INCA and Altnet response to Ofcom Request for Information in relation to the Openreach Equinox Offer

INCA, Zzoomm, County Broadband, Full Fibre, Truespeed, Fern Trading, Community Fibre, ITS, WightFibre, Persimmons, Digital Infrastructure, and Airband.

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1 Executive Summary

1. Equinox will almost certainly lead to medium- to long-term consumer harm, due to it having caused a reduction in competitive fibre infrastructure investment and deployment, reducing choice and innovation and likely resulting in higher prices for end consumers.
2. The Equinox Offer (Equinox) is a complex, long term discount scheme with several elements that separately and collectively result in strong loyalty-inducing effects on CPs purchasing wholesale fibre broadband connections across the UK.
3. The loyalty inducing effects result from a combination of significant benefits resulting from dealing exclusively (or almost exclusively) with Openreach as wholesale provider of fibre broadband connections, and significant penalties resulting for non-compliance with the Equinox qualifying criteria.
4. Equinox has no volume threshold for participation and, given that all CPs will have to use Openreach due to its national ubiquity, it is likely that all CPs will join the scheme. In fact, for a CP to not do so would put it at a significant disadvantage in the retail market where it would be competing against CPs that benefit from the substantial wholesale discounts. The intensively competitive retail broadband market would make it extremely difficult for a CP to compete if it were to not join Equinox.
5. The consequence of the strong loyalty inducing elements of Equinox is that CPs will be disincentivised from purchasing fibre broadband connection from altnets at the wholesale level and make it significantly harder for altnets to compete against the CPs in the retail market due to the very low wholesale prices resulting from the various Equinox elements.
6. The main Equinox elements are:

   The product mix rental discounts,

   The 12-month customer acquisition discount, and

   The ARPU-share element.

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1.1 The product mix rental discount element

7. After a brief initial period, this element offers between 11% and 30% discount of rental prices, with the highest discounts applied to the highest speed products. The higher speed products are adjusted by CPI-1.25% and the lower speed variants are adjusted by CPI-0. The discounts run for ten years with a review in Year 6, when Openreach has the option of discontinuing the scheme.

8. CPs must achieve a minimum of 80% fibre to the premises (FTTP) connections of their total new connections in each quarter in order to qualify for the product mix rental discounts. This means that they are disincentivised from using altnet FTTP lines in existing or future Openreach FTTP footprint areas and results in effective wholesale market foreclosure for altnets.

9. At the retail level the product mix rental discounts could result in price levels that cannot be replicated by altnets building in rural areas where the cost to deploy is higher. It may also result in it not being viable for altnets to deploy 2^{nd} or 3^{rd} networks in areas that could otherwise support infrastructure competition.

10. The government's Project Gigabit is also likely to be affected by this element. This is because Openreach can only justify the discounted price levels because it has a national network and cross-subsidises higher cost areas from lower cost areas. Altnets that do not have a national network and therefore have to recover the actual costs of deployment in each location are unlikely to be able to replicate the discounted pricing (whether at retail or wholesale level) and would be deterred from participating as they are unlikely to be successful.

11. the Equinox product mix rental discount is therefore likely to have the following effects:

    wholesale market foreclosure,

    retail pricing that squeezes out alternative providers, and

    failure to attract competitive bids for public funding in the Government's Project Gigabit initiative.

1.2 The 12-months customer acquisition discount

12. This element enables CPs to offer customers currently connected to a network other than that operated by Openreach a 550Mbps connection to the Openreach network for 12 months for the price of a 160Mbps connection.

13. This element is clearly targeted at Openreach's infrastructure competitors and has a clear and direct impact on the viability of competitive infrastructure investment. Whilst, in the short term, the primary target of this element may be Virgin Media (which is an established competitor and not the main focus of Ofcom's stated competition concerns with Openreach discounting offers), it is clear that it also targets altnets at both retail and wholesale levels.

14. Due to this element being clearly targeted at altnet connections (including Virgin Media), it has the same effect as a discount that specifies geographic locations where altnets have or are deploying FTTP and as such should be prohibited and not qualify for Ofcom consent.

1.3 The ARPU-share element

15. This element offers CPs 50% of any rental payments in excess of £17/month made to Openreach as soon as the national average ARPU for the CP exceeds £17/month/FTTP connection.

16. The £17 ARPU threshold may initially be challenging, but that level is subject to a CPI-2% annual adjustment, making it decline substantially faster than the rental prices that are subject to either CPI-0% or CPI0-1.25% annual adjustments. These adjustments result in the ARPU threshold being only marginally above the 40/10 FTTP price in year 10 of the equinox scheme.

17. This element is extremely long-term loyalty inducing with a commensurate harm to the investment viability for competitive infrastructure investors. The ARPU-share element would constitute a significant deterrent to investment for competitive fibre infrastructure.

1.4 A 10-year discount

18. Equinox runs across the current market review period and beyond the expiry of the next market review period. Its market foreclosure effect is significant and the 10-year period is not objectively justifiable.

1.5 Combined impact of Equinox and existing offers

19. The GEA Volume Offer and the FTTP-only V2 Offer are already in the market. The GEA Volume Offers provides substantial discounts on FTTP connections and incentivises CPs to keep their customers on FTTC connections until Openreach deploys FTTP in a location. The interaction between the GEA Volume Offer and Equinox are strong and the cumulative effect is an even stronger deterrent from the uses of altnets connections by CPs.

1.6 Claw-back of connection discounts

20. Although Ofcom has not included connection discounts in its WFTMR assessment, the Equinox terms which threaten to claw back connection discounts if the CP does not meet its connection forecast (which are based on a 90% FTTP threshold), represents a significant risk for CPs and is therefore also a strong loyalty inducement with the corresponding negative effect on the business prospects for altnets.

1.7 A thinly disguised anticompetitive initiative

21. Openreach's objectives for the Equinox discounts are clear. Firstly, they want to hasten adoption of full fibre networks which altnets are supportive of. Secondly, they want to use their significant market power and existing relationships with CPs to reduce the amount of infrastructure competition they will face in the future so that they can then increase prices in the future. This runs contrary to the objectives of Ofcom, HM Government, the UK economy and consumers and should be prohibited.

1.8 Increased awareness increases the impact of Equinox

22. Whilst some elements of Equinox are similar to those in existing offers, they were largely not known by altnets and their investors. The impact they would therefore normally have had, had the awareness been greater, has not been seen in the market where investment in altnet deployment has been vibrant in recent years.

23. The WFTMR, the consultation on exiting offers, and the current equinox consultation have, however raised awareness and brought understanding of the intentions and effects of existing offers and Equinox to the fore and will likely have a significantly dampening effect on future finance commitments to competitive fibre infrastructure. The limited impact on existing offers should not be relied upon by Ofcom as an indicator or the likely impact of Equinox.

1.9 Our overall assessment

24. This document sets out the level of analysis that it has been possible to conduct in the two weeks allowed by Ofcom for stakeholders to register their concern with Equinox.

25. Although we understand that Openreach has legitimate reasons for wanting to accelerate migration from copper to fibre, this offer was clearly designed to achieve that objective as well as to cause the maximum harm possible to Openreach's competitors.

26. Additionally, whilst consumers would benefit from short-term price reductions, the medium- to long-term reduction in competition likely to result from Equinox would significantly outweigh those short-term benefits.

27. Below is a table that summarises the results of our assessment.

	Product mix element	12-months element	ARPU sharing element	Forecasting penalty	10-year duration
Induces loyalty and increases barriers to switching	✓		✓	✓	✓
Denies altnets demand	✓	✓	✓	✓	✓
Increases altnet investment risks	✓	✓	✓	✓	✓
Penalty for non-compliance	✓			✓	
Targeted at altnets		✓			
Increases consumer long-term benefits	✗	✗	✗	✗	✗
Essential to Openreach business plan	✗	✗	✗	✗	✗
Meets Ofcom's overarching objectives	✗	✗	✗	✗	✗

2 Introduction

28. In compliance with Ofcom's WFTMR Statement, on July 1 Openreach notified Ofcom of its intention to launch a new offer (Equinox) for its wholesale broadband customers.

29. On July 2, Ofcom issued a Request for Information (RfI) to stakeholders on whether Equinox would raise competition concerns in the market, with particular focus on the new competition rules set out in the WFTMR:

30. Ofcom splits its new rules into two categories:

    1) geographic pricing, and
    2) other commercial terms (OCTs).

Geographic pricing

31. Ofcom has prohibited geographically targeted pricing, unless Openreach can prove that it does not harm competition and that the geographic pricing is necessary for Openreach's FTTP business case.

OCTs

32. OCTs cover other commercial terms outside geographically targeted pricing, including loyalty-inducing pricing and other pricing and/or contractual terms that could result in foreclosing the market by depriving altnets of demand for their services.

33. OCTs are not prohibited, but Openreach must pre-notify them 90 days in advance of them taking effect, affording Ofcom and stakeholders the opportunity to raise concerns. Ofcom can prohibit specific OCTs if it determines that they will cause harm to nascent competitors and are not either necessary for the Openreach FTTP business case or necessary to increase consumer benefits.

34. INCA and Altnets have already submitted to Ofcom analytical frameworks for geographic pricing and for OCTs that directly reference the WFTMR Statement, and we refer Ofcom to those frameworks.[1]

35. INCA and Altnets have separately submitted their concerns relating the other OCTs contained in the three existing Openreach offers and await Ofcom's response to that submission.

36. The OCTs in Equinox are in many aspects very similar to those in the existing FTTP only V2 Offer, although there are also new elements in Equinox. This submission covers all aspects of Equinox including where the issues described are similar to or identical to those already submitted to Ofcom.

3 Comments on Ofcom's analytical approach

37. Ofcom published its Statement on "Existing Openreach FTTP offers with geographic pricing" (Statement) on 2nd July 2021. We have a number of concerns with elements of the Statement that we comment on below by reference to Ofcom's paragraph numbers.

38. **Para 3.12**. Ofcom states that it relied on "contemporaneous internal papers" when assessing the reasons for Openreach's pricing. That evidence seems to have been sufficient for Ofcom to accept Openreach's existing offers, given that Ofcom considered it appropriate to ask Openreach to objectively justify the existing offers.

39. We find this reliance on internal papers and the decision to not ask for an objective justification surprising and worrying. We would have expected Ofcom to have examined the forward looking effect of the discounts on competition and consumers, bearing in

[1] https://www.ofcom.org.uk/__data/assets/pdf_file/0029/219728/inca.pdf

mind the raised awareness of these discounts amongst altnets as a result of this consultation. Ofcom should not rely on Openreach's own justification to determine whether Ofcom's two tests of "objective justification" and consistency with Ofcom's overarching policy objectives are met, as reiterated in para. 3.11 of the Statement.

40. **Para 3.16.** Ofcom states that it does not consider a separate assessment for each geographic market is necessary. Again, we find this conclusion surprising. Areas 2 and 3 form separate geographic markets on the basis that competitive conditions in the two areas are sufficiently different from each other. Under the definitions of these two markets Area 2 is prospectively competitive and Area 3 unlikely to have any competitive build. Whist the offers may be the same in both areas, the effect of the offers on competition and consumers could be quite different.

41. In those parts of Area 3 where competitive build is very unlikely to occur the Openreach discounts may have little to no effect on competition as the underlying economic conditions are insufficient to support more than one fibre network. However, in Area 2, and some parts of Area 3 where there may be competitive build, the discounts may have the effect of deterring competitive network build by raising barriers to entry for altnets. Claiming that a separate assessment for each geographic market is not necessary when the potential effects of the discount on competition are likely to be quite different in each market is, therefore, unjustifiable. We urge Ofcom to reconsider this position.

42. **Para 3.17.** Ofcom states that it 'theoretically' might want to consider the aggregate impact of multiple offers. We find this concerning as the interplay between offers is clearly important and something stakeholders would expect Ofcom to take into account.

43. Whilst Ofcom may not have found it necessary to make an aggregate assessment in this case (a position with which we disagree), it is important that Ofcom does not set a precedent by suggesting that aggregate impact assessment would not be a natural part of future assessments, including the assessment of Equinox and its interplay with existing offers.

4 Outline of Equinox Offer

44. Below is a summary of the components contained in Equinox, in the following sections, we address each component separately.

Geographic scope	All areas where Openreach has FTTP ready for service[2]
Offer expiry	September 2031
Rental discount expiry	September 2031
Rental discount levels	Full discounts are: no discount on 40/10 product, 11-30% discount on other FTTP products depending on speed. Ramp-up discounts are: no discount on 40/10 product, 7-23% discount on other FTTP products depending on speed (these prices are the same as for the FTTP v2 offer) Full discounts apply: 1. If national ratio from Openreach of FTTP/total >80%; 2. During on-boarding period 1 (Oct-21 – Mar-22), if national ratio from Openreach of FTTP/total >75%; 3. During on-boarding period 2 (Apr-22 – Sep-22), if national ratio from Openreach of FTTP/total >80%. Ramp-up discounts apply only: 1. During the ramp-up period (Oct-21 – Mar-22), if FTTP/total >80%

[2] Except the time limited 12 months, which, by default, applies only to where altnets have network as well as to new build.

Time-limited additional rental discount	For a period of 12 months after connection, FTTP lines new to the Openreach network (NTN)[3] between 160Mbps and 550Mbps will be charged at the 160Mbps discounted rental price. This applies only to lines connected before Sep-26.
Rental indexation	From Mar-22 to Sep-26, FTTP prices for 40Mbps – 115Mbps will maintain a constant differential to the 40Mbps price, and products of 160Mbps and higher will follow a CPI-1.25% trend (subject to a floor of zero nominal price reduction).
ARPU revenue sharing	Subject to meeting the offer threshold, where the CP achieves a rental ARPU >£17 per month then 50% of the excess ARPU over the threshold will be paid back to the CP. Openreach may reduce the ARPU sharing threshold by CPI-2% each October.
Volume criteria	None
Service mix criteria	Target for FTTP new orders as % of total new orders (FTTP + legacy) –75% or 80%[4] as outlined above. Legacy orders are defined as WLR, MPF, SMPF/WLR, FTTC/WLR, FTTC/MP. New orders (FTTP and Legacy) are defined as provides or transfers, excluding modify orders (e.g., speed), novation, and bulk moves.
Year 6 review	From Apr-2026, Openreach may: - amend rental charges and ARPU share level by up to £1.50/month

[3] According to the contract, NTN means a Premise where there have been no Openreach products and services including any FTTP and Legacy products on the relevant line at any point in the last 90 consecutive days prior to the date of an Order for the Primary Service excluding any Premise on New Sites (Greenfield / New development premises).

[4] We note that the contract is extremely complex and potentially misleading and Openreach's initial publications stated the product mix rental threshold to be 90%.

	- if Ofcom changes the anchor product to a different speed, or no longer applies the CPI limit to the 40/10 product, then Openreach may change the rental charges and indexation mechanism.
Forecasting accuracy criteria	Forecasts are required from the CPs as a condition of the offer. Inaccuracy in the forecast may affect connection discounts, but not rental.
Connection charges	**For Area 2:** NTN lines, the connection charge is £25, indexed at CPI-0% per year (cf £99.39 standard price) Non-NTN lines, the connection charge is £50, indexed at CPI-0% per year (cf £99.39 standard price) Where CPs do not meet the fibre-only target, but do meet the fibre-only threshold, the above discounted prices are increased by: - For NTN until Mar-2022, £7.50 for every percentage point downwards deviation from the fibre-only target - For non-NTN until Mar-2022, £5 for every percentage point downwards deviation from the fibre-only target - For both NTN and non-NTN, for every percentage point downwards deviation from the fibre-only target, 10% of the difference between the discounted price and the standard price list. **For all Areas:** NTN bandwidth modify from 550Mbps to a lower speed is £0 (£5.64 standard) NTN bandwidth modify from any speed to a higher speed is £0 (£5.64 standard)

5 Analysing the impact of Equinox

5.1 Combined impact of Equinox elements

45. The many elements of Equinox outlined and analysed above are largely complimentary to each other. For example, the 12-months discount could help a CP achieve its 80% product mix threshold in locations where it had previously used an altnet. As well as carefully analysing each individual element, it is also important to assess the offer as whole.

46. As a starting point for the overall assessment, it is useful to review the elements against Ofcom's OCT assessment- and geographic pricing consent-criteria, so we set out below briefly in table form the key criteria and how we have assessed them:

	Product mix element	12-months element	ARPU sharing element	Forecasting penalty	10-year duration
Induces loyalty and increases barriers to switching	✓		✓	✓	✓
Denies altnets demand	✓	✓	✓	✓	✓
Increases altnet investment risks	✓	✓	✓	✓	✓
Penalty for non-compliance	✓			✓	
Targeted at altnets		✓			
Increases consumer long-term benefits	✗	✗	✗	✗	✗
Essential to Openreach business plan	✗	✗	✗	✗	✗
Meets Ofcom's overarching objectives	✗	✗	✗	✗	✗

The product mix and 12-months discount have clear and strong anticompetitive effects and do not deliver against any of Ofcom's potentially mitigating criteria for consent of the geographic pricing 12-months discount or to not intervene against the OCTs in the product mix discount.

47. The ARPU sharing also has significant anticompetitive effects and does not deliver any of the benefits required for it to pass Ofcom's tests and its effect is clearly to further incentivise CPs to use Openreach and to sell higher speeds, at the cost of connections available from altnets.

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5.2 The product mix-based discount

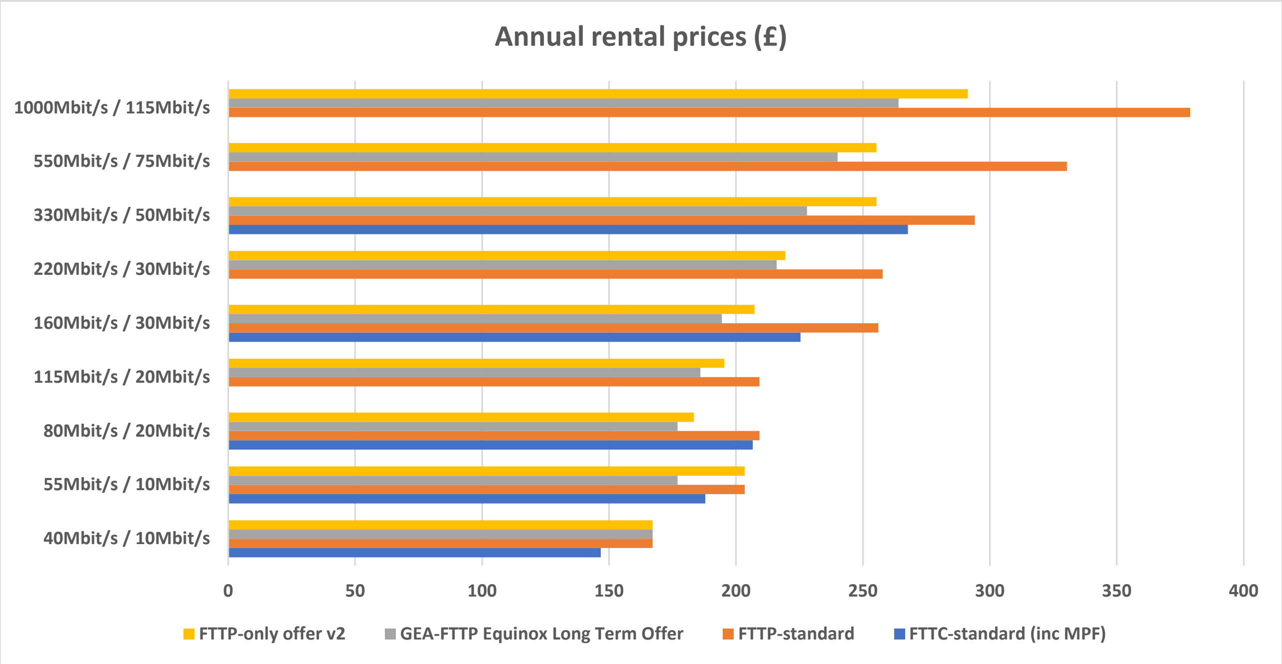
48. This discount applies to all Openreach FTTP connections contracted by a CP in areas where Openreach launches FTTP-based services from October 1st 2021 onwards for ten years.

49. The discounts are significant, with up to 30% discount on the 1Gbps product and between 11% and 30% on other FTTP products above the regulated 40/10 product.

50. The discount is triggered based on the product mix the CP contracts from Openreach across the relevant FTTP deployment areas nationally. There are two onboarding periods; until Mar-2022 the CP needs to achieve 75% FTTP ratio to trigger the discount, until Sep-2022 the ratio is 80%, and after the CP needs to achieve a 80% FTTP ratio in order to trigger the discount. There is also a "ramp-up" period from Oct-2021 until Mar-2022, where the threshold is 80%, but it appears that this is not relevant to rental discounts as it is over-ridden by the onboarding threshold relaxation.

5.2.1 Impact assessment

51. The product mix element offers very significant discounts for CPs; the graph below shows the Equinox product mix discounts compared to current full price FTTC and FTTP services and also in comparison to the FTTP only V2 Offer.



52. The product mix element requires that the CP achieves a very high ratio of FTTP orders as part of its total of new connections from Openreach. It is our assessment that it is likely to be challenging for CPs to achieve 80% FTTP connection of total connections[5], so it is unlikely that they will achieve significantly more than that.

53. If a CP has the opportunity to use altnet FTTP lines in a location that will subsequently be covered by Openreach, then the OR FTTP lines ratio for that particular location will be reduced (as much of the FTTP demand in the area would already be satisfied by the altnet) and will drag the overall national FTTP average for that CP down, putting at risk significant discounts on very large numbers of FTTP lines. It is our view that CPs would likely try to avoid that risk by not using the altnet network and not actively promoting fibre until OR reaches an area (or promoting the fibre as coming in 12-14 months), promising low prices, no connection charges etc.

54. We note that the existing GEA Volumes Offer makes FTTC discounts available nationally to CPs, to help them retain customers until OR fibre is available. We discuss the impact of the GEA Volume offer later in section 6.

55. On balance, the significant discounts available to CPs under Equinox are likely to be critical to their ability to sell FTTP connections. The prospect of wholesale price increases of between 12 and 43%[6] across the FTTP portfolio would act as a strong disincentive from using altnet infrastructure.

56. It is our view that this offer may result in wholesale market foreclosure. Importantly, it is not necessary for Openreach's prices to be below cost (whether Openreach's costs or altnet costs), as it is the potential loss of discount that creates the effect of wholesale market foreclosure.

57. It is our assessment that the impact on the altnet's wholesale business is likely to be considerably larger than that on the retail business. It will, however also have a significant impact at the retail level, this is due to the ability of CPs to offer very low-

[5] Some properties will not be able to receive FTTP services from Openreach due to the standard barriers such as wayleaves, street works, D-Poles etc and some customers will not want the inconvenience of having an engineer visit and so will want to retain their copper line services.

[6] X and Y% increase corresponds to between 11 and 30% discounts.

priced FTTP services where Openreach has deployed fibre and the continuation of FTTC discounts (through the GEA Volume Offer running till September 2023) where Openreach has not deployed fibre. Both these factors will make the retail market very challenging for altnets serving the retail market, regardless of whether Openreach has yet deployed fibre.

Impact on wholesale-only altnets

58. As explained above, the impact of this offer on altnet wholesale businesses in Area 2 is likely to be very significant. For altnets operating a wholesale-only business model, the impact is therefore likely to be very significant indeed.

59. The wholesale market foreclosure effect demonstrated above could have the impact of making wholesale-only competitors to Openreach unviable.

60. We note that Ofcom is particularly concerned about pricing that deters ISPs from switching to new network builders:

"*Openreach may want to consider different commercial terms as part of a strategy to migrate customers from copper to FTTP and support its FTTP business case. As noted above, we may be concerned if such terms deter ISPs from switching to new network builders. We would be less likely to be concerned where use of an alternative network does not affect the prices that an ISP pays for Openreach services*. "[7]

61. There can be no doubt that the product mix element has is a very strong loyalty-inducing effect and that it directly denies altnets access to wholesale demand from CPs and therefore forecloses the wholesale markets for altnets.

62. It could be argued that the Openreach discounts simply puts increased pressure on altnets to deploy as quickly as possible to get the benefits of the first mover advantage. In many places, the quality of current (Openreach-provided) broadband connectivity is such that a good proportion of customers are waiting impatiently for the advent of fibre. Indeed, many altnets operating or planning to operate in Area 3 have reacted to the

[7] WFTMR V3 paragraph 7.169.

outcome of the WFTMR by pressing hard to speed up their deployment in an attempt to overcome the effects of the BT Commitment that forms part of the WFTMR.

63. However, the product mix element of Equinox is structured in such a way that CPs are incentivised to not use altnet networks even when they are built in advance of Openreach's planned roll-out. This means that many altnets will be limited to the retail market only.

64. In the retail market, CPs will work hard to retain their FTTC-based customers until Openreach deploys fibre in the location and the ongoing GEA Volumes offer[8] gives the CPs low FTTC pricing to assist them in doing so. This makes the retail market more challenging for altnets, potentially reducing take-up of retail altnet services and causing harm to the altnet business case.

65. As a consequence, what should be a significant first-mover advantage for altnets is effectively eliminated due to the combined effects of the existing GEA Volume discount and the product mix element of Equinox.

66. In the WFTMR, Ofcom indicates what types of charges would cause it particular concern:

"*Arrangements with an element of loyalty inducement which deter ISPs from switching demand to new networks are likely to undermine alternative network expansion and undermine our goal of achieving network competition. Examples of these types of arrangements could include*

a) Exclusivity discounts (i.e. discounts conditional on the ISP purchasing all or most of its requirements from Openreach).

b) Retroactive rebates (i.e. where a rebate is applied to all units purchased over a reference period once a certain threshold is reached).

c) Structures where the price paid in one geographic area depends on whether they purchase from Openreach in another area. <u>For example, a geographic discount on</u>

[8] Which runs till September 2023.

leased line services in Area 3 or the HNR Area that is contingent on maintaining broadband volumes with Openreach in Area 2.

d) Arrangements whereby a discount on an unregulated service (e.g. leased line products in the CLA) is contingent on purchasing a certain volume and/or mix of regulated services (e.g. FTTC/FTTP)." [9] [emphasis added]

67. The product mix element appears to fall into the example described under point c). This is because the 80% threshold is national, rather than local. As Openreach expands its Fibre First footprint, CPs need to keep the 80% FTTP ratio or risk losing discounts nationally.

5.2.2 Duration of the offer

68. Equinox is set to apply to Openreach FTTP deployments for a 10-year period. This means that CPs will need to consider their ability to remain compliant with the product mix criteria over that period as the Openreach FTTP footprint expands.

69. The consequence of non-compliance would be a significant price increase across all Openreach FTTP connections, which no retail broadband provider would wish to face and which could result in consumer harm as some consumers may no longer be able to afford their broadband connection.

70. Significant long-term discounts result in a dependency on those discounts in the market and increases the power of the provider offering the discount. In section 5 of this document we critically examine the lack of justification for the extremely long duration of Equinox.

71. We also note that Openreach retains the option of discontinuing Equinox in year six. This would appear to allow Openreach to benefit from the effect of a 10-year discount (as described above), but at the same time have the option of reducing the cost of the offer by terminating it early, should the desired competitive effect have been achieved by then. We examine this in more detail later in this document.

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[9] WFTMR V3 paragraph 7.166.

5.2.3 Issues specific to Area 2

72. In Area 2, altnets will be expecting to face competition from at least one other fibre network provider, thus there is likely to be competition at both retail and wholesale levels. Altnets investing in Area 2 will do so expecting to face competition, but competition on a level playing field.

73. Given the likelihood of wholesale competition in Area 2, it is important to many altnets investing there to establish relationships with the large downstream CPs as early as possible. In the WFTMR, Ofcom acknowledges the importance of the CP relationships and the potential impact of Openreach already having established relationships, whilst altnets do not.

    "*Openreach has a relationship with all the main access seekers and it is in a strong position to migrate customers to its FTTP network as this is built*." [10]

    and

    "*We note that PIA could reduce the costs of new network build in some cases, however, this is of little significance if new networks are unable to attract access seekers due to Openreach using pricing or other commercial terms to deter switching. <u>If Openreach is able to deprive new networks of demand, they will fail</u>*." [emphasis added] [11]

74. The product mix element of Equinox has the effect of depriving altnets in Area 2 of demand at the wholesale level. In a market where wholesale competition is expected, and where downstream CPs control a significant part of the retail market,[12] it is critical to establish wholesale relationships as quickly as possible.

75. As Equinox does not have any qualifying volume threshold, it means that not only the very largest CPs are likely to take up the offer, but smaller CPs will do so too. In fact, not doing so will put them at a competitive disadvantage against those that do, in the

[10] WFTMR V3 paragraph 7.49.
[11] WFTMR V3 paragraph 7.50.
[12] Insert market shares from last submission

many parts of the country where Openreach is the first to deploy FTTP and where Openreach will be the only provider of FTTP-based services.

5.2.4 Strongest impact on wholesale-only altnets

76. As we have described in earlier submissions to Ofcom in relation to the existing Openreach offers, altnets operate different business models. In particular they fall into three groups:

- retail-only
- retail & wholesale, and
- wholesale-only

77. As Equinox is a wholesale level offer, it has the most direct impact on altnets that operate in the wholesale market. Nevertheless, there will be effects in the retail market as the competitive nature of the retail market means that wholesale discounts are likely to be passed on to consumers via retail prices.

78. The denial of wholesale demand described above effectively removes the business opportunity for wholesale-only altnets. The potentially significant benefits to consumers of two open competing fibre infrastructures for retail CPs to use would be lost and it is likely that investment in competitive fibre infrastructure would be reduced as a consequence.

79. The effects of Equinox also makes it very unlikely that altnets will build fibre networks in locations where Openreach has already deployed or is planning to deploy.

5.2.5 Issues specific to Area 3

80. Some parts of Area 3 can also support more than a single fibre network. for those areas, the issue highlighted above for Area 2 is also applicable. As the economics of infrastructure competition in those locations may be weaker than for locations included in Area 2, the impact on altnets in Area 3 is likely to be harder than for those in areas 2.

81. Other parts of Area 3, however, can only support a single network.[13] Where altnets deploy in those locations, they may start as fully vertically integrated businesses, addressing the retail market only, but over time, if they wish to operate the only fibre network in the relevant towns and villages, they will likely need to offer wholesale access to their networks. If, however, CPs are concerned that Openreach may choose to overbuild the altnet network in the future, then they may be reluctant to purchase FTTP connections from the altnet as this could put at risk their discounts across the rest of the country.

82. In locations where Openreach does not then subsequently overbuild, the end customers will have been deprived of the retail choice resulting from the wholesale access.

83. For locations where state aid has been awarded to altnets (on the assumption that the location cannot justify the commercial deployment of even a single fibre network), altnets have an obligation to offer wholesale access to their networks in order that consumers in those locations can benefit from the full retail choice available in other parts of the country.

84. There is a significant body of evidence that Openreach has overbuilt networks built using state aid funding[14], so CPs may chose to not engage with the altnets until they are certain whether Openreach will build in individual locations.

5.2.6 Impact on the collective altnet wholesale market

85. A group of altnets is building a shared wholesale platform and a number of other altnets have registered their interest in using that platform. The rationale for the shared wholesale platform is that the costs for a CP to on-board a new supplier are significant and the CPs therefore require that the onboarding process gives them access to a large number of premises. By combining the footprints of several smaller altnets under the

[13] And some need public subsidies to justify fibre deployment at all.

[14] For example, Openreach overbuilt Gigaclear in many locations despite Gigaclear having received state funding to deploy in locations that it was understood were not viable for commercial deployment.

single shared wholesale platform, the altnets are reducing the barrier to switching for CPs and several large CPs have expressed strong interest in this project.

86. As set out above, however, Equinox results in CPs being strongly disincentivised from using altnets. Thus, despite the efforts of altnets to create a commercially and operationally attractive wholesale interface for CPs, it is questionable whether the demand from CPs will still exist if Equinox is allowed to proceed as currently designed.

5.3 Core reasons for concern with the product mix element

87. The product mix element give rise to three separate reasons for concern:

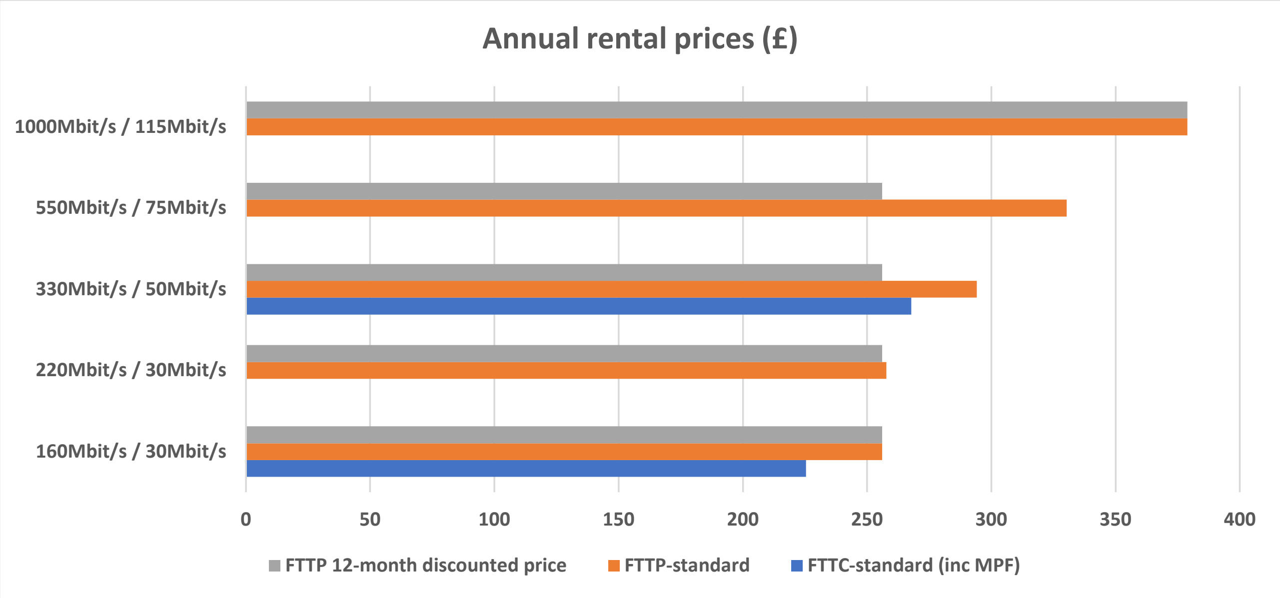
1) The national average product mix is a strong incentive for CPs to not use altnet networks and instead use GEO Volumes Offer discounts to keep retail customers on FTTC services,

2) The levels of discounts are such that the risk of losing the discount could seriously affect the CPs business and cause consumer harm in the event the discount was withdrawn, and retail prices had to be increased correspondingly, and

3) The duration of the discounts is unnecessary to support FTTP migration and only serves to lock in CPs, thus denying demand to altnets.

5.4 The 12 months discount for New Openreach connections

88. This element applies to new CP connections that were not previously using the Openreach network (thus either new sites or premises connected to other networks). It enables the CP to offer FTTP speeds of up to 550 Mbps for the rental price of the 160 Mbps service, but only to what Openreach calls new to network (NTN) connections. (We refer to this specific Equinox element as the NTN discount). The chart below shows the impact.



89. Whilst other elements of Equinox incentivise CPs to convert existing customers to FTTP once Openreach has deployed to specific locations, the NTN discount incentivises the CP to attract customers currently using a competing network provider.[15]

90. When defining geographic discounts in the WFTMR, Ofcom said:

> "*The geographic discrimination prohibition we are imposing prevents differentiated prices and <u>other pricing measures which might have the same effect</u>.*" [16] [emphasis added]

91. Whilst it could be argued that the NTN discount does not target specific geographies, it very clearly targets altnet customers. The NTN discount therefore 'has the same effect' as a discount targeted at the specific geographies where altnets networks exist (for example in Virgin Media areas) and as such is by definition prohibited under the WFTMR framework.

92. Ofcom has the power to grant Openreach a waiver for any geographic discounts that satisfy the test set out in the WFTMR. That test is:

[15] Although NTN discounts also apply to newly built premises, they constitute a much smaller market than do customers served by other networks. Additionally, Openreach serves the vast majority of new builds in the country.
[16] WFTMR V3 paragraph 7.72.

"*In assessing whether to consent to differential geographic pricing we would consider:*

- *any objective justification provided by Openreach for the differential pricing;* _and_
- *whether it is consistent with our overarching policy objectives (including our strategy to promote network competition).*" [17] [emphasis added]

93. Whilst we have not been party to any objective justification provided by Openreach for the NTN discount, we strongly encourage Ofcom to include any such justification in its consultation to follow this RfI.

94. We note that Ofcom in the WFTMR invited Openreach to share with it any planned discount schemes and are concerned that Ofcom may have given indication to Openreach that Equinox would be acceptable, prior to consulting with stakeholder directly affected by the offer.

"*We would expect Openreach to explain the purpose of the scheme and why it will not deter new alternative network build. We would be happy to discuss with Openreach any specific initiatives that it is considering*."[18]

95. If that were the case, then we believe Ofcom would be acting contrary to its transparency duties and the 90-day notification period could be seen as window-dressing and potentially misleading stakeholders to believe their inputs would be taken into account before Ofcom makes any such decisions.

96. With regards to the second of the two parameters (both of which must be satisfied for Ofcom to grant consent), however, we can see no possible rationale for how the NTN discount is consistent with Ofcom's overarching objective of promoting network competition.

97. The NTN discount is targeted directly at attracting existing retail customers away from competing networks, with the clear objective of harming the operators of those competing networks and thus reducing the viability of infrastructure competition.

[17] WFTMR V3 paragraph 7.129.
[18] WFTMR V3 paragraph 7.130

5.4.1 Impact assessment

98. The impact of the NTN discount could take two forms:

1) Participating CPs engaging in active campaigns to offer the substantially discounted 550Mbps service to customers served by other networks in areas where that CP is also providing Openreach FTTP-based services, and
2) Participating CPs that may have initially sold FTTP-based services using altnets, attempting to convert those customers to Openreach-based customers by offering this significant discount.

99. Marketing option 1 would be complex, as only some customers would be entitled to the NTN discount. Marketing option 2, however, would be much easier as the CP would simply have to contact their existing customers and offer the new discounted service in return for the customer allowing the installation of the Openreach fibre connection to replace the altnet connection.

100. Option 1 could be used in Virgin Media areas, where targeting would be easier, whereas option 2 could help CPs convert altnet connections to Openreach connections, so that they remain within their 80% product mix threshold.

101. Both of these applications of the NTN discount are very likely to harm infrastructure competition and increase the risk for altnet investors and appear clearly intended to do so. It is our firm view that this element must be prohibited, and that no justification exists for it to be subject to a consent by Ofcom.

5.4.2 Issues specific to Area 2 or Area 3

102. We have not identified parameters in the NTN discount that affects Areas 2 and 3 differently, with the exception that the impact on an altnet of losing retail customers in Area 3 could be more critical that in Area 2 as Area 3 locations typically require a higher penetration level to deliver an acceptable return on investment.

5.5 ARPU Revenue Sharing

103. The ARPU sharing element offers that the CP shares 50% of any national average ARPU for the CP in excess of £17/month.

104. This provides a clear incentive to CPs to sell higher speed connections where possible and is therefore a significant loyalty inducement. We can understand Openreach's motivation behind this element, but do not believe it can be justified within the parameters set out by Ofcom in the WFTMR.

105. It also, however, reduces the effective price for high speed connections even further than indicated in the product mix price comparisons show earlier in this document and thus further increases the price pressure on altnets. This could have negative impacts om competitive infrastructure investment cases in both Area 2 and 3.

106. We do not understand, how this element is either essential for Openreach's business plan, nor essential for providing increased consumer benefits.

107. It seems less likely that this type of discount will be passed on to consumers in the form of directly discounted higher speed connections (compared to the product mix and 12-month discounts), as the CP will not know what its average Openreach ARPU is until after that sales period has closed. In the longer term once the CP has achieved the threshold for a period of time it would however be likely to pass on those discounts to enhance its competitive position against CPs that have not been able to achieve the ARPU-sharing threshold.

108. In the short term, however, this discount is likely to simply increase CP margins overall, offering no incremental benefits to consumers, but potentially harming altnets by its loyalty inducement and further increasing barriers to switching.

109. Finally, we note that the ARPU threshold is subject to an CPI-2% annual adjustment which takes it in a considerably steeper decline than the product-mix discounted prices which are subject to either CPI-0% or CPI-1.25%. That means that, over time the ARPU threshold becomes easier to meet, and thus incentivises the CP to keep selling as many high speed Openreach connections as possible in anticipation of very substantial discounts in later years.

110. There can be do doubt that this element would have strong loyalty inducing effect that is harmful to competitive investment.

5.5.1 *Issues specific to Area 2 or Area 3*

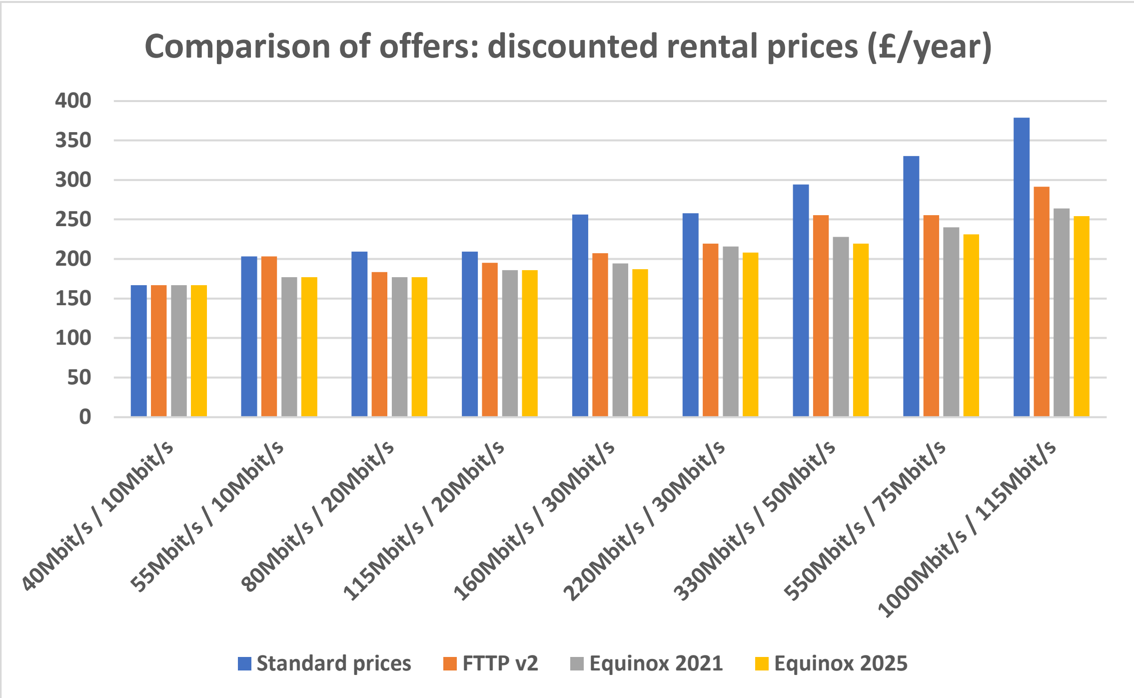
111. We have not identified reasons to believe that this element would affect Area2 and 3 differently.

5.6 Absolute levels of pricing resulting from Equinox

112. The Equinox offer provides product-mix-related rental discounts beyond those already available under the FTTP only V2 offer:

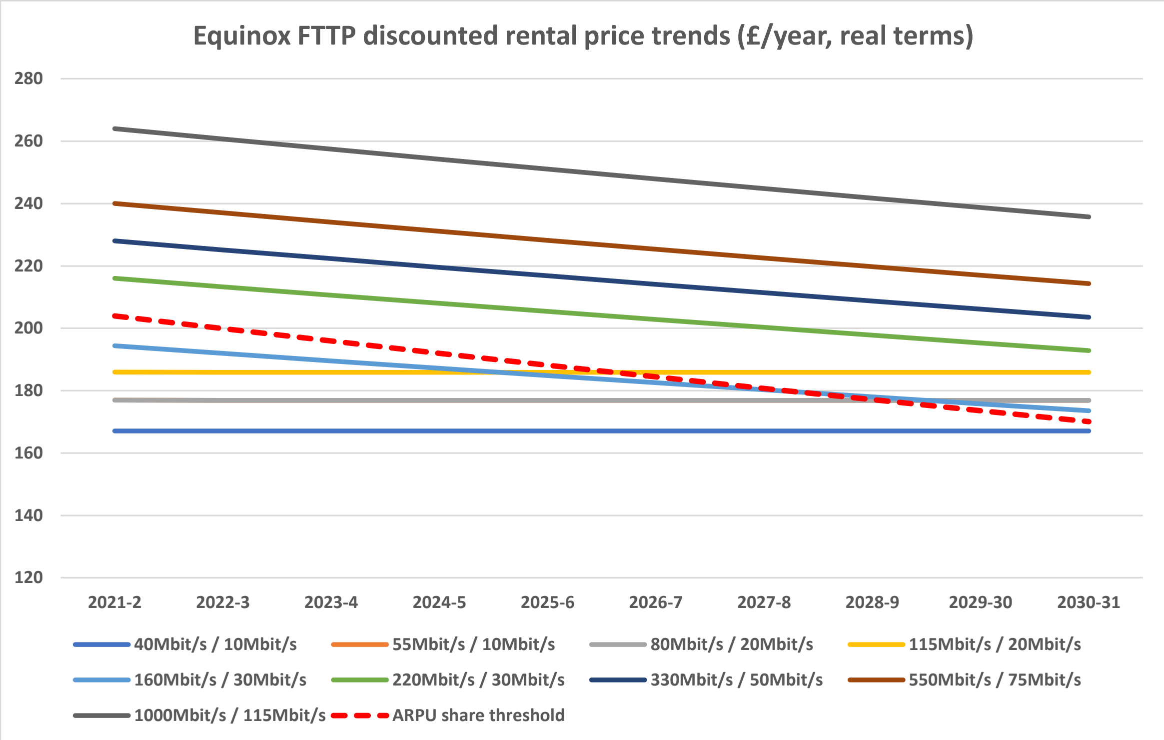
- discounts generally increase with speed;
- prices for higher speeds (160Mbps and above) decrease by CPI-1.25% per year (this is at Openreach's discretion, but they clearly signal their intention to apply this trend);
- by 2025 (when the rental discounts expire for the FTTP only V2 offer) the discounts under Equinox for the 550Mbps product will be 30% below standard prices and 9% below the prices of the expiring offer.

113. This is illustrated in the chart below.



114. By the time the rental discounts expire for the FTTP only V2 offer in 2025, the discounts under Equinox for the 550Mbps product will be 30% below standard prices and 9% below the prices of the expiring offer.

115. Over the longer term, the CPI-1.25% annual price declines cumulate to very significant further discounts for the higher speeds, as shown in the chart below:



116. While Openreach has signalled that the pricing will be reviewed in year 6 of the offer, the price list does refer to CPI-1.25% reductions for the remainder of the 10 year period (and this is assumed in the chart above, with no changes introduced in year 6).

117. It should also be noted that Openreach states that the ARPU Share threshold level may be indexed at a rate of CPI-2% per year; this is shown on the chart, and such declines would make achievement of this threshold very likely in the later years of the offer.

5.6.1 Issues common to Area 2 and Area 3

118. Altnets operating in Area 2 and parts of Area 3, where more than one FTTP network is likely to be viable, may find that the Equinox pricing makes it unviable to be the second or third network operator in those areas.

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119. In order to compete, altnets have to offer a discount against the BT pricing in order to tempt the CPs away from Openreach [19](one reason being that for a CP there are substantial costs associated with onboarding a new wholesale provider). This was confirmed by Ofcom in the WFTMR:

120. "*In addition, Openreach has an established relationship with existing access seekers and some level of systems/process integration. Because no other operator has national coverage, access seekers will have to purchase wholesale services from Openreach in some parts of the UK. As discussed below, there is a cost to access seekers dealing with multiple network operators, which means that alternative network operators are likely to need to offer terms that are at least as attractive as Openreach's to win business*."[20]

121. Altnets deploying FTTP tend to target a higher proportion of high-speed products than the average mix for Openreach, and this means that the Equinox discounts are likely to have a disproportionate impact on altnet revenues. This will mean that the altnet will either sacrifice market share (which will increase unit costs and reduce revenue) or reduce prices; in either case, the business case will be negatively impacted, potentially to the point where the altnet is no longer viable.

122. This impact will be most severely felt by wholesale-only altnets, where the discounts have a direct effect on the only revenue stream.

123. In cases where an altnet has already established a significant market share in the wholesale market[21] in some areas, the impact may be less severe in those areas as economies of scale may be well established, and significant CP sales already in place. However the reduced pricing levels will nonetheless reduce returns, and may call into question expansion plans into new areas where the investment case no longer meets acceptable criteria.

[19] It is common that CPs require altnets to include commitments to match or beat future Openreach pricing in order to agree to use an altnet network.

[20] WFTMR V3 paragraph 7.46.

[21] Including self-supply.

124. Although Openreach is signalling strong price reductions over a ten-year period, the review after six years allows Openreach to assess the impact of the Equinox scheme. If Openreach considers that its objectives to claim/reclaim market share have been met, and the competitive threat has declined or disappeared, then this mechanism would allow it to reverse the discounts and reduce their costs of the scheme.

5.6.2 Issues specific to Area 3

125. In parts of Area 3, where only one FTTP network is likely to be commercially viable and/or where public subsidy is necessary, it may become unviable for altnets to deploy at all, or to submit successful bids for public subsidies. This is due to the ability by Openreach to deter CPs from using altnets, combined with the reduced competitive price levels (Equinox applies nationally to the Openreach FTTP areas, including in areas subject to public subsidies[22]).

126. Openreach's national coverage gives it the advantage that it may offer wholesale pricing that is not replicable by altnets at the local level, but which Openreach can justify based on nationally averaged costs.

127. In these areas, altnets entering the market would expect to gain first-mover advantage and establish scale economies quickly to secure low unit costs. However, given the likelihood of Openreach entering the market with the low prices available under Equinox, and the fact that the discounts endure over such a long period, CPs may prefer to wait for Openreach to provide FTTP.

5.6.3 Impact on Project Gigabit

128. The Government's Project Gigabit initiative has as one of its primary objectives to encourage competitive investment in fibre infrastructure across the UK. Equinox, however, (as described throughout this submission) has as one of its primary objectives and near-certain consequences a substantial reduction in competitive fibre investment,

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[22] Although Openreach reserves the right to exclude any premises where the network was funded - directly or indirectly, in whole or in part - by public money.

leaving Openreach as the monopoly supplier of fibre connectivity across the vast majority of the country.

129. Equinox, therefore, is in direct conflict with Government policy and there is a significant risk that it will undermine Project Gigabit due to a reduction in participation by competitive providers, leaving Openreach as the only option to bid and deploy uncontested.

130. Lack of competition for Government funding will reduce competitive pressure on Openreach to submit meaningful bids and result in an increase in the need for public funding. It will also likely result in significant delays in rural deployment as Openreach will be under little or no competitive pressure to do this and will therefore focus on rural deployments where it may still face some level of competition.

5.7 A 10-year Discount scheme

131. Equinox runs for ten years.

132. However, Openreach stop sell notifications show that, once it starts deploying fibre in an exchange area, it will likely reach the stop sell threshold in less than 24 months.

133. We can identify no justification for offering continued discounts that purport to encourage FTTP migration in areas where stop sell had been implemented and only FTTP connections are available.

134. It may be argued that it remains in Openreach's interest to encourage retail customers to move to FTTP as quickly as possible, even after stop sell has been triggered, but if two years of heavily discounted FTTP-based services have not persuaded consumers by then, then it is very questionable whether sustained heavy discounting can be justified either as being essential to the Openreach business case or as being necessary in order to increase benefits to consumers.

135. If low pricing is necessary to secure migration, then that should be done in the form of permanently lower prices, not discounts that tie in CPs due to the risk of significant price increases if they fail to comply with the qualifying criteria.

136. It is our view that a ten-year discount cannot be objectively justified and that the consequences of such long-term discounts are likely to be a reduction in competition and a resulting lack of choice for consumers.

137. We also believe that Ofcom would be limiting its ability to conduct an objective market review after 5 years if it has already condoned discount practices and schemes that will run the entirety of that 5-year market review. Ofcom must be careful to not fetter its discretion to be able to perform its statutory duties.

138. We note that Openreach reserves the right to terminate Equinox after six years. As discussed above, this option does not lessen the impact of Equinox and its anticipated 10-year duration, but simply allows Openreach to reduce the costs of Equinox by terminating it early, should the desired effects of the offer have been achieved by then.

139. the ability to terminate Equinox after six years would indicate that Openreach is likely to increase its prices once it has achieved it dual purposes of migrating customers to FTTP as quickly as possible and reducing infrastructure competition to an absolute minimum.

6 Long-term impact for consumers

140. In this section, we consider the effects of the Equinox discount scheme on consumers directly and via a reduction in competition. We also extend the analysis to consider the cumulative impact of Equinox and existing offers, in particular the GEA Volume Offer, on likely switching behaviour and, therefore, the competitiveness of the market.

141. In our submission on concerns arising from Openreach's existing FTTP discount schemes, we discussed the potentially harmful impact on consumers of discounts and other commercial terms that induce loyalty and so reduce the likelihood of switching. The section of that report has been reproduced here as Annex A. These were divided into direct effects on consumers via a "loyalty penalty" (whereby loyal customers pay higher prices than consumers who shop around) and the negative effects on choice

and innovation when loyalty inducing terms deter consumers and CPs from switching to new entrant altnets. We concluded that, whilst loyalty inducing terms can be pro-competitive, they may also be anticompetitive if they erect barriers to switching, and therefore entry, and that Ofcom should investigate such terms in detail before allowing discounts and OCTs.

6.1 Cumulative impact of Equinox and existing offers

142. The GEA Volume Offer offers a discount of up to 25%, dependent on volume tier, on both FTTC and FTTP based wholesale services. As with Equinox a proportion of access lines must be on fibre, including FTTC, for the CP to qualify for the discount. Whilst FTTP discounts are limited to the legacy footprint prior to July 2018 and BDUK locations, the FTTC discounts are available in all locations.

143. The effect of this discount is that, where Openreach intends to build fibre access, CPs using the Openreach network have no incentive to switch to an altnet in the same area as this would affect the mix of fibre and copper and based services and so may make the CP ineligible to the discount.

144. The retail market is effectively competitive, so we can assume that retail prices are already at the competitive level meaning that CPs have no capacity in the retail price to absorb any wholesale price rise. This of course means that if the CP were to lose the threshold discount, it would need to raise retail prices causing a loss of consumer welfare.

145. It might be argued that if all CPs switched away from Openreach in such areas there would be no effect on competition as all CPs would face the same wholesale price increase that they would have to pass on to consumers. However, there are two problems with such an argument.

146. First, as long as just one significant CP does not switch away from FTTC, that CP and its consumers would still benefit from the discount. So long as there is just one competitor who remains on Openreach FTTC wholesale service, it is unlikely that others will switch away and be forced to raise their consumer prices.

147. Secondly, in the event that all CPs do transfer to an altnet where they can do so and so lose their GEA Volume Offer discount causing a rise in consumer prices, there will be a negative effect on consumer welfare. The size of such an effect will depend on the difference in price and level of price elasticity, but we can expect there will be a reduction in consumer welfare as prices rise and demand decreases.

6.2 Incremental Effect of Equinox

148. We now consider what happens when a CP has remained on FTTC due to the GEA Volume Offer Discount and Openreach builds fibre in an area where an altnet also plans to offer wholesale fibre access. The simple question is, would the Equinox discount deter such investment?

149. Of primary concern here is that the Equinox discount is likely to create a loyalty-induced barrier to switching such that CPs will be deterred from moving their customers from Openreach to an altnet. This will have the second order effect of reducing competition with potential negative effects on longer-term prices and innovation[23].

150. The Equinox discounts are substantial, ranging from 11% - 30% once the CP has achieved the 80% threshold, with a “cliff edge” meaning that if the proportion of FTTP acquired from Openreach falls below 80% the price immediately reverts to the list price. The extent to which an altnet is able to match the BT discount of course depends on its own costs. However, these are likely to be higher than Openreach’s costs as altnets do not enjoy the same economies of scale and scope as Openreach.

151. In addition to the threshold discount, altnets can benefit from the 12 months additional rental discount and the ARPU revenue share. The exact level of these benefits is dependent on several factors, but at the extreme can be significant. For example, if all 550 Mbps lines were sold to new customers to the Openreach network, the discount against the list price available for the first year would 41%.

[23] See Annex A

152. A CP that stays with Openreach on FTTC and then upgrades customers to FTTP will therefore benefit from significant discounts against the list price, although the exact level will depend on product mix and the number of NTN customers it can attract.

153. It is our view that this level of discount, and its duration of 10 years, will act as a significant barrier to entry for altnets. Faced with this discount, there would be a great deal of uncertainty as to whether an investment in an alternative network could ever attract enough customers to earn a return on the investment and therefore whether the investment would be made in the first place.

154. Without entry by rival networks, the market at wholesale and retail level will not benefit from the "competition that should bring benefits to consumers (…) from innovation, (…) choice, stronger incentives to price keenly to attract customers, and higher quality of service"[24].

155. As pointed out in Annex A, the Austrian regulator (RTR) established just such a problem in 2006 when it found that Telekom Austria had used switching costs to exclude rivals from the market.

156. In conclusion, we consider that Ofcom should investigate the likely effects of Equinox on CPs switching costs to rival networks to establish if the terms of the discount are likely to raise switching costs to a level where entry is deterred. If this is the case, Ofcom should conclude that these discounts are likely to have a material effect on nascent network competitors **and** the arrangements are not necessary to Openreach's business case for fibre roll-out.

6.3 Short term benefits

157. A possible response from CPs in support of the threshold discount is that it will mean cheaper consumer prices and subsequent increased consumer welfare. However, we argue that such a response would be contrary of Ofcom's overriding objective and sacrifice long term benefits for a few short term gains.

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[24] Ofcom (2021) *Promoting competition and investment in fibre networks: Wholesale Fixed Telecoms Market Review 2021-26 Volume 1: Overview, summary and structure.* (Para. 2.10)

158. First, Ofcom's overarching objective is the promotion of network competition. Any pricing strategy adopted by Openreach that deters investment by altnets must be contrary to that objective, however much that discount may immediately benefit consumers through lower prices. Ofcom has accepted that it is only competition between networks that drives innovation and dynamic efficiency gains.

159. Secondly, a discount scheme that provides lower prices in the short term but deters competitive investment in the long term will, ultimately, have a detrimental effect on the level of competition in the market. At the extreme, it could leave Openreach as the only provider of wholesale FTTP if all others providers exit the market. Openreach could then be in a position to raise prices above the competitive level with a consequent reduction in consumer welfare unless Ofcom imposes intrusive regulation to control its prices directly. CPs and their consumers would be the victims of such a policy in the long term. In our view it is far better for Ofcom to ensure that Equinox and other discount policies do not deter competitive investment and so allow competition to regulate the market.

7 Scale of impact

160. There is already a considerable amount of funding committed to altnet deployment across the UK[25], much of it to serve locations in Area 3 which are lower down the Openreach list of priorities.

161. It is unlikely that Equinox will cause a sudden cessation of network deployment by altnets and many altnets may still react by trying to speed up their deployments in an effort to capture any elements of first mover advantage still available to them.

162. However, the Equinox scheme may well have an effect on investment at the margins and will at least reduce the number of households passed by altnets' fibre networks. The larger the size of the marginal area where it is no longer rational to invest,

[25] https://www.inca.coop/altnet-metrics-point-topic-2018. It should be noted that much of the investment included here are statements of intent. Should regulatory or market conditions change substantially then that intent would be subject to review.

the less alternative investment there will be and so the less likely that Ofcom will reach its overriding aim of infrastructure competition.

163. Further, for additional funding the due diligence assessment of the competitive conditions and regulatory framework will likely identify Equinox (and the existing offers) as significant risk factors.

164. Whilst the existing offers were in place when some recent funding commitments were made, their profiles were low and the details were largely unknown to new market entrants.

165. More recently there has been a good faith anticipation in the investment community that Ofcom's statements in the WFTMR consultation process would lead to a robust framework that would prevent Openreach from engaging in commercial and pricing behaviour that would harm altnet investment incentives beyond that of general competition.

166. The newfound general understanding of the existing offers and of Equinox is therefore likely to present a much more significant hurdle to altnets looking for future investment commitment. The fact that recent investment commitments have been made while existing offers were in place should therefore not be taken as an indication of them not representing material investment deterrents.

Annex A – Consumer impact assessment

Effect on Consumers: Extract for GOS Consulting Report “Competition concerns arising from Openreach’s existing FTTP discount offers”

1. This section of the paper considers the likely effect of the proposed OCTs on consumers. In this analysis, we presume that the retail market is effectively competitive and therefore the long-term discounts provided by Openreach to Communications Providers (CPs) will be passed on to consumers, albeit maybe in a different form.

2. As noted in the previous section, the GEA Volume offer and the FTTP only offer V2 are structured in ways that continue to incentivise CPs to purchase high speed (FTTP) access from Openreach, even though (for the GEA volume offer) purchases from other network operators count towards the overall volume of circuits required to be purchased to earn the discount. This is because, whilst purchases from other network operators count towards the total, they do not affect the proportion of FTTC and FTTP services acquired from Openreach that affects the discount. Despite appearances, therefore, the two schemes are likely to induce loyalty to Openreach by CPs to ensure they maximise their discounts and so minimise the cost of wholesale inputs.

3. The discount schemes devised by Openreach are a form of price discrimination under which some consumers will pay more or less for a product that has the same marginal cost. We consider below two reasons why this might be of concern to Ofcom: first the potential detrimental effects of the discount on consumers directly that reduce consumer welfare and, secondly, the exclusionary potential of discounts and the negative effects of that exclusion on consumer choice and innovation via weaker competition and lost dynamic benefits[26]. We then explain why it is necessary for

[26] See Buccirossi, P. (2008). Handbook of antitrust economics. The MIT Press. (Chapter 12)

Ofcom to undertake proper analysis to ensure any discount scheme is pro-competitive.

7.1 Direct Effects on Consumers

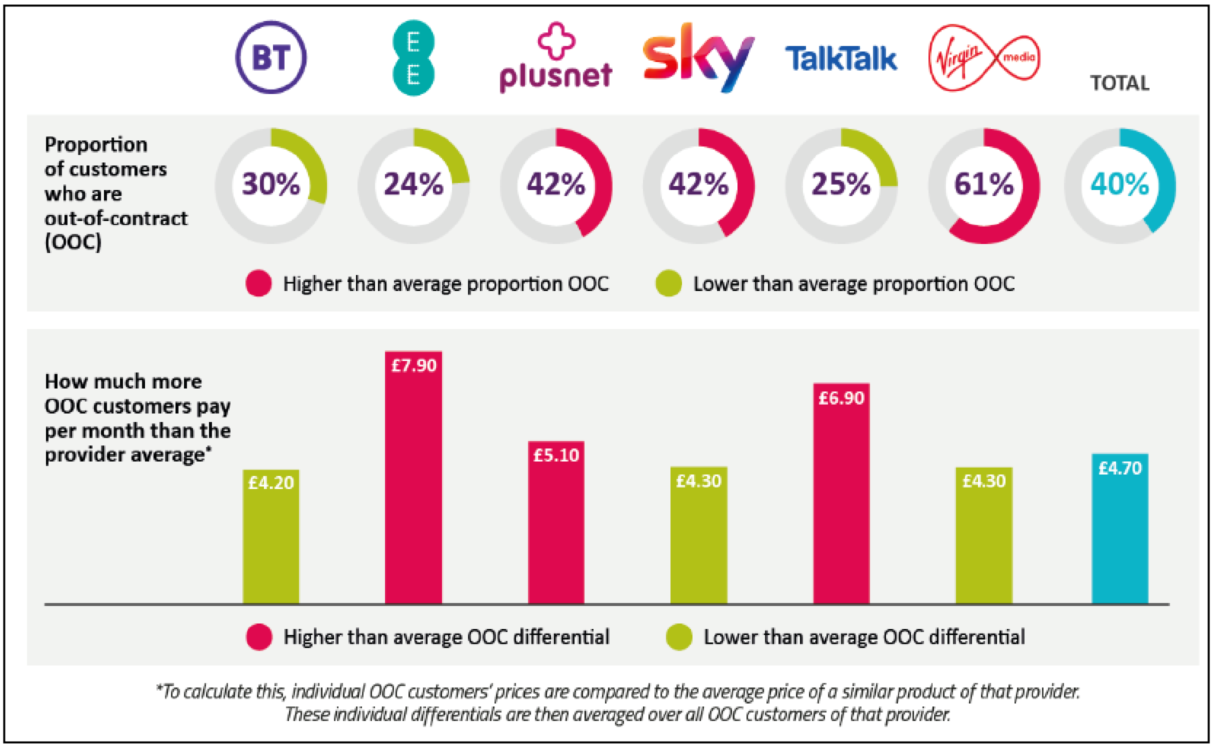
4. In December 2018, the CMA published its response to a "super complaint" by Citizens Advice which alleged that loyal consumers who are unlikely to switch suppliers end up paying higher prices than non-loyal consumers[27]. This premium for loyalty was termed the "loyalty penalty".

5. The CMA found that that "*the loyalty penalty is significant and impacts many people, including those who can least afford it*" (p. 5). The CMA also found that one of the five markets most susceptible to the loyalty premium is the broadband market. The loyalty penalty arises because suppliers take advantage of many consumers' unwillingness to shop around if the purchased service does not consume a significant proportion of household income and is particularly acute for consumers who are offered roll-over renewal on contracts.

6. Following the CMA report, Ofcom produced its own analysis of the effect of the loyalty penalty in the telecoms sector[28]. This found that between 24% and 61% of broadband consumers were out of contract (OOC) and that the loyalty penalty was as much as £7.90 per month per OOC consumer. All principal CPs had a significant proportion of OOC customers and charged a substantial loyalty penalty. Figure 3 below is taken from the Ofcom report.

Figure 3: Monitoring headline customer outcomes[29]

[27] CMA (2018) *Tackling the Loyalty Penalty*
[28] Ofcom (2020) *Helping consumers to get better deals: Review of pricing practices in fixed broadband*
[29] Ibid. P. 9



(Source: Ofcom)

7. Our concern is that the OCTs offered by Openreach, and most likely passed on to consumers, may result in lower levels of customer switching that may be harmful for at least some consumers. This could arise for one or both of two reasons:

8. First, the CP may pass the discount to all consumers who then perceive a reduction in price, inducing some degree of loyalty. However, this lower price from the existing supplier may still be higher than the price an OOC customer could obtain from an alternative supplier if he/she shopped around.

9. Secondly, the CP may pass the discount on only to new FTTP customers and leave current FTTC customers on the same higher price. The loyalty penalty for any OOC customers will therefore increase relative to new customers, perhaps substantially.

10. The direct effect of the OCTs may well then be an increase in the loyalty penalty paid by consumers and, therefore, a reduction in consumer welfare. Any such increase is likely to hit vulnerable customers the most as they are more likely to be OOC than non-vulnerable customers.

7.2 Effect on Choice and Innovation

11. To justify the expense of building a new network, rivals to Openreach require CPs to switch from Openreach and to bring their consumers with them or, where the new operator does not offer a wholesale variant, attract a critical mass of retail customers. If the new network operator is unable to attract CPs or retail customers there will not be a business case to build the network and so a lack of switching acts as a barrier to entry and/or expansion.

12. If OCTs result in CPs being more loyal to Openreach, new network operators may be deterred from entering the market or expanding the size of their existing networks.

13. New network builders are in all circumstances building FTTP networks so any reduction in building will have a deleterious effect on CPs and consumers who will have less choice of network operator and so are likely to experience lower levels of product and service innovation. The effects of a reduction in choice (competition) in the market are well known. Prices are likely to rise and there is less incentive for existing players to innovate and develop new services.

14. Ofcom itself recognises the benefit of competition and choice in the WFTMR Statement, where it states that "network competition should bring benefits to consumers in the long term from innovation (including innovation to increase efficiency and reduce costs), choice, stronger incentives to price keenly to attract customers, and higher quality of service"[30]. It follows that a lack of competition will have the opposite effect: reducing incentives to innovate, reduce costs and provide a higher quality of service.

7.3 Conclusion

15. We recognise that there is plenty of evidence in academic literature to show that price discrimination, including discounts that enhance loyalty, can be pro-competitive in some circumstances. Therefore, we do not believe that discounts based on volumes

[30] Ofcom (2021) *Promoting competition and investment in fibre networks: Wholesale Fixed Telecoms Market Review 2021-26*
Volume 1: Overview, summary and structure. (Para. 2.10)

or loyalty are harmful *per se.* For example, where there is no dominant firm, loyalty discounts cannot realistically be used to foreclose the market to rivals.

16. However, as David Spector pointed out in 2005:

"Dominant firms willing to engage in an exclusionary strategy may find that cleverly fine-tuned pricing schemes involving loyalty rebates possess several advantages over simple predatory pricing strategies: they can achieve exclusion at a lower cost, be more credible, and erect a permanent barrier to entry without any need for a recoupment period"[31].

17. The Austrian NRA found that discount schemes introduced by Telekom Austria could be anticompetitive by erecting barriers to entry. In Decision 9/06-57 it stated:

"Another potential competition problem is that Telekom Austria erects market entry barriers vis-à-vis potential competitors by artificially raising switching costs (primarily through contractual terms and conditions). Increasing demand-side switching costs through contractual terms and conditions can simultaneously lead both to an increase in costs for competitors (e.g., through higher expenses for marketing and sales) and to a restriction of competitors' sales.

In the absence of corresponding area-specific obligations, it cannot be ruled out that Telekom Austria may realize incentives for anti-competitive behaviour. This would raise the barriers to market entry for potential competitors, as it is more difficult for new companies entering the market to acquire customers. Higher barriers to market entry may prevent or hinder the emergence of effective competition and thus run counter to the objectives of regulation"[32].

Given that discount schemes could be either pro or anti-competitive they deserve intense scrutiny to ensure they are not detrimental to consumers or competition. In the case of ex ante regulation, Openreach's rivals and the consumers they serve cannot wait for schemes to be introduced and challenged through the courts under competition

[31] Spector, D. (2005). Loyalty rebates: An assessment of competition concerns and a proposed rule of reason. *Competition Policy International*, *1*(1), 89-114. (p. 89)

[32] Available at https://www.rtr.at/TKP/aktuelles/entscheidungen/entscheidungen/Bescheid-M-9-06.de.html. Informal translation

law. Instead, Ofcom needs to use its powers to investigate the likely competitive effects of OCTs associated with the GEA volume offer, the FTTP only offer, and the local marketing offer before they are approved to determine if any of the schemes is likely to be harmful to consumers via exclusion or any other anticompetitive effect. If it concludes that the OCTs associated with these offers could result in an increase in the loyalty penalty and/or reduce incentives for CPs to switch to alternative networks and therefore deter market entry, such OCTs should not be permitted.

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Worked Example:

There is a town in which 1,000 households want to switch to TalkTalk

Scenario 1:

Openreach is the first company to bring full fibre to the town.

TalkTalk markets its service and 900 households agree to have fibre installed as part of the switch.

50 households can't be full fibre enabled in a reasonable time due to wayleave and street works issues and so take a copper service.

The final 50 households don't want to have the hassle of having a new cable installed and so just take a TalkTalk service using their existing copper line.

TalkTalk FTTP ratio with Openreach is 90%

Scenario 2:

City Fibre roll out fibre to the town first

It cannot enable 50 of the properties due to the same wayleave and street work barriers

The same 50 households don't want the hassle of having a new cable installed

900 customers sign up to TalkTalk over the CityFibre network

Openreach roll out their full fibre soon after and the 100 customers living in properties that can't get fibre and those that don't want a new cable installed decide to sign up to TalkTalk using the FTTC solution.

TalkTalk FTTP ratio with Openreach is 0% seriously impacting its national average and putting at risk millions of pounds of discounts.

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