

Inter-exchange connectivity, Leased lines and Ancillary Services Market Reviews

INCA submission to Ofcom

July 2024

Non-confidential

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Executive Summary

- 1 In this paper, INCA sets out its proposals for the forthcoming Telecoms Access Review ('TAR') for the Leased lines Access, Inter-Exchange Connectivity and Ancillary Services Markets. We also comment on the high levels of return that Ofcom's overall approach to regulation in the WFTMR has allowed BT to return and some urgent steps that Ofcom should take to address BT's current anti-competitive pricing.

Inter Exchange Connectivity

- 2 BT's returns in the Inter-Exchange Connectivity Market are far in excess of its costs – in FY23 BT earned a return of 105.5% on its sales to external customers in BT Only Exchanges areas compared to Ofcom's allowed level of return in cost-based price caps of 6.8%. There is no policy to encourage competitive investment in this market by allowing a higher rate of return and Ofcom should take immediate steps to address this excessive pricing.
- 3 INCA considers that BT's dominance in the Inter-Exchange Connectivity markets is likely to strengthen as a result of BT's exchange closure program and in the TAR Ofcom should ensure that BT is required to provide critical aggregation and backhaul services at cost-based prices.

Leased Lines Access Market

- 4 INCA considers that BT's current pricing of ethernet leased lines circuit is discriminatory and weakening the prospects for competitive entry. Ofcom should take steps to address this before the TAR.
- 5 Ofcom's decision in the TAR to exclude leased line circuits used for broadband aggregation from the regulated leased line market has resulted in BT applying extremely high exploitative and discriminatory surcharges to those circuits. In the TAR Ofcom should address this by mandating BT to provide cost-based broadband

aggregation services in all areas.

Ancillary Services Markets

6 Ancillary services provided by BT are generally not subject to any competition – they can only be provided by BT. Therefore, the only constraint on BT’s prices is that set by Ofcom’s charge controls or other pricing obligations. Ofcom’s approach in the WFTMR to constraining BT’s prices has not worked – returns across all markets since 2021 have been persistently significantly above the cost of capital which Ofcom would have applied in a cost-based price control. In the TAR, Ofcom should apply an immediate starting price adjustment to bring prices down to cost and then apply a cost-based price cap to prevent future over-recovery of costs.

BT’s Overall Returns

- 7 In the WFTMR, Ofcom deregulated, or set flat prices in real terms (with annual inflationary increases at CPI) across many markets in most cases to promote network investment by other operators (and BT itself).
- 8 INCA recognises that in some cases this was appropriate to support investment in competitive networks, but it has also strengthened BT’s advantage over its competitors by enabling it to very high levels of return, in many cases in excess of its cost of capital. For example, Openreach returns in non-SMP markets in FY22 and FY23 were and 24% and 30% respectively, compared to BT’s actual cost of capital of 7%. These very high levels of returns in unregulated markets (and also in some regulated markets) have more than offset BT’s losses on its FTTP services and enabled Openreach to earn overall returns in excess of its capital. This provides BT with a huge advantage over its competitors who are seeking to compete in the FTTP market where all operators are incurring ‘start-up’ losses as they roll out networks and begin to build a customer base.
- 9 In the period covered by the TAR, a significant proportion of competing network will have been built out and the focus of the market will shift from network construction to customer growth. INCA therefore requests that, in the TAR Ofcom takes the following steps to help the market move towards a more level playing field and

minimise the advantage that BT has gained through Ofcom's attempt to establish a favourable investment climate:

- Impose cost-based charge controls with starting price adjustment down to cost in the following areas
 - Inter-exchange connectivity market
 - Ancillary services in all markets
- Impose a price floor (i.e. a wholesale economic replicability test) for FTTP services in the WLA market
- Require BT to increase the level of equivalence in the provision of PIA services.
- Strengthen the *ex ante* regime used to ensure BT does not engage in anti-competitive pricing tactics such as discounts or disaggregated pricing

Inter-Exchange Connectivity Market

Introduction

10 The Inter-Exchange Connectivity market provides Altnets with essential network connectivity between their local access networks and backhaul to the internet. In the WFTMR, Ofcom set different remedies according to the level of competition in BT's exchange areas as shown below.¹

WFTMR Inter Exchange Connectivity Charge Control Remedies

Area	Definition	Charge Control Remedy
BT+1 Exchange	One other operator providing inter-exchange connectivity at or near to an exchange	Charge control on all leased lines set at 2021 prices plus inflation (CPI-0%)
BT Only Exchange	No other operator providing inter-exchange connectivity	Charge control on all leased lines set at 2021 prices plus inflation Cost-based charge control on dark fibre

11 In BT+1 areas, Ofcom justified maintaining current price levels and not setting a cost-based price for leased lines on the basis that it would “*make investment more attractive for new competitors*” for operators who could make use of PIA infrastructure.²

12 In BT Only exchange Areas Ofcom considered that, even with the availability of PIA, it would not be economic for new entrants to install competing fibre to provide IEC services, and so Ofcom required BT to offer dark fibre IEC services in these exchange areas.³

¹ WFTMR Volume 4, paragraph 3.2.

² WFTMR Volume 4, paragraph 3.22.

³ WFTMR Volume 4, paragraphs 3.28-29.

13 INCA considers that Ofcom's decision in the WFTMR to define separate markets for leased lines access services and IEC services remains valid on the basis that the competitive conditions are very different for the two services.

14 INCA considers that the competition concerns in the IEC market identified by Ofcom in the WFTMR remain valid⁴:

- BT has incentives to refuse to supply services
- BT could set excessive prices or prices that amount to a margin squeeze
- BT could provide access on less favourable terms compared to those obtained by its own downstream businesses
- BT could target discounts or prices to deter roll out of new networks by its competitors

15 INCA's primary concerns relating to the IEC market relate to:

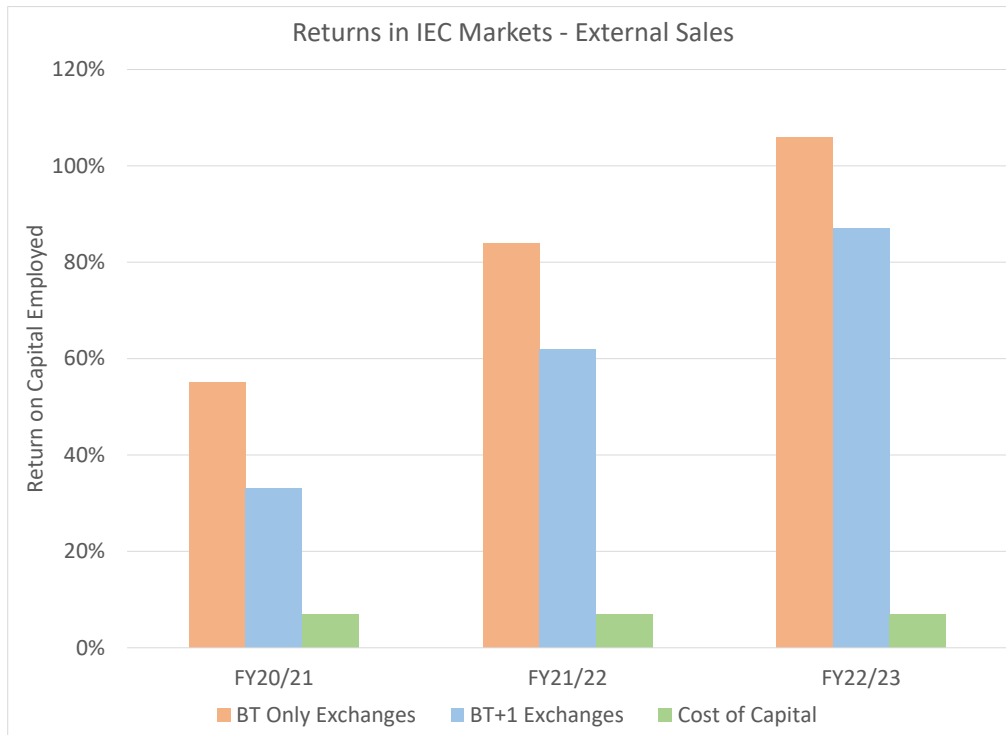
- Price levels
- Exchange closure

Price levels

16 Openreach's returns in the IEC market since the WFTMR (FY21 – FY23) shown in BT's Regulatory Financial Statements ('RFS') have been significantly above Ofcom's 'allowed' cost of capital used to determine cost-based prices as shown below.

⁴ WFTMR Volume 2 paragraphs 8.323-8.324.

Returns in IEC Markets

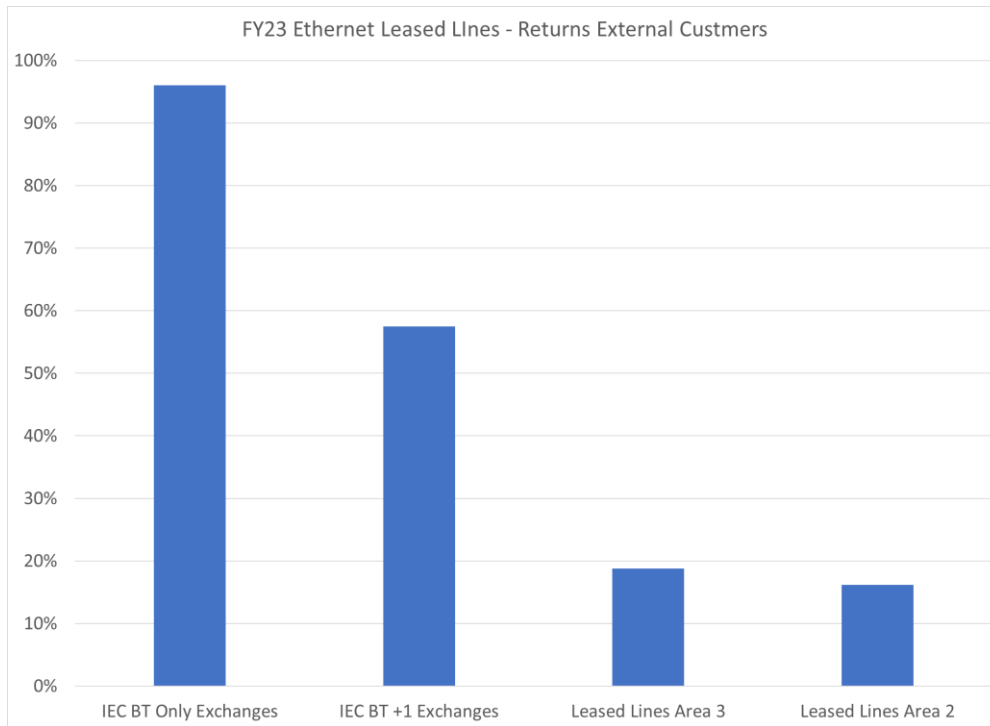


17 These levels of return clearly demonstrate that Ofcom’s approach in the WFTMR has failed to meet Ofcom’s stated objective of preventing BT from setting excessively high prices. INCA notes that returns in the period were high in part due to unforeseen current cost accounting holding gains, but that even after adjusting for these, BT’s returns were far above Ofcom’s estimate of a competitive cost of capital.

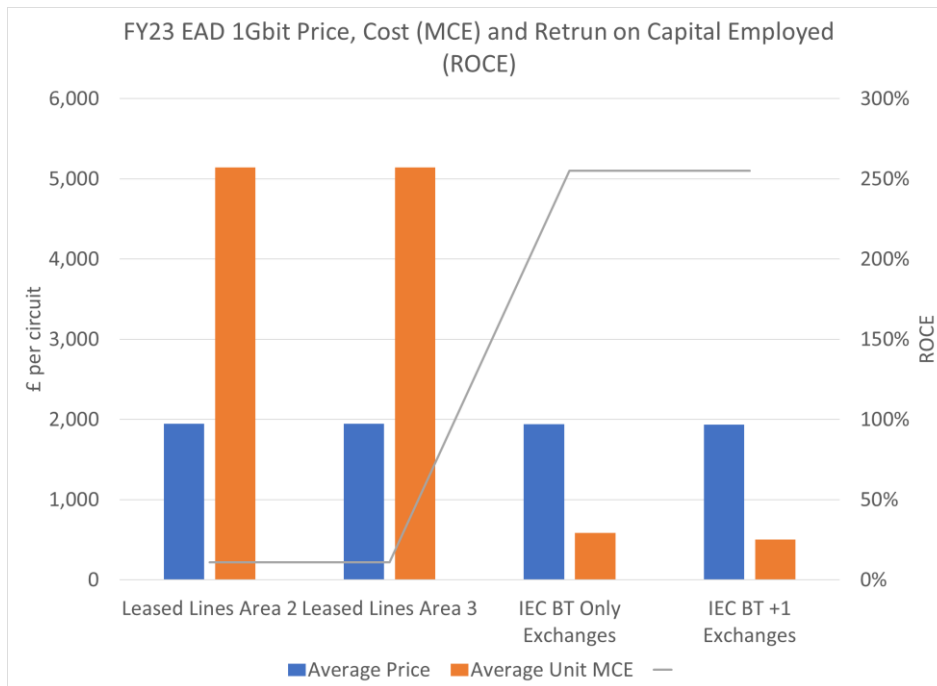
18 Whilst INCA agrees that incentivising investment in competing networks is a good thing, it is important that (a) inefficient investment is not promoted by unnecessarily high pricing signals and (b) BT does not generate persistently excessive returns as a result of the approach.

19 INCA notes that, in the RFS, BT reports much higher returns for leased lines services in the IEC markets compared to other leased lines markets, as shown below.

Ethernet Returns



20 The reasons for this large difference in returns appears to be due to several factors including differences in the mix of services in each market. One area of concern to INCA is that, whilst BT's prices for leased lines circuits across the different markets are the same, the unit costs implied by the RFS for some services are very different as illustrated in the chart below.



21 The chart shows that, whilst the price for a 1Gb EAD rental service is the same across all four reported markets, the average unit mean capital employed ('MCE') for an EAD 1Gbit circuit in the leased lines markets is approximately ten times that in the IEC markets, contributing to the difference in reported returns (along with differences in operating costs).

22 INCA requests Ofcom to investigate as a matter of priority the very high levels of reported returns in the IEC markets, and, if appropriate, consider what action it needs to take to ensure that BT is compliant with its regulatory obligations.

23 For the TAR, INCA proposes that Ofcom sets a cost-based price cap on BT's IEC services, including where appropriate a starting charge adjustment to reduce prices down to cost-reflective prices.⁵

24 We further consider the impact of setting constant prices in real terms later in this paper.

⁵ We note that the IEC market definition needs a fundamental review, but that does not effect the need to ensure that BT is not generating supra-normal profits in the provision of the relevant services.

Exchange Closure

25 In its July 2024 submission to Ofcom, INCA sets out the issues facing Altnets associated with BT's planned exchange closure programme including:

- Reduced supply of competing backhaul services from BT exchanges from third party providers
- Uncertainty of availability of dark fibre services
- Uncertainty over availability of replacement IEC services following exchange closure.

26 Against this background, INCA considers it likely that Openreach's dominance in the IEC markets will strengthen rather than weaken during the period covered by the TAR. INCA therefore considers it important that in the TAR:

- Ofcom ensures Openreach is required to provide suitable backhaul and aggregation services during the exchange closure process.
- Those services are set at a cost-based level.

Leased lines Access Market

27 In the WFTMR, Ofcom imposed different remedies on leased lines markets depending on the level of competition in the BT exchange area as shown below⁶

WFTMR Leased lines Charge Control Remedies

Area	Price Control
Area 2	Charge control on all leased lines set at 2021 prices plus inflation (CPI-0%)
Area 3	Charge control on all leased lines set at 2021 prices plus inflation (CPI-0%) Cost-based charge control on dark fibre
High Network Reach (HNR)	Requirement that charges are fair and reasonable

28 Ofcom's rationale for not imposing cost-based charge controls on leased lines services was the same as for the IEC market, i.e. to stimulate investment in competing infrastructure, either using Openreach PIA or dark fibre.

29 INCA's key concerns relating to the leased lines charge controls which it asks Ofcom to consider in the TAR are:

- Anti-competitive pricing of ethernet circuits
- Surcharge on broadband aggregation services

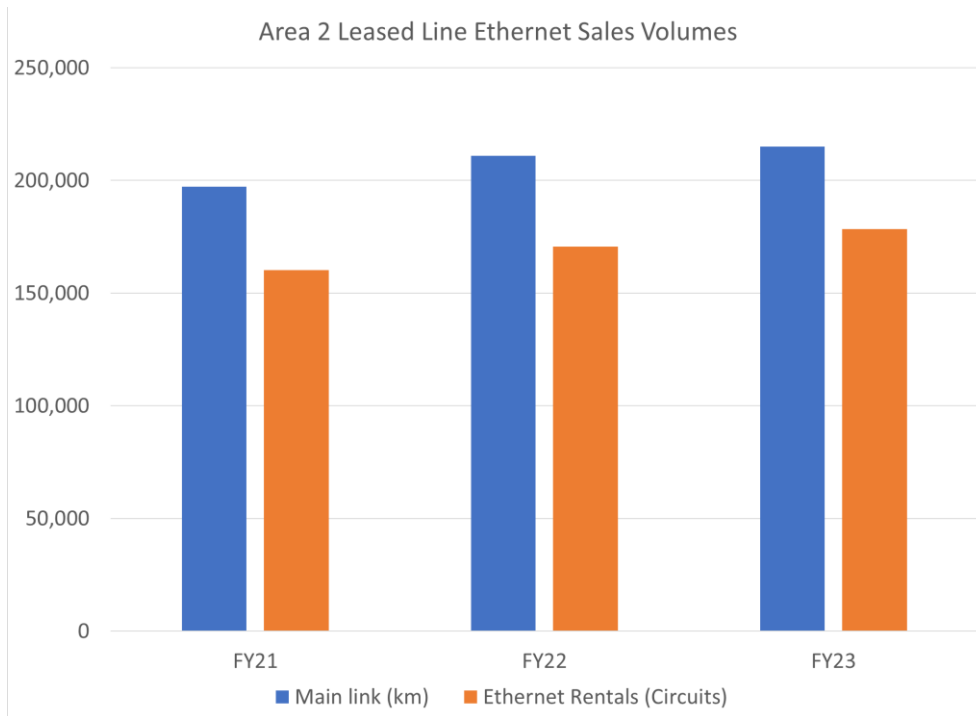
Anti-competitive pricing of ethernet circuits

30 Ofcom considered that its approach of setting a basket capped at 2021 prices in real terms plus annual inflation adjustment would support network competition using dark fibre and PIA. Whilst the fibre networks being rolled out by Altnets have the potential to drive competition and innovation into the leased lines market,

⁶ WFTMR Volume 4, Tables 1.1 and 2.1.

competition in many areas is limited and BT has been able to increase volumes during the WFTMR, as shown below.

Ethernet Services Rental Volumes, Area 2



31 INCA proposes that in the TAR Ofcom conducts a thorough survey of competition in the Leased lines markets to fully understand the barriers to entry and what specific remedies are needed to prevent BT from engaging in potentially anti-competitive pricing.

32 In particular, INCA considers that in using a basket approach to regulate ethernet services, Ofcom has provided BT with the flexibility to set prices in its ethernet portfolio in a way that hampers competition. The table below shows how BT has set very different levels of cost recovery for different products in the Ethernet leased lines basked of services in Area 2.

BT Returns, Ethernet Services, External Sales Area 2

	FY21	FY22	FY23
EAD 1Gbit/s rentals	10%	11%	11%
Other EAD rentals	5%	6%	9%
EAD LA 1Gbit/s rentals	4%	4%	6%
Other EAD LA rentals	0%	1%	3%
Main link	65%	165%	258%
Connections	331%	444%	622%
Total Ethernet services basket	7%	13%	15%

33 BT's Ethernet rental services comprise:

- Ethernet Access Direct ('EAD') services
 - Connectivity between two end sites (excluding any connectivity between exchange areas)
- EAD Local Access (LA) Services
 - Provides connectivity from customer to local exchange
- Main Links
 - Connectivity between BT's exchanges

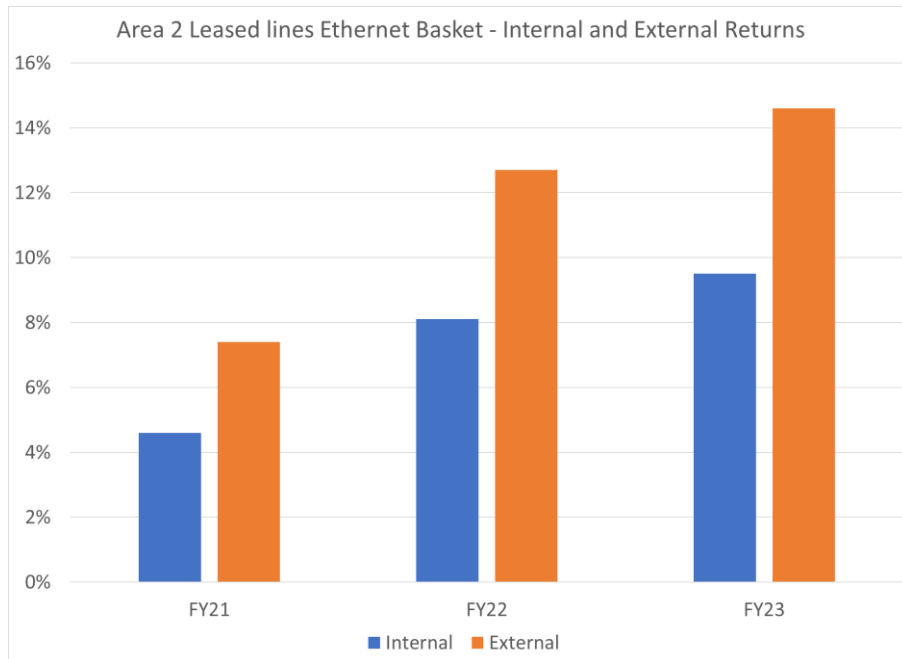
34 Where local fibre Altnets have rolled out their network, they will have the network to provide the EAD and EAD LA connectivity elements of a point-point network. They are much less likely however to have the fibre infrastructure needed to provide the Main Link portion of leased lines circuit –they would need to buy from BT or another network operator where available.

35 The table shows that BT has adopted a pricing strategy which:

- Prices the services where it is most likely to face the most competition (i.e. EAD LA services) below cost (i.e. its returns are less than those needed to earn BT's cost of capital of +/-7%), which is indicative of anti-competitive pricing.
- Prices Main Link services well above cost, and at levels that are far above what could be regarded as 'fair and reasonable', suggesting that BT has the ability to bundle its leased line products in a way that is potentially damaging competition.

36 Finally, INCA notes that BT's pricing of ethernet circuits has resulted in very different levels of profitability for its internal customers and external customers as shown below.

BT Returns, Ethernet Services, Area 2



37 The significant and persistent differences in the levels of return between internal and external customers suggest that:

- BT is discriminating between its internal downstream customers and external customers
- There is insufficient competition to constrain BT from pricing in this way

38 INCA requests Ofcom to investigate as a matter of urgency whether BT's pricing of its ethernet leased lines services is compliant with its regulatory obligations, and not wait until the TAR.

39 To the extent BT's pricing strategy remains at the time of the TAR, INCA proposes that Ofcom applies a cost-based price control for the different elements of BT's

ethernet leased lines products to ensure BT is not able to profitably adopt anti-competitive pricing strategies.

Broadband Aggregation Surcharge

40 Prior to the WFTMR Openreach announced that it would apply a surcharge to its Ethernet Access Direct (EAD) leased lines services where those services were used to carry aggregated broadband traffic. Openreach explained that

“Openreach isn’t obliged to connect ‘intermediate nodes’ (such as street cabinets) for alternative FTTP providers, using leased lines. But if companies do want to use this route rather than building their own Full Fibre networks, we’re happy to connect street cabinets at a reasonable price”⁷

41 In the WFTMR, Ofcom confirmed that it did not consider leased lines to aggregate FTTP traffic to fall within the leased lines access market:

“we define LL Access circuits as dedicated circuits between an end user site and the first point of aggregation (or in some cases between end user sites). Therefore, leased line circuits being used to aggregate FTTP to multiple premises may fall within the LL Access markets, depending on whether a FTTP cabinet is viewed as an end-user site. However, the network access obligations that we impose in the LL Access markets reflect our strategy to promote network competition where it is viable. We will interpret the network access obligations in the LL Access markets not to require Openreach to provide active leased line circuits or dark fibre access circuits where they would be used to aggregate FTTP to multiple premises for the purposes of deploying a fibre access network. We do not consider such access to be reasonable as telecoms providers already deploying their own fibre access networks are able to use PIA for these connections.”⁸

42 The level of surcharges is punitive: for 1Gbit services is averages 26%, but for the 10Gbit services the surcharge is up to 187% of the standard charge⁹. Given that at the standard price, Openreach is more than recovering its costs and earning a fair profit, Openreach’s claims that such prices are “reasonable” is simply wrong.

⁷ [Ofcom Side with Openreach Over Extra Charge for FTTP AltNets - ISPreview UK](#)

⁸ WFTMR Vol 3, para 5.110

⁹ Standard price for a EAD 10000 (84 month minimum period) is £1,096pa for the FTTP Aggregation service, £8,880pa [Price List \(openreach.co.uk\)](#) 24 June 2024

43 INCA considers Ofcom's decision not to set a price cap on broadband aggregation circuits in the WFTMR to be wrong for several reasons¹⁰:

- Ofcom's decision has allowed Openreach to set prices far in excess of cost for services where it faces no competition.
- Ofcom's argument that Altnets can use PIA infrastructure to deliver backhaul assumes that this is (a) viable and (b) economic. Neither of these necessarily hold true. There are some routes where PIA is simply not available. If it is available, Altnets would install fibre where it is economically viable to do so, but in many cases it is not. The fact that Altnets continue to use EAD and OSA circuits, even after the surcharge was introduced, shows that PIA is often not an economically viable upstream substitute.
- The lack of access to cost-based backhaul will inevitably weaken the investment case for Altnets to roll out to more remote or less dense areas.
- Openreach's policy is discriminatory, as its own downstream businesses are not required to use the surcharged EAD circuits. Access to cost-based circuits for broadband aggregation would help create the level playing field that Ofcom correctly has as a fundamental objective of its regulatory approach.
- INCA considers that Ofcom must address this issue in the TAR and impose a price cap on BT's ethernet services used for broadband aggregation. Given that BT's current prices are clearly exploitative, and not based on cost at all, INC considers Ofcom should reduce prices to cost immediately with a starting charge adjustment and not over time through a glide path.

¹⁰ See INCA/UKTA letter to Ofcom 10 February 2021 ([incaukcta-joint-letter-with-regard-to-openreach-surcharges-on-backhaul-circuits-used-for-ftp \(ofcom.org.uk\)](https://www.ofcom.gov.uk/consult/condocs/incaukcta-joint-letter-with-regard-to-openreach-surcharges-on-backhaul-circuits-used-for-ftp/incaukcta-joint-letter-with-regard-to-openreach-surcharges-on-backhaul-circuits-used-for-ftp.pdf)) and GOS Consulting Report, Review of Openreach proposed new surcharges for EADs and OSAs used for FTTP aggregation February 2021 ([incaukcta-report-from-gos-consulting-with-regard-to-openreach-surcharges-on-backhaul-circuits-used-for-ftp \(ofcom.org.uk\)](https://www.ofcom.gov.uk/consult/condocs/incaukcta-report-from-gos-consulting-with-regard-to-openreach-surcharges-on-backhaul-circuits-used-for-ftp/incaukcta-report-from-gos-consulting-with-regard-to-openreach-surcharges-on-backhaul-circuits-used-for-ftp.pdf))

Ancillary Services

44 Ancillary services include essential Openreach inputs required for Altnets and other Openreach customers to provide services using other Openreach inputs. They include:

- Cablelink
- Power
- Accommodation services

45 Prices for some Ancillary services are subject to a price control, others are subject to a basis of charges obligation, typically requiring Openreach to set cost-based prices.

46 Revenues and costs for Ancillary services are reported in BT's RFS under the individual SMP market, or where the services are used to support services in more than one market, in a 'Shared Ancillaries' statement.

47 Ancillary services provided by BT are generally not subject to any competition – they can only be provided by BT. Therefore, the only constraint on BT's prices is that set by Ofcom's charge controls or other pricing obligations. In this section we explain why Ofcom's price controls and obligations for Ancillary services have resulted in demonstrably excessive levels of pricing.

1.1 PIA Ancillary Services

48 Ancillary services comprise a significant proportion of total PIA costs for Altnets – 27% in 2022/23.¹¹

49 PIA Ancillary services include power, accommodation at BT's exchanges and a database containing details of OR's physical infrastructure.

¹¹ Ancillary charges (excl network adjustments) revenues of £3.5m and total PIA revenues of £12.8m – BT's RFS 2022/23.

50 Ofcom did not impose price caps on BT's PIA ancillary services rather it required them to set prices to include:

- any incremental external charges paid by BT (e.g. the cost of external labour used to provide the ancillary)
- an allowance for any incremental costs incurred by BT when providing ancillaries (e.g. BT's internal labour and planning costs relating to PIA ancillaries)
- an appropriate mark-up for common costs (e.g. general overheads) and a return on capital employed (where applicable).¹²

51 BT's returns for PIA specific ancillary services are shown below

£m	FY21	FY22	FY23
Revenues	0.1	1.5	3.5
Costs	0.0	0.8	0.4
Return	0.1	0.7	3.1
MCE	0.0	0.2	0.2
ROCE	286%	1540%	1540%

52 Given that Ofcom's cost of capital when setting cost-based prices was +/-7% in the period, it is clear from the table that BT's prices for PIA Ancillary services are far in excess of cost (including a reasonable ROCE). In the WFTMR Ofcom stated that: "

*"we expect BT to be able to explain and justify any significant differences between PIA ancillary prices and associated FAC for the purposes of the basis of charges obligation."*¹³

And

"we have imposed financial reporting obligations on BT in respect of PI ancillaries. This requires BT to provide us with a cost breakdown for each PI ancillary on an annual basis. For compliance monitoring purposes, we will review this information to ensure that charges are aligned to costs and monitor trends in cost. Where we observe large

¹² WFTMR paragraph 5.13

¹³ WFTMR paragraph 5.15

and/or unexpected variances or movements, we will investigate as appropriate and if we find that BT is in breach of the basis of charges obligation, we will consider what enforcement action to take” ¹⁴

53 INCA considers that the very high returns BT is earning for its PIA ancillary services are *prima facie* evidence that BT is not compliant with its basis of charges obligations and requests Ofcom to investigate as a matter of priority and not wait until the TAR. Furthermore, Ofcom should consider require BT to refund Ancillary Services customers for breaching its regulatory obligations by setting charges which include an excessive return on capital employed.

54 As part of the TAR process Ofcom should set cost reflective price caps on BTs PIA services to ensure BT does not charge excessive prices in future. Given the very high levels of returns currently being earned by BT, unless prices are dropped between now and the TAR, Ofcom should reduce prices with a reduction in starting charges, and not reduce prices down to cost using a glidepath over the period of the TAR remedy.

55 In the WFTMR Ofcom stated in relation to PIA ancillary services that:

*“Openreach should charge itself internal transfer charges which are consistent with the charges faced by competing telecoms providers using PIA.”*¹⁵

56 In BT’s RFS, BT reports no costs or revenues for its own use of PIA Ancillary services implying that it either does not use these services itself or they are provided on a different basis.

57 INCA considers that this shows that PIA is not being provided on a ‘level playing field’ basis – a key objective of the WFTMR. In the TAR, it is critical that Ofcom requires Openreach to provide PIA on a fully equivalent basis, and that this is reflected in the RFS.

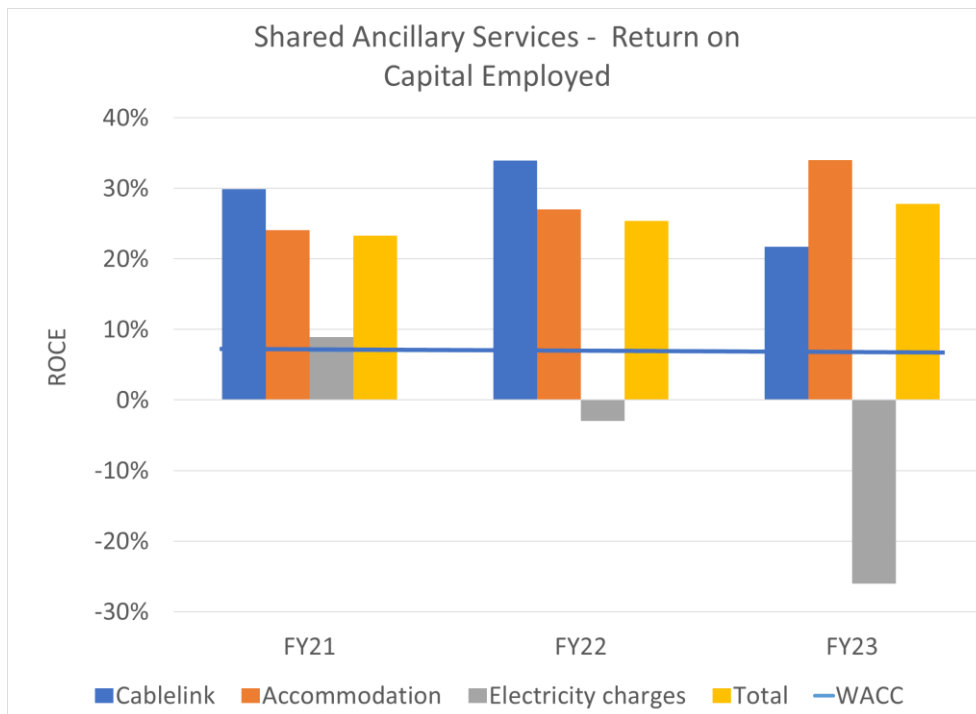
¹⁴ WFTMR paragraph 5.18

¹⁵ A8.46

Shared Ancillary Services

58 Shared Ancillary Services include Cablelink, Accommodation and Electricity services needed by network operators making use of other Openreach PIA and network services.

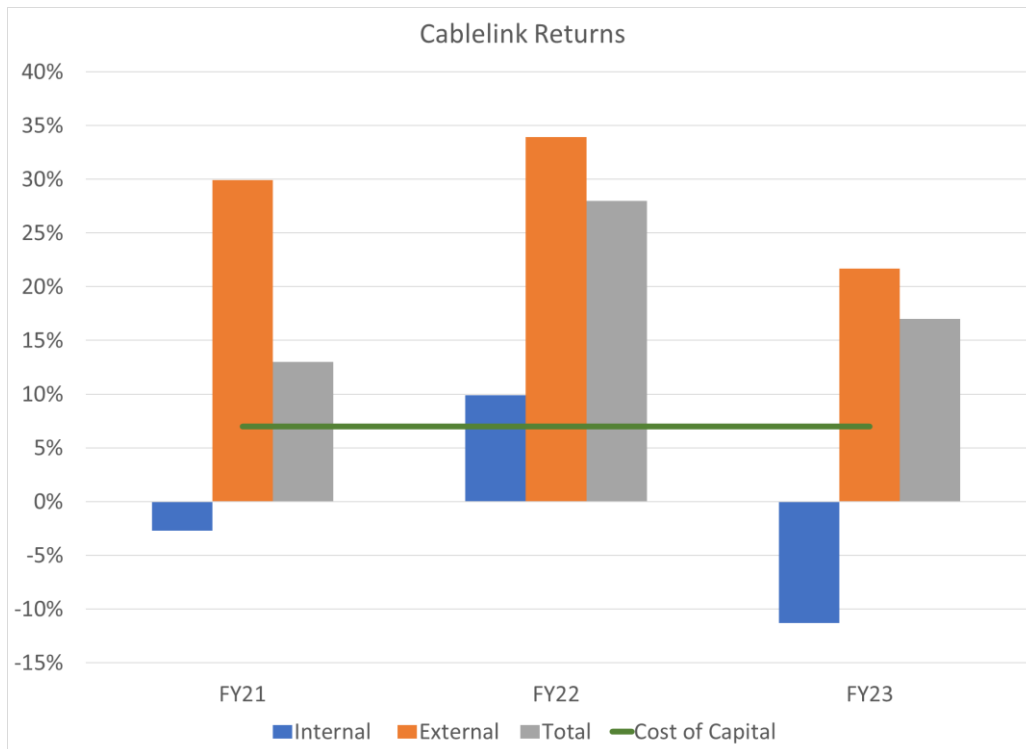
59 Cablelink and Accommodation services are subject to a price control and Electricity to a basis of charges obligation. BT's returns Ancillary Service for 2021- 2023 averaged 25.5%, far in excess of its regulatory cost of capital (7.0%).



1.1.1 Cablelink

60 Cablelink is an important Openreach product which enable their party operators to connect their networks to Openreach network in and around the exchange.

61 In the WFTMR, Openreach set Cablelink prices to be constant in real terms, based on a basket of all services with inflationary increases at CPI. Actual returns are shown below:



62 The table clearly shows that:

- Returns from external sales of Cablelink were far higher than those on internal sales.
- In FY21 and FY23, internal sales of Cablelink were made at a loss.
- Overall returns were in excess of the cost of capital Ofcom would have used had it set cost-based prices.

63 It is not clear from BT's RFS why BT's returns on Cablelink are so different for internal and external sales, but on the face of it at least, it is suggestive of discriminatory pricing. Ofcom does require BT to publish a 'Compliance Model' each year showing whether it has complied with its price control obligations, but this simply shows at an aggregated level the overall price increases compared to the allowed level.¹⁶

64 INCA therefore proposes that in the TAR:

¹⁶ [wftmr-compliance-model-22-23.xlsx \(live.com\)](#)

- In the TAR Ofcom considers differences in the composition of internal and external services in markets where it uses a basket approach to ensure that external users are not treated unfairly.
- BT is required in its RFS to show returns for the baskets disaggregated by internal and external users in a way that explains any differences in returns between them.
- Ofcom makes explicit allowances for BT's discriminatory pricing and over-recovery of costs by BT in the WFTMR by setting starting price reductions.

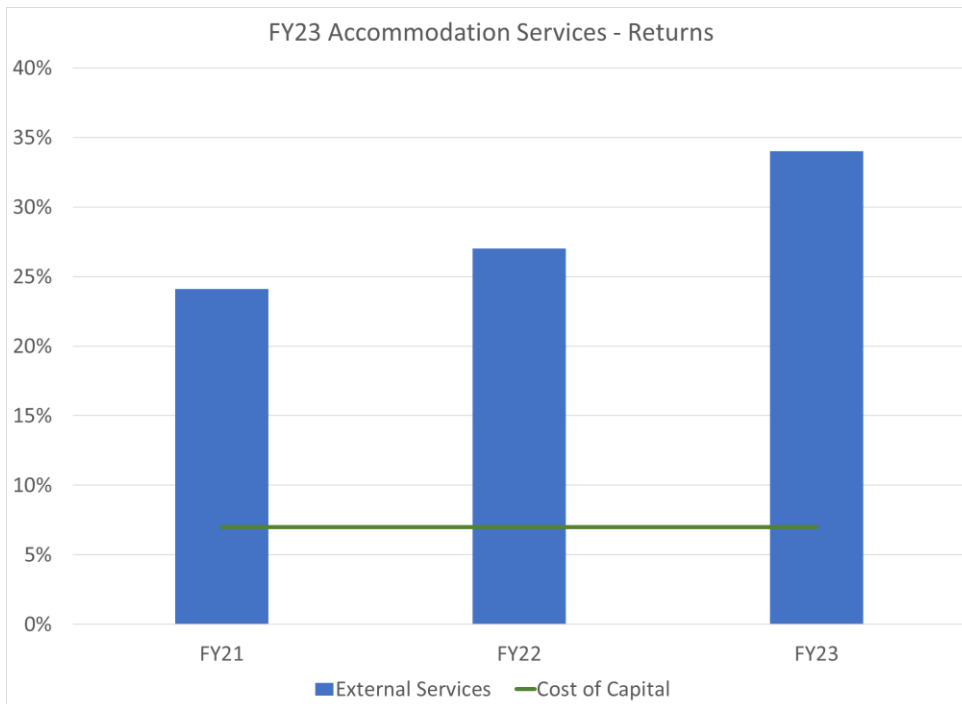
1.1.2 Accommodation

65 Accommodation services comprise over 500 services relating to occupation of BT's exchanges. They include services relating to power (but not electricity), security, rack space.

66 These services are generally not provided on an equivalence of inputs basis, and are not used by Openreach, with a small number of services being consumed by other BT downstream businesses.

67 In the WFTMR, Openreach imposed a price control on the basket of accommodation services set at constant prices in real terms with an annual CPI inflationary increase.¹⁷ Reported returns for accommodation services are shown below.

¹⁷ WFTMR Volume 4, Table 5.6.



68 The chart shows that BT’s returns on its external sales of accommodation services were significantly above cost.

69 In the WFTMR Ofcom explained that its approach to setting a charge control for ancillary services was to address the problem that *“Absent regulation in each of the physical infrastructure, WLA, LL Access and IEC markets, there is a risk that BT would have the incentive and ability to fix and maintain prices for ancillary services at an excessively high level”*.¹⁸

70 In INCA’s view, Ofcom’s approach of capping prices in real terms has not been sufficient to prevent BT from setting prices at an excessive level and that in the TAR Ofcom should:

- Impose a starting price adjustment to bring prices down to cost
- Impose a cost-based price control based on estimates of BT’s future costs which take into account its proposed cost-saving initiatives

¹⁸ WFTMR Volume 4 paragraph 5.3.

Openreach's Overall Returns

71 In the WFTMR, Ofcom deregulated, or set flat prices in real terms (with annual inflationary increases at CPI) across many markets in most cases to promote network investment by other operators (and BT itself):

“We decided to hold price caps for the relevant WLA and LL Access services constant in real terms (CPI-0%) to incentivise investment by Openreach and altnets, while also protecting consumers and competitors reliant on Openreach over the review period”¹⁹

72 This approach of holding prices constant in real terms has meant that in many markets, prices have been significantly higher than they would have been under a stricter cost-based price control.

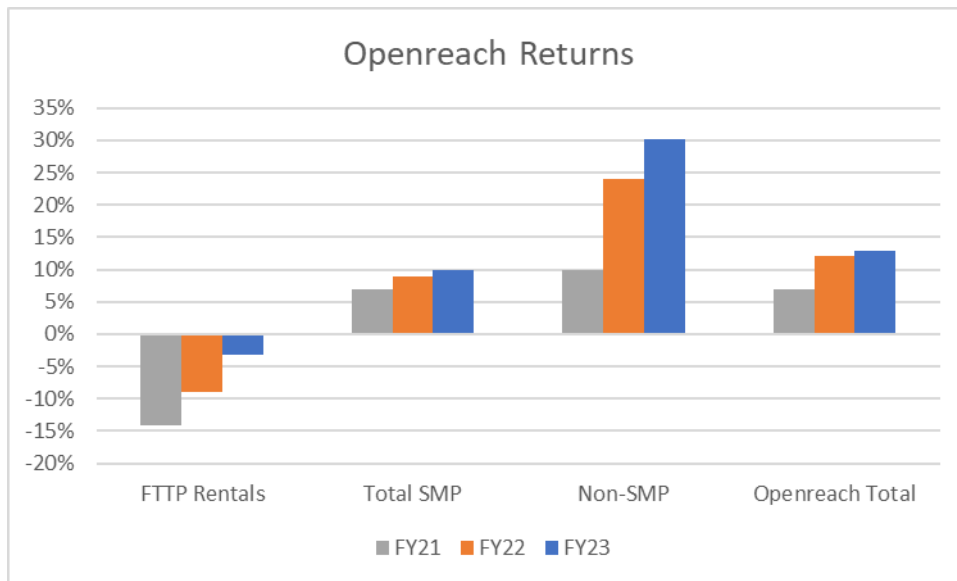
73 High levels of inflation since the TMR have meant that BT has been able to increase prices at a time when it has been aggressively reducing its overall cost base –

“We have successfully delivered our £3bn gross annualised cost savings, announced in May 2020, 12 months early and at a cost of £1.5bn, £0.1bn lower than forecast. We plan to further transform our cost base and improve our productivity by delivering a further £3bn gross annualised cost savings by the end of FY29, including a further £0.6bn of savings from the current transformation programme as it concludes in FY25, at an overall cost to achieve of £1bn. We expect c.40% of the £1bn cost to achieve in FY25, the remainder is spread across the years”²⁰

74 The chart below shows Openreach returns in various markets since the WFTMR.

¹⁹ Ofcom. Telecoms Access Review 2026, Starting work on the 2026-2031 review. 26 March 2024, paragraph 2.11.

²⁰ [Results for the full year to 31 March 2024 \(bt.com\)](#)



75 The chart shows that:

- Overall, Openreach returns in non-SMP markets (primarily copper services) are generating very high rates of return.
- Overall, Openreach’s operating losses in FTTP rental markets are more than offset by high returns in non-SMP markets.
- Over the period FY21-FY23, the excess of returns over and above the cost of capital amounted to earned by Openreach was £1.8bn, compared to losses in the FTTP rental markets of -£0.6bn – effectively BT was able to finance losses on its fibre business and generate £1bn of excess which it could use to finance its own FTTP network rollout.

76 Ofcom has indicated that in the TAR it intends to “continue with the same underlying objectives of incentivising investment and promoting network competition”.²¹

77 INCA acknowledges that Ofcom’s approach in the WFTMR has helped to establish a market which has attracted a significant amount of investment in competitive infrastructure from Altnets. However, the enormous financial benefit BT has derived from Ofcom’s approach illustrated above is not enjoyed by BT’s competitors – many

²¹ Ofcom, *Telecoms Access Review 2026, Starting work on the 2026-2031 review*. 26 March 2024, page 3.

of which are still operating at a loss as they roll out their network and start to build a customer base – in contrast to Openreach’s position of overall profitability, and in fact earning more than Ofcom’s estimate of their cost of capital every year since the WFTMR.

78 However, as the market moves onto the next stage of building up a customer base involving direct competition with BT (and its wholesale ISP customers) INCA is concerned that the high levels of profitability which the regulatory regime has afforded BT have tilted the playing field significantly in BT’s favour by providing it with a significant financial advantage over its competitors which will enable BT to cross-subsidise losses in competitive markets enabling and engage in predatory pricing or margin squeeze.

79 INCA therefore requests that, in the TAR, Ofcom takes the following steps to help the market move towards a more level playing field and minimise the advantage that BT has gained through Ofcom’s attempt to establish a favourable investment climate:

- Impose cost-based charge controls with starting price adjustment down to cost in the following areas
 - Inter-exchange connectivity market
 - Ancillary services in all markets
- Impose a price floor (i.e. a wholesale economic replicability test) for FTTP services in the WLA market
- Require BT to increase the level of equivalence in the provision of PIA services.
- Strengthen the *ex ante* regime used to ensure BT does not engage in anti-competitive pricing tactics such as discounts or disaggregated pricing

80 Taken together, these measures should help ensure that Ofcom’s initial success in attracting competing FTTP investment is followed through into a sustainable competitive market.