the Hull market, the current market reality is that KCOM is dominant at all market levels from the physical passive infrastructure all the way through to the furthest downstream retail markets. The successful deployment by MS3 and others of competitive full-fibre networks in Hull has demonstrated that network-level competition alone is not enough to overcome the issues experienced in the Hull market. MS3 is particularly concerned with the retail market failures.
- 3 The Hull TAR presents the opportunity for Ofcom to take decisive action and design a set of regulatory interventions that can overcome the market failures observed and documented by MS3 at all levels. MS3 believes that a decisive short-term increase in regulatory interventions in Hull, in combination with the existing and growing levels of competition at the network-level, can reverse this situation and that such new regulations can be scaled back at the end of the TAR period. MS3 believes that such action can deliver material and enduring benefits to residents and businesses in Hull
- 4 To address the current levels of dominance by KCOM, Ofcom would need to identify and intervene in more markets that it has done previously. Below is an illustration of the SMP markets MS3 has identified for regulatory intervention:



- 5 Despite Ofcom’s previous attempts to encourage competition, MS3 believes that the conventional approach to regulation has failed in Hull and that this has failed the consumers and citizens of Hull. In the illustration below, we have identified what we consider to be the general problem in each of these markets:



2 Introduction

- 6 MS3 has made separate submissions for each of the major markets or market groupings in Hull. This document presents MS3’s overall rationale and explains the interdependencies between the different regulatory structures suggested in those separate submissions.
- 7 Although having successfully deployed new full fibre networks to 128,878 residential premises and 15,590 business premises (a total of 144,468 premises) in Hull. Despite Hull having some of the highest broadband prices in the UK, MS3 and its ISP partners have not been able to make substantial in-roads into the Hull broadband market. This is not due to high levels of satisfaction and loyalty by KCOM’s broadband customers, nor to the MS3-based broadband services being unsatisfactory. It is due to market failures that are not the same as those experienced in the rest of the UK (RoUK).
- 8 In Hull, Ofcom has historically applied ‘soft’ versions of the regulatory remedies applied to BT in the RoUK market. This has resulted in KCOM retaining its market power and it is now, therefore, necessary to adopt a different approach. Failure to recognise the need for a significant change in approach to regulation in Hull will be to the direct and costly detriment of consumers and could damage the prospects of telecoms competition in Hull beyond repair.

3 Hull telecoms markets

9 As set out in MS3’s market definitions submission, the Hull telecoms markets are complicated.

The broadband markets are characterised by:

- A currently unregulated white label wholesale broadband market that (at least until March ’24) counted for 100% of KCOM’s external wholesale broadband sales.
- A regulated wholesale local access (WLA) market with zero sales, and thus no impact of the regulatory remedies imposed.
- A currently unregulated retail broadband market with excessively high early termination charges (ETCs) and discounted retail prices to levels below both the unregulated white label wholesale product and the regulated WLA product.

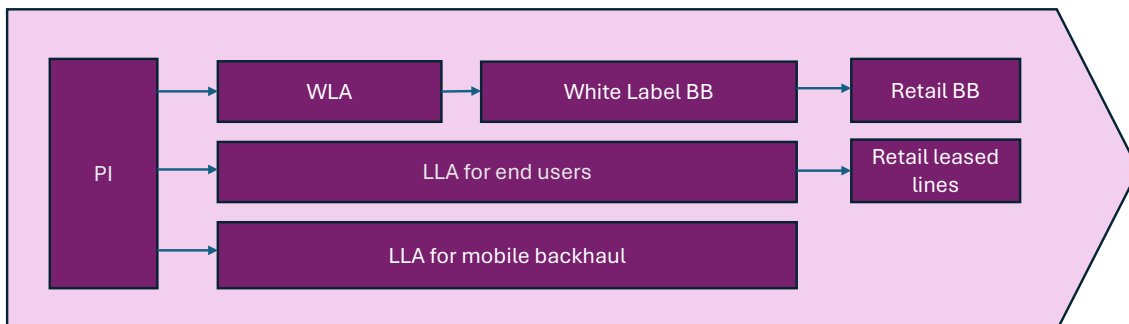
The leased lines markets are characterised by:

- A leased lines access (LLA) market providing connectivity to end-user premises with very limited competition, and
- An LLA market providing connectivity for mobile backhaul purposes, with a significant amount of competition.
- A currently unregulated retail leased lines market.

10 There is no formally identified physical infrastructure (PI) market in Hull and no PI access (PIA) remedy has been applied in Hull to apply in either the broadband or the leased lines markets.

3.1 The conventional regulatory approach has failed in Hull

11 Below is an overview of the relevant markets MS3 has identified for Hull.



*Although MS3 has not advocated the introduction of a new PI market for Hull, it has advocated for the application of a PIA remedy to enable network competition in both the broadband and leased lines downstream markets. It is, therefore, appropriate to include the PI market in the above illustration.

- 12 To compete in the retail markets, a provider must be able to access a wholesale product.
Wholesale products differ with some simply offering the retail provider the opportunity to rebrand and reprice the product and resell the service as presented at the wholesale level, whilst others offer differing levels of disaggregation with the corresponding opportunities for the retailer to change the attributes of the retail product.
- 13 To compete at the wholesale level, a provider either needs access to a disaggregated wholesale product, to the PI the network uses or to build its own PI.
- 14 The conventional approach taken to introduce competition into telecoms markets has been to mandate wholesale access to the dominant provider's services, with a gradual move towards increased disaggregation at the wholesale level up to the mandating of access to the PI. As wholesale access increases, regulatory interventions at the retail level (and downstream wholesale levels) are typically removed.
- 15 This was the approach taken by Ofcom in the UK both for the Hull market and in the rest of the UK (RoUK) market. MS3 considers that Ofcom can consider its approach in the RoUK markets to be successful, in the round. In Hull, however, it has not worked as expected. Although Ofcom has moved its regulatory focus gradually upstream and relaxed or removed regulation downstream, no actual real competition has emerged, even at the pure retail resale level.
- 16 At present, Ofcom regulates only the WLA and the LLA markets (with the LLA markets for end customer connections and for mobile backhaul combined as a single LLA market). The WLA market, however, has seen zero external sales as of the end of March 2024 and the LLA market appears stagnant. The very limited competition that exists in the retail broadband market is based on access to the unregulated white label BB market against which KCOM offers discounted retail prices at significant negative margins.
- 17 With the exception of the limited levels of competition in the retail leased lines market, MS3 considers that Ofcom's attempts to promote competition in the Hull telecoms markets have unfortunately failed. MS3 considers that this is likely due to premature withdrawal of downstream regulation (before there was evidence of real competition) and to the relatively light monitoring and enforcement regime applied by Ofcom in Hull.

- 18 In recent years, an unexpected development has been the emergency of network competition in Hull, with several providers building new competitive full-fibre network in and round Hull. This should, in theory, help unlock downstream wholesale and retail competition, but the existing trading practices by KCOM are such that the retail market is partially foreclosed, and the new competitive networks are not having the expected downstream effect.

4 The Hull TAR is an opportunity

4.1 The broadband markets

- 19 When Ofcom initially withdrew retail competition in Hull and the subsequent removal of regulation in the white label BB market in 2021, this was with the expectation that the regulated WLA access would enable effective competition at the retail level. For a variety of reasons, this has not materialised, and Ofcom now needs to take a step back and completely re-evaluate its approach to the Hull market.
- 20 The fact that Hull is a much smaller market than the RoUk market, does not mean that the residents and consumers of telecoms services in Hull should not be entitled to the same level of quality and value for money in the telecoms market as those who happen to live in the RoUk market. MS3 recognises that Ofcom has regulated the Hull market in good faith to this point and would expect Ofcom to continue to do so in light of the factual market conditions that are now evident.
- 21 Continuity of focus at the wholesale layer, cannot address broadband market failures observed in Hull. They are:
- No PI access;
 - An unused regulated WLA remedy that has been largely ineffective;
 - An unregulated white label BB market that is priced significantly above KCOM retail offer prices; and
 - A retail market where customers are forced into new 24-month contracts to avoid high ‘out of contract’ charges and where disproportionate early termination charges (ETCs) are applied to customers wishing to terminate contracts before their full expiry.

4.1.1 Network competition is part of the solution

22 Effective network competition can help overcome some of the current market failures, but it would require Ofcom to step in to temporarily prevent KCOM for engaging in tactics to prevent this from happening. In theory, network competition should be able to address all the current market failures, including:

- Increased wholesale competition as MS3 (as a wholesale-only operator) competes with KCOM to attract retail service providers to use its network, and
- Increased retail competition as the competitively priced and user-friendly WLA-equivalent product attracts more retail service providers to the Hull market to compete with KCOM's retail business.

23 There are two main obstacles to network competition successfully addressing the current market failures in Hull:

- 1) There is a public dislike of duplicate telecoms network infrastructures (especially telegraph poles) and there is currently no regulated PI access mandated in Hull. Additionally, some parts of hull cannot be economically served by separate stand-alone networks; and
- 2) KCOM's retail practices are such that new retail service providers using the MS3 network cannot attract sufficient levels of service take-up for them to build economically sustainable businesses.

Those obstacles, in turn, cause the take-up of the MS3 network to be significantly lower than anticipated.

MS3 is in a strong financial position. It has no debt and expects to be cash-flow positive before the start of the TAR regulatory period. But, given the current market circumstances in Hull, MS3 has taken precautionary measures to stop speculative build in Hull the short term. MS3 wants to cover the remaining 50,000 premises in Hull and offer those residents and business the full benefits of network competition, but KCOM's market behaviour (enabled by the current regulatory framework) could put that network expansion at risk.

24 This is a vicious cycle, that only Ofcom has the power to break.

4.1.2 The holistic solution

- 25 Instead of focusing on regulation at the active wholesale level, Ofcom needs to address the market failures at the PI and retail market levels:
- It would likely be necessary to maintain regulatory remedies at the wholesale level (including the white label BB market, which is the only product currently consumed by external retail service providers), but, as network competition takes hold (and especially because MS3 is a wholesale-only operator), the need for wholesale regulation should be reduced to basic safeguard provisions. In the short term, protection against anti-competitive pricing initiatives should be introduced;
 - PI access should be mandated (in a manner that is proportionate the likely scale of use of the remedy and the size of KCOM as an incumbent); and
 - Consumer protection and effective safeguards against anti-competitive practices should be introduced in the retail BB market.
- 26 MS3 believes that, although a short-term increase in regulatory interventions is necessary to address the unique situation presented in Hull, the existence of network competition and the presence of a wholesale-on competitor to KCOM will ensure that those additional regulatory interventions will no longer be necessary after the TAR period.

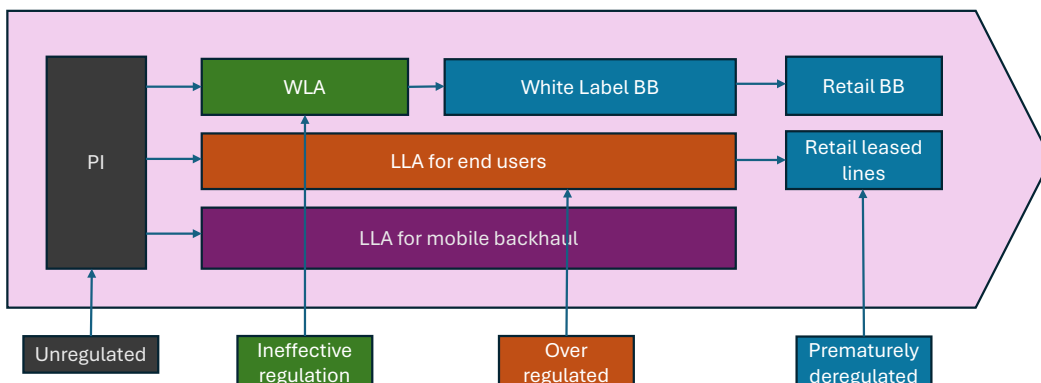
4.2 The leased lines markets

- 27 In many ways, the leased lines markets have similar characteristics to the overall picture described above for the broadband markets, with KCOM holding a very strong position at both retail and wholesale levels.
- 28 The retail leased lines market, however, is very different to the retail broadband market, in that leased lines customers are often large business and often have multiple sites in different parts of the country. This means that the KCOM position at both retail and wholesale levels is slightly less strong and that large retail providers will service the Hull retail market and use the KCOM wholesale products to do so.
- 29 MS3 has three main concerns in the leased lines markets:

- The LLA market for end-user customer connections is over-regulated with the imposition of a cost-based dark fibre access (DFA) remedy even though MS3 and other competing network operators are actively competing with KCOM in this market. The recent Hull market entry by CityFibre further strengthens the position that the Hull LLA market is prospectively competitive and cost-based DFA is inappropriate in this situation. MS3 understand that DFA may be an important remedy in the LLA market for mobile backhaul connections, so has proposed that these two markets are split up and DFA is retained as a remedy in the LLA market for mobile backhaul connections.
- The LLA markets in Hull suffer from a lack of transparency. The regulatory financial statements (RFS) produced by KCOM are not sufficiently disaggregated to provide useful insights into the market and MS3 has made specific proposals for how this can be overcome.
- There are signs that KCOM is starting to introduce retail pricing measures that increase the barriers to switching for leased lines customers, including new 5- and 7-year contracts with attractive pricing. MS3 has suggested that new retail-level remedies should be introduced to prevent KCOM from introducing retail pricing and other terms that unduly increase barriers to switching for customers in the LLA market.

5 Conclusion

30 The current regulatory structure in Hull is ineffective. This is illustrated below.



31 A major short-term adjustment is necessary. Network competition should address most market failures in the coming years, but that cannot happen without regulatory action to address the significant issues outlined above and set out in more detail in MS3's separate pre-consultation



submissions. MS3 particularly asks that Ofcom focus on remedying the market failures presented to Ofcom in the relevant MS3 Hull TAR submissions as well as in the draft competition compliant submitted to Ofcom in August 2024.