Openreach proposed FTTP offer starting 1 October 2021

TalkTalk submission

September 2021

NON-CONFIDENTIAL VERSION

1 Summary

1.1 This is TalkTalk's response to Ofcom's consultation, dated 6 August 2021, regarding Openreach's proposed Equinox discount offer for its FTTP products, currently scheduled to take effect from 1 October 2021.

1.2 In line with TalkTalk's response to the initial call for inputs, we remain of the view that the proposed Equinox contract is broadly pro-competitive and will significantly benefit consumers. The lower wholesale prices will reduce retail prices, thereby increasing consumer uptake; it will also enhance retail competition. Whilst Equinox may have a negative impact on altnet FTTP returns and investment, this is likely to be very small since it will only affect a small portion of all consumers. Furthermore, because Openreach's prices remain well above the efficient costs of altnets, it will not discourage efficient altnet investment – thus, to the extent that the Equinox offer does deter any entry by altnets, that entry is highly likely to have been inefficient, and it will be welfare-enhancing for it to be prevented.

1.3 In fact, consumers would benefit from further material reductions in wholesale prices beyond those provided through the Equinox offer – we estimate that prices could fall by a further 20%-30% and still allow efficient altnet investment. Thus, Ofcom should encourage Openreach to go further in its discounts.

1.4 However, though we are broadly supportive, we do consider that there are some negative impacts on consumers from the Equinox proposal, but that they can be easily remedied. There are two main objections. First, the offer will result in a weakening of competition in the market for providing wholesale broadband services to other downstream ISPs. This impact could easily be addressed by allowing CPs to have separate contracts for their retail customers and wholesale customers for 12-24 months until contracts with downstream ISPs can be amended. Second, we also consider that the way that averaging is applied for assessing whether a CP is eligible for catch-up discount is unreasonable, but that this can be easily amended in ways we suggest below. We think that Ofcom should require these changes to be made.

2 Specific comments on issues raised in the consultation document

2.1 At §2.28 *et seq.* of the consultation document, Ofcom sets out a series of concerns which have been raised regarding the Equinox proposals. We discuss these below.

2.1 Low Openreach FTTP prices act as a barrier to altnet entry and expansion

2.2 At §§2.28-2.33 Ofcom sets out the altnet view that low Openreach FTTP prices may act as a barrier to entry or expansion, and Ofcom's analysis which demonstrates that there will be no such barrier. We agree with Ofcom for two key reasons.

- The prices set by Openreach remain well above efficient altnet costs and so will not discourage efficient entry or expansion by altnets.

- Due to the nature of contracts with altnets and the altnet build approach the amount of altnet build affected by lower Openreach wholesale prices will be limited.

2.1.1 *Prices remain well above efficient entrant costs*

2.3 Ofcom rightly noted (§2.31) that the Equinox prices/ARPU (which will around £15 to £16[1]) is above the costs that an efficient entrant would incur (between £9.53 and £13.67). In fact the Openreach prices could reduce by 20% to 30% and still be above the mid-point of efficient entrant costs.

2.4 Thus to the extent that lower wholesale prices do prevent any entry by altnets, that lost entry is highly likely to be inefficient, and therefore it will be welfare-enhancing for it to be prevented.

2.5 Furthermore, as TalkTalk has previously set out in its various submissions to Ofcom, the regulated price set under WFTMR21 is also well in excess of Openreach's cost level (around £9.50 per customer month). Ofcom implied at §2.29 that this figure was TalkTalk's estimate of the costs. The analysis was conducted independently by Frontier Economics and was based on Ofcom's model and data. This analysis further supports the conclusion that the Equinox pricing is not anti-competitive.

2.1.2 *Lower wholesale Openreach prices will have limited effect on altnets*

2.6 Although in principle lower Openreach wholesale prices can disincentivise CPs from using altnets and/or will reduce the price altnet can charge, in practice this is unlikely to occur to any material degree in this case.

2.7 Lower wholesale prices can only affect altnets in areas where altnets build FTTP. [✂ REDACTED ✂]

2.8 [✂ REDACTED ✂][2]

2.9 [✂ REDACTED ✂] the lower price will have a limited effect due to the delay before Openreach enters and [✂ REDACTED ✂].

2.10 We note that Ofcom's analysis in Annex 8 regarding overlap in altnets footprints is simplistic and ignores some key evidence and dynamics. For instance: Ofcom ignores all altnets except CityFibre; and it does not consider [✂ REDACTED ✂].

2.11 We also note that the concern expressed by INCA in its submission appears to be based on the unrealistic prospect that a CP will offer Openreach FTTC and altnet FTTP within an area where FTTP is available from both Openreach and an altnet. Given that by the time such overbuild happens all CPs are likely to be well placed to sell FTTP, it is unlikely that there will be any meaningful level of FTTC sales in areas where two FTTP networks are available. Consequently, Equinox will have no impact on CPs' willingness to sell altnet FTTP.

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[1] Will depend on mix

[2] [✂ REDACTED ✂]

2.12 INCA's submissions on this point are based on unsupported assertions, such as that "*The wholesale market foreclosure effect demonstrated above could have the impact of making wholesale-only competitors to Openreach unviable*" (§59). No evidence is presented to support this assertion. Ofcom should only accept this point if supported with evidence and analysis demonstrating the impact on altnet returns, and how this might lead to the foreclosure effect alleged by INCA and more particularly the reduction in efficient investment.

2.2 Impact on CPs that wholesale to other ISPs

2.13 In its response to the call for inputs, TalkTalk raised the issue of CPs purchasing Openreach wholesale products who sell that product on to other (downstream) ISPs – and that the Equinox offer would weaken competition in this market. The concern was that these downstream ISPs could continue to purchase FTTC (rather than FTTP) and could jeopardise [✂ REDACTED ✂].

2.14 Ofcom referred to this concern in two places in its consultation:

- at §2.53 Ofcom said that the effect was small and time limited and therefore was not likely to effect CPs ability to meet Order Mix Targets. Ofcom reached this view since: it expected contracts with downstream ISPs evolve to allow suitable provisions to be introduced; CPs have the ability to offer inducements; and since stop-sell provisions will in time force downstream ISPs to purchase FTTP.
- At §2.73*ff* Ofcom said that the impact on downstream competition was not the purpose of this consultation and that stakeholders should raise these concerns through other means

2.15 We are of the view that Ofcom should consider the impact on downstream competition and there is no legal or administrative reason why it should not be considered in this consultation process.

2.16 [✂ REDACTED ✂][3]

2.17 This negative impact on wholesale markets could be easily addressed by allowing CPs to have separate contracts for their retail customers and wholesale customers for 12-24 months until wholesale contracts can be amended and stop-sell provisions will cover a large proportion of FTTP areas. None of the other features of the offer would need to be amended and there would be no negative impact from the change. This ability to have separate 'contracts' within one business is already done for existing FTTP offers – for example the FTTP Only Offer allows only certain brands or resellers to participate[4].

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[3] [✂ REDACTED ✂]

[4] See FTTP Only Offer contract Schedule 1 Section 5. §5.1 says: "*If the Communications Provider: (i) sells the Primary Service through different brands that are controlled by one of the Communications Provider's Group Companies ("Sub-Brands"); or (ii) wholesales the Primary Service to third-party resellers ("Reseller"), the Communications Provider may by written notice to Openreach advise which of its Sub-Brands and Resellers will participate in this Offer, and the commitments in this Offer*

2.18 We consider that Ofcom should require Openreach to make this small change.

2.3 Approach to determining thresholds for discounts in initial periods

2.19 At paragraph 4.3, the Equinox contract sets out that:

> *In the event of a Shortfall Quarter the Communications Provider may within 60 days of the end of the Shortfall Quarter and during the Offer Period but excluding any Shortfall Quarter during the On-Boarding Periods send to Openreach a Relief Notice to require Openreach (using the same formula set out in paragraph (**Error! Reference source not found.**) to measure the Communications Provider's orders for the Primary Service within the Offer Area as a proportion of all orders for the Products in the Offer Area across the entire Subsequent Catch-up Period. If the Communications Provider has achieved the Fibre Only Target or the Fibre Only Threshold as a straight average across the Subsequent Catch-up Period, Openreach shall (if there was a Shortfall Quarter) credit to the Communications Provider on the next available invoice the difference between the Standard Price and the Discounts for any Premises in Offer Area where the Standard Price was charged.*

2.20 This means that a CP can gain a discount for a quarter if it misses the Order Mix Target in that quarter by outperforming the target in subsequent quarters so that it reaches the target across several quarters. However, the calculation of whether a CP meets the target over several quarters is based on the simple average of the level achieved in each quarter rather than reflecting the volume in each quarter (i.e. a weighted average).

2.21 TalkTalk considers that, at a time when Openreach is rolling out its network, and when downstream CPs are themselves rolling out their FTTP offers, the use of a simple average is likely to distort behaviour, relative to the use of a weighted average. It will attribute disproportionate importance to the initial periods, when numbers of customers taking FTTP are likely to be low, and the small number of premises ready for service is likely to make the percentage in each quarter more volatile, introducing uncertainty.

2.22 It should also be noted that Openreach's proposed approach is likely to disproportionately benefit BT's downstream divisions, which is furthest along in its roll-out of FTTP to its customer base, and therefore most likely to meet its targets in the first period. Conversely, other operators which are less advanced in selling FTTP to their customer bases are less likely to be able to meet their targets in initial periods, and are less likely to be able to catch up using the mechanism as set out at paragraph 4.3. A change to using a weighted average would have no negative impacts.

2.4 Other concerns raised by altnets

2.23 At §2.26 Ofcom summarises the issues raised by stakeholders. A number of issues are discussed above; the remaining issues are:

Contract and the Offer pricing will apply to the sales of each participating Sub-Brand and Reseller separately"

- Conditionality acts as a barrier to altnet entry and expansion;
- Targeted discounts deter altnet build;
- Compatibility of the Order Mix Targets with the prohibition on geographic targeted pricing;
- Competitive impacts on ISPs;
- The Order Mix Targets may leave vulnerable consumers exposed; and

2.24 Aside from the points raised above, we mostly agree with Ofcom's provisional conclusions on these issues. In general stakeholders that have raised concerns have not presented any evidence or reasoning to justify them.

2.25 We also note that in general there is a lack of quantitative analysis by Ofcom in circumstances that are amenable to such analysis and where Ofcom has the necessary data. For example, there is no attempt to provide even a broad range of estimates of the amount of altnet investment that might be deterred by the Equinox offer (which for the reasons given above is likely to be small) or the benefits from the Equinox offer in terms of lower consumer prices (which might be around £200m per year by 2025[5]). It is only by doing such quantitative analysis that Ofcom can robustly assess whether the benefits of the offer outweigh the costs.

[5] For example, by 2025 Openreach built to 15m homes, with 50% uptake and an average discount of £3 per customer per month and assuming 80% passed through in lower consumer prices – this gives £220m.