Ofcom consultation

Openreach Proposed FTTP Offer starting 1 April 2023

Virgin Media O2 response

14 March 2023

Non-confidential Response

Executive Summary

VMO2 aims to be a scale wholesale network competitor to Openreach

A well-funded, scaled, wholesale network competitor with at least one large retail anchor tenant is likely to be key to enabling the greatest competitive benefits (not just in terms of lower pricing or better commercial terms but through technological development and innovation) for ISPs and, ultimately, end consumers due to the competitive constraints it can impose on Openreach.

Since the formation of the Virgin Media O2 joint venture ("VMO2") in June 2021, we have made a series of announcements regarding the significant level of investment we are making both in terms of the fibre upgrade[1] of our existing network footprint of 16.1m homes[2], as well as seeking to expand our network through becoming an anchor tenant of the Nexfibre joint venture[3].

Entry by a scale wholesale competitor requires significant long-term commitments from some key ISPs. When considering contracting with an alternative network provider ("altnet"), an ISP will need to weigh up the certainty of the terms it gets from the altnet against any uncertainty caused by the conditions it receives from Openreach for the continued application of the discount mechanisms in Equinox 2. We show that there are three types of uncertainty created by the Equinox 2 offer that will form a barrier to either contracting with altnets in the first place, or subsequently using altnets under contract:

- Uncertainty as to whether an ISP can achieve the Order Mix Targets ("OMTs") if it contracts [✂] with a large altnet;
- Uncertainty as to the effectiveness and operation of the Failsafe Mechanism ("FSM"), especially where, as we currently observe, ISPs are struggling to meet the OMTs needed to obtain a discount; and
- Uncertainty created through continuous engagement by Openreach with the largest ISPs, to the effect that they do not wish to commit demand to altnets today, in case they remove the ability to comply with a cliff-edged discount scheme in any future, further Equinox offer (i.e. "drip-feed pricing").

[✂]

Therefore, the negative consequences of any barrier to entry or expansion as a result of Equinox 2 – especially where it has effect at scale – should be of grave concern to Ofcom and subject to profound and rigorous scrutiny.

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1 https://news.virginmediao2.co.uk/virgin-media-o2-bolsters-future-network-with-fibre-upgrade-plan/
2 https://news.virginmediao2.co.uk/2022-financial-results/q4/
3 https://news.virginmediao2.co.uk/new-4-5bn-investment-to-extend-virgin-media-o2s-fibre-footprint-to-80-of-the-uk/

Ofcom's own analysis shows that Order Mix Targets are capable of having a loyalty inducing effect that will impact VMO2 and other altnets

In "Openreach Proposed FTTP Offer starting 1 April 2023"[4] ("the Consultation"), Ofcom recognises that, given the ubiquitous nature of Openreach's network and the already entrenched relationships with the incumbent provider, ISPs' retail businesses will continue to depend on access to Openreach's network for the foreseeable future. Ofcom also acknowledges that the level of discounts that ISPs can achieve if they meet the OMTs are significant, and those discounts will continue to grow as an ISP adds FTTP customers to its base on Openreach's network.

ISPs are therefore highly incentivised to ensure that they can achieve the OMTs set by Openreach in order to maintain those significant discounts, before they are willing to contract with an altnet.

However, Ofcom accepts that most if not all the key ISPs will struggle to meet the OMTs if they make a large commitment to a large altnet, specifically citing VMO2 and Nexfibre. This important point is contained in two opaque and heavily redacted paragraphs of the Consultation (§§ 3.64-3.65).

It follows that the OMTs, on their own, are a disincentive to using altnets and therefore a barrier to altnet entry and expansion. If ISPs consider there is a risk of jeopardising Equinox discounts across their entire Openreach base, they will not contract with altnets, or, if they do, will do so on a much-reduced basis to ensure they hit the OMTs.

Alone, the OMTs therefore operate to induce loyalty to Openreach and limit the scale of entry that the market will support because so much demand remains tied to Openreach as a result. Effective competition to the incumbent therefore would be foreclosed or significantly dampened, contrary to Ofcom's policy objectives.

The FSM is not completely effective and does not remove the anti-competitive effects of Order Mix Targets

Given the substantial risk to competition posed by the OMTs, any remedial terms in the Equinox offer must comprehensively remove the anti-competitive effect, in all realistically possible circumstances. Ofcom believes that the new FSM completely offsets the barriers to using altnets raised by the OMTs, yet:

- Ofcom has surveyed just 3 of the 49[5] current Equinox customers and acknowledges that even the three largest third-party ISPs are having or will have issues achieving the 80% fibre only threshold if they were to switch to a large altnet[6]. It is therefore realistically possible that these and/or the 46 other ISPs could continue to struggle to reach the 80% fibre only threshold now or at any point in the future;

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[4] https://www.ofcom.org.uk/__data/assets/pdf_file/0024/252663/Consultation-Openreach-Proposed-FTTP-Offer-starting-1-April-2023-Equinox-2.pdf

[5] https://www.reuters.com/business/media-telecom/britains-bt-unveils-equinox-2-wholesale-fibre-offer-2022-12-14/

[6] Consultation, §§ 3.64-3.65

- Ofcom's current analysis of the FSM only includes examples where ISPs will want to maintain the discounts already achieved (i.e. where they have order mixes greater than 90%[7]). Its assessment omits circumstances that are more than realistically possible, they are actually observed in the performance of ISPs today.[8] Where ISPs are struggling to achieve the threshold, effective operation of the FSM is critical for the ISP, given the scale of the discount once the cliff edge is reached;

- In the short time allowed for this consultation response, we have identified realistic scenarios where the FSM would fail to secure Equinox discounts for an ISP, specifically, where ISPs are struggling to achieve the 80% fibre only threshold; in addition

- There is a large amount of ambiguity and uncertainty as to the actual operation of the FSM term in practice; and

- Ofcom itself recognises (at §3.86) that it cannot be sure that the FSM will work in all circumstances and seeks to rely on its ability to intervene in the future to rectify any potential problems that arise.

What is proposed at §3.86 is tantamount to an ex post fix to a problem which has been identified ex ante.[9] This problem needs to be comprehensively fixed ex ante to avoid a risk of foreclosure caused by uncertainty. To do otherwise would be a failure by Ofcom to adhere to its duties.

Ofcom asserts that ISPs' current use of Openreach's GEA-Volume Agreement Special Offer ("VASO") demonstrates that ISPs would find the FSM easy to apply and fit for purpose. VASO contains a term, Volume Target Relief ("VTR"), which has the same objective as the FSM – allowing ISPs to benefit from discounts whilst committing volumes to altnets.

A VTR-like mechanism works by adding altnet gigabit service demand to Openreach FTTP demand, creating a network agnostic measurement of copper to fibre migration. The FSM, by contrast, creates a partial measure for migration from Openreach copper to Openreach fibre by selectively subtracting areas where there is altnet usage (subject to many caveats). Mathematically they are distinct and furthermore – VTR is much more effective in addressing the realistically possible scenarios we identify in our response. It follows that ISPs will be less sensitive to the operation of VTR. The FSM is not effective in such scenarios, so ISPs will be more sensitive to it. VTR does not help Ofcom in deciding whether FSM is workable in practice, rather it further highlights the shortcomings of the FSM.

Drip-feed pricing

VMO2 welcomes Ofcom's decision to seek evidence from ISPs, altnets (and we assume Openreach), with regard to the continued signalling of future prices in the market by the incumbent. The uncertainty this creates, especially in the presence of cliff edged discounts,

[7] Consultation, § 8.85 *et seq.*
[8] As we note below, starting at § 60.
[9] We note that Ofcom cannot fetter its discretion or pre-determine the outcome of a future consultation and therefore no reliance can be placed on Ofcom's ability to act.

acts as a barrier to the conclusion of significant contracts with altnets and is consequently a barrier to switching. The evidence we have provided to Ofcom supports these conclusions.

A way forward

First, Ofcom should find that the Equinox 2 offer materially impacts on competition and should take action to prevent the Equinox 2 Offer from being introduced in its current form. As it stands, Equinox 2 contains terms that disincentivise ISPs from using altnets, the effects of which are not comprehensively remedied by other terms/mechanisms within the offer. Equinox 2 creates uncertainty for ISPs such that the terms will act as a barrier to making commitments to altnets today for their future volumes. Even if contracts are entered into, there are plausible circumstances whereby an ISP will not provide volumes to an altnet because of the way the FSM is constructed.

Second, because Ofcom accepts that OMTs are capable of acting as a barrier to ISPs switching in the wholesale market, it should intervene to prevent such terms in the future and issue a direction to impose an SMP condition in order to preserve and foster competition. Given the material impact on competition, we propose that commercial terms that involve cliff-edge discounts should be prohibited except where explicitly authorised by Ofcom, in an equivalent process to that currently used for geographic discounts. The dominant firm has a special responsibility not to act in an anti-competitive manner and so the burden of proof needs to rest with Openreach, where classes of terms are demonstrably anti-competitive.

Third, with the SMP condition in place, it would be open to Openreach to submit an amended set of commercial terms for a new review. Above we identify an existing scheme already approved by Ofcom, which provides a destination network agnostic incentive to migrate from Openreach's copper network.

Fourth, in relation to Openreach's repeated pricing engagement with ISPs (i.e. drip-feed pricing), Ofcom should open an investigation with a view to issuing a direction creating an SMP condition which provides a "closed period" after any Openreach GEA-FTTP offer is approved. Such an SMP condition would provide certainty for ISPs and enable competition to operate undistorted by the continued signalling of future prices by Openreach. The SMP condition should also ensure that a dominant firm's engagement with ISPs about the nature of new prices must also take place in a short, regulated timeframe.

The wholesale fibre market is facing a small window of opportunity for investment to bring about an effective competitive constraint on the incumbent. This market exhibits a peculiar market structure which we believe warrants a tailored ex ante regulatory solution to address the incumbency advantage exploited by Openreach and manage the ability to tie in its customer base through repeated price signalling, i.e. drip-feed pricing.

Introduction

1. VMO2 was formed in June 2021 through the combination of Liberty Global's Virgin Media fixed telecoms assets and Telefónica's O2 mobile assets. The joint venture became the largest competitor to BT in the retail market. Following the joint venture formation, its shareholders subsequently announced plans to overlay the existing fixed network footprint with fibre, expand the network through another venture and enter the wholesale market in competition with Openreach.

2. VMO2 is already upgrading its cable network by overlaying fibre using XGS-PON technology. This project is fundamentally a technology upgrade to provide a more flexible, cheaper to run and future proof platform. To date VMO2's cable network covers 16.1m homes, or about 54% of UK homes. [✂].

3. Nexfibre is a joint venture between VMO2's shareholders (Liberty Global and Telefonica), with Infravia. [✂] and has VMO2's retail operation as an anchor tenant. [✂].

4. [✂].

5. [✂].

6. It is within this market context that we consider Ofcom's provisional conclusions in this consultation response.

Outline of response

7. Our response to the consultation is structured as follows:

    - A commentary on Ofcom's duties and objectives with regard to this review of Equinox 2;
    - We review Ofcom's provisional conclusions and evaluate its analytical framework for this consultation;
    - We look at the experience following Equinox 1 and set out how this should inform the approach to evaluating Equinox 2, particularly where reliance is based on market evolution;
    - We assess the competitive effects of the Order Mix Targets terms, we support Ofcom's static analysis that shows that Order Mix Targets (and cliff-edged discounts more generally) can create a barrier to the use of altnets;
    - Using a static analysis we evaluate realistically possible scenarios that would mean the FSM fails to comprehensively mitigate the effects of OMTs which warrants a different conclusion in Ofcom's final decision;
    - We go beyond Ofcom's approach and look at dynamic competition effects of Equinox 2;

- As Equinox 2 creates a barrier to using altnets under Question 1 of the analytical framework, we undertake a preliminary assessment of Questions 2 and 3;
- We address the adverse impact of drip-feed pricing;
- We consider the procedural shortcomings in this consultation; and
- We set out what Ofcom should do to remedy the competition problems that have been identified through both its and our analysis.

Ofcom's duties and objectives

8. In this section we provide an overview of Ofcom's duties and objectives as set out in the Communications Act 2003, the Statement of Strategic Priorities ("SSP") and the Wholesale Fixed Telecoms Review ("WFTMR"). These duties and objective must underpin Ofcom's assessment of Equinox 2.

Communications Act 2003

9. Under section 3 of the Communications Act 2003 (Act), Ofcom's principal duties in carrying out its functions are to *"(i) to further the interests of citizens in relation to communications matters; and (ii) to further the interests of consumers in relevant markets, where appropriate by promoting competition.*" (emphasis added)

10. In performing its duties, section 3(4) of the Act states that Ofcom must have regard to a range of factors including:

> *"(b) The desirability of promoting competition in relevant markets*
>
> *(d) The desirability of encouraging investment and innovation in relevant markets*
>
> *(e) The desirability of encouraging the availability and use of high speed data transfer services throughout the UK."*

11. Section 4 of the Act requires Ofcom, when carrying out its functions, to act in accordance with a number of requirements including:

- To promote competition in the provision of electronic communications networks and services, associated facilities and the supply of directories;

- To encourage, to such extent as Ofcom considers appropriate the provision of network access and service interoperability for the purpose of securing: efficient and sustainable competition; efficient investment and innovation; and the maximum benefit for customers of telecoms providers and of persons who make associated facilities available; and

- To promote connectivity and access to very high-capacity networks by members of the public and businesses in the UK.

SSP

12. Ofcom is also required, under section 2B(2) of the Act to have regard to the UK Government's SSP. A key strategic priority is *"The Government's commitment to world-class digital infrastructure for the UK, reflecting the conclusions of the Future Telecoms Infrastructure Review ("FTIR")"*[10]. In this regard, the SSP notes that the FTIR concluded that "the most effective way to deliver nationwide gigabit-capable connectivity at pace is to promote competition and commercial investment where possible, and to intervene where necessary"[11].

13. Building on this, the FTIR outlined a number of strategic priorities to deliver the Government's connectivity ambitions, including "*Stable and long-term regulation that incentivises network investment and ensures fair and effective competition between new and existing network operators*"[12]. To achieve this goal, the SSP states that:

> *"The Government's aim is to promote investment and competition in world-class digital networks, to as many people and businesses as possible. Investment in new networks by BT and alternative providers is key to improving consumer outcomes, in terms of choice, service quality, and innovation. The Government's view is that promoting investment should be prioritised over interventions to further reduce retail prices in the near term.*
>
> *We regard competition where possible as a key driver of network roll-out. It is essential that competition is fair and effective between existing network operators and new entrants, and we expect Ofcom to adopt an engaged, proactive approach to monitoring any anti-competitive behaviour. Ofcom has powers at its disposal - including information gathering, audit enforcement and penalty powers - to perform this role."*[13]

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[10] Statement of Strategic Priorities for telecommunications, the management of radio spectrum, and postal services (publishing.service.gov.uk), § 8
[11] SSP, § 10
[12] SSP, § 11
[13] SSP, § 18-19

WFTMR

14. In light of its duties, Ofcom stated in the WFTMR that its "strategy is to promote investment in gigabit-capable networks through network competition in areas where this is sustainable. We consider that network competition brings potentially significant benefits to consumers, compared to competition based on regulated access to BT's network and wholesale services"[14].

15. With the above general principle in mind, Ofcom highlighted the concerns it had in relation to certain commercial terms that could induce loyalty and deter ISPs from switching demand to alternative networks.

> *"New network builders that operate a wholesale model rely on selling ultrafast services to access seekers. If Openreach uses commercial terms to induce loyalty from access seekers, meaning they purchase all or most of their ultrafast requirements from Openreach, then it will deprive these network operators of demand. Ultimately this could undermine alternative operators' FTTP investment plans."*[15] (emphasis added)

16. The underlined section of the WFTMR above, recognises the two key barriers to use of an altnet. First, the ability and incentive of access seekers (ISPs) to enter into a contract, based on future long-term commitments, with an altnet. Second, should a contract have been entered into with an altnet, the continued ability and incentive of the ISPs to then place volumes under that contract rather than deferring to use of Openreach.

17. Ofcom stated that its "*objective is to promote investment in gigabit-capable networks by Openreach and other operators to promote network-based competition, and this will be our guiding principle in assessing commercial terms proposed by Openreach. Our key concern is commercial terms that could undermine investor confidence in new network build and impact rollout plans e.g. by discouraging access seekers from switching demand to alternative networks."*[16]

18. As acknowledged by Ofcom, the above objectives are set in the context that Openreach is the only operator with a national network footprint and ISPs will, for the medium- to long-term, continue to require access to some wholesale services from Openreach in order to serve their end consumers. Therefore, the incumbent provider has an inherent advantage over other network providers as an unavoidable trading partner, along with the benefits of the economies of scale and entrenched commercial relationships.

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[14] WFTMR, Volume 1, § 2.20
[15] WFTMR, Volume 3, § 7.32
[16] WFTMR, Volume 3, § 7.159

Ofcom's Duty of Enquiry /Sufficient Evidence

19. Ofcom holds itself out to be an evidence-based regulator[17]. As has widely been established, Ofcom has considerable power when issuing its decisions and, as an expert regulator, is afforded a wide discretion to exercise that power.

20. Ofcom must, however, act rationally. There is a wealth of case law that reinforces that a public authority, such as Ofcom, must act reasonably and ensure that the inquiries it makes prior to issuing a decision are sufficient so as to arrive at a rational conclusion. As acknowledged by the Competition Appeal Tribunal ("CAT") in the CityFibre appeal[18], it is also an established principle that *"[t]he wider the discretion conferred on the Secretary of State, the more important it must be that he has all relevant material to enable him properly to exercise it*"[19].

Procedural Fairness: Ofcom's Duty of Consultation

21. As a public authority, Ofcom is also subject to the public law duty of consultation. When issuing a consultation and inviting responses from interested parties, Ofcom is obliged to follow the *Gunning/Sedley* criteria[20] which includes the following principles:

- First principle – "*that consultation must be at a time when proposals are still at a formative stage*";
- Second principle – "*that the proposer must give sufficient reasons for any proposal to permit of intelligent consideration and response*"; and
- Fourth principle, that "*the product of consultation must be conscientiously taken into account in finalising any statutory proposals*".

22. These principles of procedural fairness have been expressly endorsed by the Supreme Court[21].

Ofcom's provisional conclusions

23. In this section we summarise Ofcom's Equinox 2 consultation and the analytical framework it has used to assess Equinox 2 as informed by CAT judgment in the Equinox 1 appeal.

Overview of the consultation

24. Openreach launched its proposed Equinox 2 offer on 14th December 2022. It was not until 3rd February 2023 that Ofcom published its consultation on the Equinox 2 offer.

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[17] Consultation, § 2.8
[18] CityFibre Limited v Ofcom [2022] CAT 33, p.88
[19] R (Pharmaceutical Services Negotiating Committee) v Secretary of State for Health [2017] EWHC 1147, § 56(6)
[20] R v Brent London Borough Council, ex p Gunning (1985) 84 LGR 168, p.189
[21] R (Moseley) v LB Haringey [2014] UKSC 56, p.25

Respondents were given precisely 30 days to submit their views, with the consultation period closing on Saturday 4th March.

25. Prior to the consultation, VMO2 and others made preliminary submissions to Ofcom regarding Openreach's proposal. Ofcom sought to address these preliminary submissions in its consultation document.

26. Subsequently VMO2 has provided a wide range of documents to Ofcom both (initially) informally, and under Ofcom's statutory powers. Not all of these documents were sought by Ofcom in a timeframe which allowed it to consider them before making a provisional finding. Furthermore, Ofcom confirms that information from ISPs was also incomplete or not fully analysed at the time it formed its provisional view. [22]

27. Based on incomplete information, the consultation considered a number of issues raised by stakeholders; namely[23]:

- Order Mix Targets
- Forecasting requirements
- Lower Openreach FTTP prices; and
- Openreach's "*practice of repeatedly amending its FTTP prices*"[24].

[22] For example, Consultation, § A8.35 and § A8.49.
[23] § 3.1 refers
[24] Consultation, p.27 (as printed)

Ofcom's analytical framework

28. In the Consultation, Ofcom has clarified the analytical framework it is using to assess the Equinox 2 offer.

29. In § 3.35 of the Consultation, Ofcom reiterated the 3 questions which were applied in the Equinox 1 assessment:

- Question 1: Does the Equinox Offer potentially create a barrier to using altnets?
- Question 2: Is the Equinox Offer likely or unlikely to have a material impact on nascent network competitors?
- Question 3: Is the Equinox Offer likely to generate clear and demonstrable benefits?

30. As Ofcom acknowledges, Question 1 was the subject of much debate as part of the Equinox 1 appeal to the CAT. The CAT held that when applying Question 1, Ofcom must determine the extent to which a notified offer (or a commercial term within it) might create a barrier for ISPs' use of altnets. The issue must be "*something which was not just a theoretical possibility, but instead was something plausible*".[25] In this regard, the CAT held that *"It was appropriate for Ofcom to make evaluative judgements about whether there was a realistic possibility of certain outcomes, such that it should be concerned about ISPs not using altnets."*[26] (emphasis added)

31. Ofcom has therefore concluded that when applying Question 1 it will consider "*the likelihood of events happening (or not happening)… In making our assessment we will ascertain whether scenarios are real enough to justify intervention, bearing in mind our wider duties and responsibilities"*[27].

32. Ofcom also clarified, based on feedback from the CAT, that if it were to find that Question 1 is satisfied, it will consider the formulation of the analytical framework as set out in the WFTMR which is a clearer formulation of the tests set out in Question 2 and 3 above. In the WFTMR, Ofcom articulated that if there was a barrier to using altnets, such barriers would only be justified where:

- The impact on nascent network competitors in unlikely to be material; and
- The arrangements will generate clear and demonstrable benefits, such as:

    i. The arrangements are essential to Openreach's business case for fibre roll-out; or

[25] CAT Judgment, 1426/3/3/21 CityFibre Limited v Ofcom, § 144
[26] Ibid, § 149
[27] Consultation, § 3.40

ii. The arrangements are necessary to offer more efficient prices that would deliver benefits for consumers.[28]

33. As explained in more detail below, Ofcom's analysis is a purely static one that focuses on ISPs incentives to make use of an altnet in a given quarter. Ofcom has failed to address the impact Equinox 2 could have on investment incentives from a dynamic perspective. This omission is addressed in more detail below.

Ofcom's conclusions

34. In light of its assessment, Ofcom provisionally concluded that it should take no action at this time to prevent the Equinox 2 Offer terms being introduced. It stated:

> *"In reaching our provisional view, we have considered the impact on competition. For the reasons set out above, we do not consider that the Equinox 2 Offer will have a material adverse impact on competition. We have considered the impact on different stakeholders:*
>
> *a) Citizens and consumers: Our provisional conclusion is that the Equinox 2 Offer is consistent with promoting investment in gigabit-capable networks by Openreach and other operators and promoting network-based competition, ultimately delivering better consumer outcomes.*
>
> *b) Altnets: As a result of the Equinox 2 Offer, altnets are likely to face stronger competition from Openreach. However, we provisionally conclude that the OMTs and forecasting requirements do not create a potential barrier to using altnets. Our provisional conclusion is therefore that the Equinox 2 Offer is consistent with network-based competition.*
>
> *c) ISPs: We consider that ISPs are likely to benefit from network-based competition. As explained above, we provisionally conclude that ISPs will continue to be free to use altnets where they wish to do so."*[29]

35. The analysis undertaken by Ofcom is static, in that it examines how the terms of the Equinox 2 Offer work under a set of static conditions. As we shall show, Ofcom's own findings regarding OMTs alone already make its provisional conclusions unsustainable. Furthermore, in order to be complete, an analysis must consider the dynamic consequences of contractual terms. An analysis that not only considers what events might happen in the future but also assesses the likelihood that they will take place is prospective by design. As part of its analytical framework, Ofcom should therefore consider both the static competition effects and dynamic competition effects in order to properly assess the realistic possibility of certain outcomes.[30]

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[28] WFTMR, Volume 3, § 7.154
[29] Consultation, § 3.136
[30] By 'static' we are referring to competitive effects in a narrow, single period manner, while 'dynamic' effects also take into account a broader perspective of competition and competitive effects, including how they evolve over time.

Ofcom must learn from developments since Equinox 1 and take a cautious approach to reviewing Equinox 2

36. The impact of Equinox 2 must first be considered in the context of Ofcom's conclusions in respect of Equinox 1 and subsequent observed outcomes in the market. This is in line with the CAT's recommendation to Ofcom in the CityFibre appeal which encouraged Ofcom "*to maintain careful scrutiny of the market at this important time, to ensure that the judgements it has made in the Statement continue to be validated by the emerging evidence of actual competitive conditions*"[31].

37. In Equinox 1, Ofcom provisionally concluded that no action was necessary given the proposed terms of the scheme. In the consultation it noted certain "theoretical concerns" but broadly judged these to be just that – theoretical – and that in any event they were likely to be immaterial, transitory, or both. As a result of that analysis, Ofcom affirmed its provisional view not to take any action.

38. In this consultation, with the benefit of hindsight, almost 1.5 years of data on the performance of the Equinox 1 scheme, as well as further progress of altnet build and corresponding analysis of such build, it seems clear that the assumptions in Ofcom's Equinox 1 consultation and statement have not been borne out by experience in two key aspects.

39. First, it is clear that Ofcom understated the extent of potential overlap between Openreach and altnets under Equinox 1. Ofcom has now extended its analysis of competitor overlap between Openreach and its competitors to include a *"high overlap scenario"* with 60% overlap with the Openreach FTTP footprint.[32] This is a welcome improvement. It is important, because in a contract lasting many years, an ISP will need to consider the dynamics of the Equinox Offer terms in both the current state of the market and the end state of overlap. Yet Ofcom only considers the *"high overlap scenario"* in a static way, looking at how the Equinox 2 terms would operate with such high overlap. It does not consider how ISPs will evaluate contracting with altnets with *"high overlap"* in their end state, when making an upfront contractual commitment.

40. Second, Ofcom overstated ISPs ability to meet the OMTs in the Equinox 1 decision. There are still ISPs struggling to achieve the Order Mix "threshold", and it is realistically possible that this state of affairs will continue. Yet in its Equinox 2 provisional conclusions, Ofcom is only ever analysing scenarios whereby ISPs are above the Order Mix "target". This assumption does not look plausible in the medium-term.

41. It is a realistic possibility that ISPs will continue to find the threshold and target within the Order Mix Term a challenge. To fail to address these scenarios at all is not reasonable.

42. There may be many reasons why the target or threshold remain challenging, for example, some ISPs may continue (for a longer period and to a more significant degree than

[31] CAT Judgment, 1426/3/3/21 CityFibre Limited v Ofcom, § 152
[32] Consultation, § 3.61

considered by Ofcom) to need access to new copper products due to supply to their own wholesale partners (whose business the ISPs have no control over) and therefore do not have full control over their order mixes.[33]

43. By the time Ofcom receives responses to this consultation, c.40% of the WFTMR 2021 market review period will have elapsed, and the oft-cited “small window of opportunity” to encourage infrastructure competition will have closed still further.

44. As a consequence, with this benefit of hindsight, it would be reasonable for Ofcom to develop and improve its analysis within the construct of the framework set out in the WFTMR, to avoid the risk that its assumptions and expectations are, again, overly optimistic.

45. Given such limited time has passed between iterations of Openreach’s long-term discount schemes, and this is only the second of what may be many further flavours of Equinox or subsequent complementary schemes, this review is an important opportunity for Ofcom and stakeholders to re-evaluate how Ofcom could and ought to apply its analytical framework. In particular, where the potential impact of the risk is significant (e.g. foreclosure of a wholesale competitor), then Ofcom cannot rely on speculation and assertion as to how the market might develop in future.

46. To this end, VMO2 urges Ofcom to take a cautious approach when reviewing Equinox 2. It is important to recognise that the scenarios we have put forward in this response represent just a subset of the plausible scenarios that could result in ISPs being disincentivised from using altnets. Ofcom should not rely on assertions about how the market may, or may not, play out. The experience of the last 18 months has shown that this is a flawed approach to regulator decision making. Rather, Ofcom should undertake a more complete analysis, that evaluates a wide range of circumstances.

47. If Ofcom were to consider a complete set of scenarios, it would show that ISPs may be disincentivised from using altnets in plausible circumstances, such that gating Question 1 is met and Ofcom should proceed to consider Questions 2 and 3.

[33] Such wholesale arrangements are likely to be a source of complexity when attempting to utilise the FSM, e.g. where a customer of wholesale ISP separately contracts with one or more altnets, but it is the wholesale ISP that needs to evidence this to the independent verifier. Under the FSM this would require the exchange (via Openreach’s customer) of a lot of confidential information.

Equinox 2 must be considered in the context of the wider incentives of Openreach

48. The dominant firm has a special responsibility to ensure that its conduct does not distort competition. That responsibility exists because of the scale of the benefits is would accrue from seeking to overtly maintain or reinforce its position in the market. Within the ex ante framework, therefore, Ofcom's assessment of Equinox 2 needs to be mindful of these incentives.

The design of Equinox 2 needs to be considered in the context of the commercial incentives of Openreach to foreclose rival altnets

49. In the consultation, Ofcom does not appear to test the claim by Openreach that the commercial rationale for the Equinox 2 Offer is to promote movement of its customer base from legacy products to FTTP. However, recent actions and statements by BT and Openreach illustrate that the design of Equinox 2 must be considered in the context of Openreach's enduring incentive to foreclose rival altnets.

Concerns prompted by design of offer and public statements

50. Historically, via the VASO, Openreach has deployed discount schemes to encourage particular customer behaviours such as over-indexing on higher fibre speed tiers and migration to newer technologies, but in a way that was agnostic to which networks it was delivered on. This scheme predated the WFTMR publication and Equinox 1 followed shortly thereafter. It is perhaps relevant that just prior to the publication of the WFTMR, when discussing its expectations about the forthcoming publication, BT noted to its investors that:

> *"On commercial deals, it is going to be difficult to sign long-term volume-linked contracts. However, CPs' current appetite for deals Openreach has in the market gives us confidence that long-term demand for the product is there. And, as copper stop-sell takes effect, and our footprint rapidly expands, this is likely to increase. We will continue to look at options to accelerate the migration to full fibre, ensuring that we address any constraints from competition law."*[34]

51. In our view, it is notable that after BT recognised that Openreach would find it difficult to deploy explicitly volume-linked contracts, it changed its previous network-agnostic approach adopted for constructing discount schemes and developed the mechanics that now define the Equinox scheme. In that context, Ofcom should apply a degree of regulatory scepticism and assess whether the Equinox scheme has as at least one

[34] BT trading update call, Third quarter to 31 December 2020 (04/02/2021), https://www.bt.com/about/investors/financial-reporting-and-news/results-events-and-financial-calendar/2020-21#q3-2020-21-results

objective to ensure loyalty and retain volume on Openreach; (i.e. to *de facto* replicate the outcomes of long-term volume-linked contracts)[35].

52. In that regard, Equinox 2 is not essential to Openreach's business case for fibre roll-out. Indeed, BT Group CEO Philip Jansen recently claimed[36] that the Openreach's FTTP rollout programme is "*unstoppable*", and that no rival "*has got a machine anywhere near ours*". Furthermore, even without Equinox 2 being in place, BT has recently confirmed that FTTP penetration is ahead of its expectations and that line-loss to altnet competitors is lower than expected.[37]

53. Given that observation, Ofcom should have assessed whether Openreach's intention in designing Equinox 2 was to assist in inhibiting the realisation of Ofcom's vision for widespread full-fibre competition across the UK. Openreach's intention should be assessed within the context of the statements of Mr Jansen in the same interview, for example that he saw no need for "*multiple providers*", and that there is "*only going to be one national network*".

Ofcom must review internal documents in light of the above

54. In the case of Equinox 1, Ofcom had at least requested and reviewed Openreach's internal board papers prior to forming a provisional conclusion.[38] It is not clear from the consultation that Ofcom has yet requested these in the case of Equinox 2.

55. BT's Compliance Committee (BTCC) noted Equinox 2 as an on-going major project since at least July 2022 and so we would expect substantial documentation would have been generated to assess options and variations of the offer and the benefits and drawbacks of different approaches.

56. Furthermore, the Openreach Board Audit, Risk and Compliance Committee's (OBARCC) 2022 Commitments Compliance Report noted:

> *"A detailed review of the governance processes for an amendment to the Equinox (fibre pricing) offer highlighted some minor improvement opportunities to ensure that Openreach's greater strategic and commercial independence can be clearly demonstrated."*

57. It may be expected that additional documentation and scrutiny of the decision-making process would have been applied within Openreach and/or BT plc group companies in the context of this previous review and identified improvement area and if so, such

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[35] Later we discuss a term within VASO that we believe is of merit as an alternative to the FSM in Equinox 2. Whilst we put forward such a suggestion to Ofcom, this should not be taken as an acceptance or advocacy of volume discounting by providers with SMP.
[36] Financial Times (2 February 2023), BT chief warns Openreach fibre push will 'end in tears' for rivals, https://www.ft.com/content/031dcf72-dfaf-4e90-85d2-335ef703dbd1
[37] BT trading update call, Third quarter to 31 December 2022, https://www.bt.com/about/investors/financial-reporting-and-news/results-events-and-financial-calendar/2022-23#q3-fy23-results
[38] https://www.ofcom.org.uk/__data/assets/pdf_file/0032/222989/Equinox-condoc.pdf, § A7.8

documentation may be informative for Ofcom's assessment of the proposed scheme and the underlying rationale. VMO2 therefore urges Ofcom to seek such documentation to determine the accuracy of their assumptions regarding Openreach's genuine intent and rationale.

Order Mix Targets

Ofcom accepts that Order Mix Targets are capable of creating a barrier to ISPs contracting with large altnets

58. Ex ante regulation is meant to act prospectively, i.e. it is meant to prevent anticompetitive effects from happening.

59. In order to discharge its duties during its review, Ofcom should undertake an analysis of the impact of Equinox 2 on a future wholesale entrant the size and scale of VMO2/Nexfibre. This is a perfectly 'plausible' and realistically possible scenario, within the meaning adopted by the CAT as set out above [39].

60. Ofcom appears to have attempted to undertake such an analysis under its "high overlap scenario", although as we state above, the overlap assumption is overly conservative. We reproduce the findings here, including text previously redacted from the original consultation document but subsequently released on Ofcom's website [40]:

> *"3.64 Accordingly, we consider that [REDACTED] would not potentially be deterred from using altnets other than VMO2 and Nexfibre as a result of the OMTs, even if the Failsafe Mechanism was not in place. This is because placing orders with these altnets is unlikely to jeopardise meeting the OMTs. However, this is not the case for all ISPs. We consider that [there may be points in the future] where using an altnet potentially affects the discounts received by [REDACTED] (absent the Failsafe Mechanism).*
>
> *3.65 Provided an ISP is comfortably exceeding the OMTs, then it is unlikely to be deterred from making use of a mixture of cable and FTTP from VMO2 and Nexfibre for a significant proportion of its orders, notwithstanding the higher overlap. It is possible that [REDACTED] will be in this position, particularly as we expect that: (i) an ISP is unlikely to switch all its FTTP orders from Openreach to altnets in such a large overlap area; and (ii) the time it would take to reach and implement such an agreement may give the ISP a future opportunity to improve its Order Mix. However, this is not certain, so even [REDACTED] might face difficulties in meeting the OMTs as a result of shifting large numbers of orders to VMO2 cable and altnet FTTP, absent the Failsafe Mechanism. It is more likely that [REDACTED] might face these difficulties." [our emphasis]*

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[39] See § 30

[40] We note that the newly revealed redaction has no confidential information, yet it is vital to understanding the future risks of ISPs failing to achieve the OMT.

61. Furthermore, footnote 53, in its new less redacted form, now reveals *"In the light of ISPs' practical experience now that the Equinox 1 Offer is in place, it appears that [REDACTED] may take longer to surpass the OMTs than originally expected."*

62. This finding may be the reason for Openreach's decision to waive the Fibre only Target requirement until July 2023, cited at footnote 51 in the Consultation. Therefore there are, and will continue to be, circumstances where ISPs will not meet the 90% OMT threshold to obtain the full Equinox discount and might not meet the 80% OMT target to obtain any Equinox discount. Alternatively, it may take more time for ISPs to move from the 80% threshold to the target of 90% to secure the full discount. These points are relevant for our later assessment of the FSM.

63. Reading between the redactions and the double negatives in §§ 3.64-3.65, these very carefully drafted paragraphs spell out Ofcom's conclusions that:

- If [some] ISPs switch sufficient volume to VMO2, then those ISPs would endanger their Equinox discounts now and at *"points in the future"*;
- Therefore, Order Mix Targets will deter [some] ISPs from using VMO2 and Nexfibre, at least absent an effective corrective mechanism.

Saw-tooth or cliff-edge discounts discriminate in their effect on retail competitors

64. In our pre-consultation submission, we noted that the cliff edge / saw-tooth discount construct has historically been considered per se prohibited by Ofcom, due to a presumption of being unduly discriminatory. In the consultation,[41] Ofcom provides a cursory rebuttal to the specific example provided by VMO2 (paraphrased):

- The presumption was due to the complexity of applying a price-cost test;
- The WFTMR did not specify such a presumption;
- It would not be relevant to rely on such an assumption given Ofcom has carried out an evidence-based assessment of OMTs; and
- The specific form of pricing may not be comparable since OMTs are not based on aggregate expenditure.

65. VMO2 highlighted this example not with the intent of drawing direct and specific parallels to the precise circumstance of the market or the form of the pricing construct, but because of Ofcom's previous acknowledgement of the need to adopt a precautionary approach to mechanisms that could plausibly enable an operator with SMP to abuse that market power to the detriment of nascent competition or the prospect of new entrants.

66. Nevertheless, the 2004 case did exhibit similar characteristics that broadly apply in the case of Equinox 2 including non-replicability and the ability to leverage this advantage (in

[41] Consultation, footnote 50

2004 it was the product set, in Equinox 2 it is geographic scope) and practical necessity of purchasers to contract with the holder of SMP (BT in 2004, Openreach in Equinox 2).

67. However, there are various historical examples[42] where Ofcom has been alive to the significant risk that BT might seek to adopt a saw-tooth discount strategy to abuse its SMP. In Ofcom's Leased Line Charge Control (2009), it noted[43]:

> *"In the BCMR Statement, we concluded that there would be a general presumption that certain volume ("saw-tooth") discounts would be discriminatory. The reason for this general presumption is that as BT is usually the largest user of its own wholesale services, it is likely that volume discounts on services such as PPCs would mainly benefit BT and allow it to undercut competitors in downstream markets."*

68. Furthermore, in Ofcom's Business Connectivity Market Review ("BCMR") statement (2013), it noted[44]:

> *"Although we do not consider this requires specific provision in the condition, we note that there is a particular risk in relation to saw-tooth discounts which will often be unduly discriminatory, in view of their potentially anti-competitive effects. Saw-tooth discounts are discounts which can lead to a decline in the overall level of charges following an increase in the level of consumption. To give a simple example, a supplier may offer a 10% discount if pre-discount expenditure exceeds £100. If the discount applies to all expenditure, rather than just the incremental expenditure in excess of £100, an increase in volumes, which just triggers the pre-discount expenditure threshold, could lead to a reduction in post-discount spending.*
>
> *"We consider that saw-tooth discounts may often act as a barrier to market entry or expansion and, in a market characterised by SMP, may restrict the development of competition."*

69. Again, this example illustrates Ofcom's previous awareness of the potential risk that such saw-tooth mechanisms present. This example also illustrates a specific concern about how the saw-tooth mechanism operates under Equinox 1 and 2 and whether it creates the potential for undue discrimination in favour of BT Retail as a participant in the scheme, or whether this potential risk has the effect of inducing loyalty from other participants in the scheme as an indirect result of BT Retail's participation.

70. Ofcom states in the consultation that Sky, TalkTalk and Vodafone comprise the key potential customers of altnets. BT Retail is under common ownership with Openreach and

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[42] Inter alia, in Ofcom's 2008 BCMR consultation, it discusses this concern throughout its documents, e.g. part 4 §§ 8.122-8.126 and § 8.343. https://www.ofcom.org.uk/consultations-and-statements/category-1/bcmr

[43] https://www.ofcom.org.uk/__data/assets/pdf_file/0019/40807/llccstatement.pdf, § 3.316

[44] Ofcom, BCMR Statement (published 28/03/13), https://www.ofcom.org.uk/__data/assets/pdf_file/0031/63499/sections8-16.pdf, §§ 10.88-10.89

therefore it is reasonable to expect BT would continue to exclusively use Openreach as its network provider for FTTP services.

71. As a result, in the same way that under the 2009 LLCC BT Retail would have been expected to be the largest consumer (and hence greatest beneficiary) of saw-tooth discounts, it is reasonable to assume that BT would exhibit the greatest fidelity to Openreach amongst its customers under Equinox 1 or 2.

72. As a consequence, in our view Ofcom should also consider the potential risks inherent in Equinox 2 from an undue discrimination perspective amongst ISPs.[45] The discount mechanism rewards ISPs that maximise the proportion of new Openreach FTTP volumes as a proportion of total new Openreach volumes. It also rewards ISPs that over-index on higher bandwidths through the ARPU-share mechanism.

73. The saw-tooth (and cliff edge) mechanics within Equinox 2 amplify the relative success or failure to meet OMTs by applying the discounts to all volumes. Each other ISP is knowingly competing against BT on the same offer terms and knows BT Retail will remain loyal to Openreach and therefore place all future FTTP demand onto its network, thus always maximising the potential benefit of the scheme.

74. As a result, it seems logical that ISPs would recognise predictable risks when considering a strategy that involves using altnets:

- Scenarios might arise where OMTs are challenging to meet and the ISP either fails to meet the threshold outright or underperforms against the target. It will know this was a feature of Equinox 1, is a feature of Equinox 2 (albeit the FSM seeks to address it), and may be a feature of future discount schemes;

- Any deficiency in either Openreach's or the ISP's operation of the FSM (or potential scenarios where it is not fully applied) could cause the ISP to fail to meet or underperform against OMTs; and

- Scenarios that lead the ISP to place high-speed tier volumes elsewhere would diminish the ARPU-share achieved.

75. In each case, the ISP will evaluate these risks in the context of a credible commitment by its largest competitor, BT, to pursue a strategy unencumbered by these risks and thus able to maximise the potential gains from the current saw-tooth and cliff-edge discount mechanics. By construction these mechanisms amplify the impact of incremental under- or over-performance by applying the discount achieved across the entire volume base.

76. As a consequence, in our view, Ofcom ought to apply greater scrutiny to the saw-tooth and cliff-edge features of the scheme and what effect BT's credible commitment to always

[45] Irrespective of not having specified a per se prohibition of the saw-tooth mechanic in WFTMR.

use Openreach and any long-term discount schemes that reward fidelity may have on ISPs' decision making in both a static and dynamic context.

Saw-toothed or cliff-edge discounts require a precautionary approach

77. Although Ofcom has briefly acknowledged stakeholders' previous comments on the per se appropriateness of the saw-tooth and cliff-edge mechanics embedded in Equinox 1[46] and 2[47], we believe Ofcom should consider these concerns more fully.

78. First, Ofcom has already shown in its analysis that OMTs have a loyalty inducing effect. Something that was not properly appreciated during the Equinox 1 review.

79. Second, as we discuss above, we believe there is also merit in Ofcom analysing whether the OMTs also risk establishing undue discrimination as between BT's downstream business, which will have no incentive to wholesale from a network other than Openreach (and thus will have no impact on its ability to meet the OMTs) and the prospective wholesale strategies of other ISPs who would be more inclined to seek the benefits of wholesale competition. In our view, this distinction and the mechanics of Equinox 2 could result in a mechanism designed to reward BT Retail's loyalty, as well as deter ISPs from using altnets to avoid BT Retail having any such competitive advantage.

80. Ofcom has previously placed significant weight on the potential risk of mechanisms acting as a barrier to market entry and expansion, and as a result has adopted a presumptive prohibition of this contractual term in past decisions. In the WFTMR statement Ofcom left ample scope to elaborate on what forms of other commercial terms it may subsequently consider to be problematic[48].

81. In light of data now available to Ofcom on the ISPs' performance in meeting OMTs, and the amplified effect this has (and will increasingly have) on the value of the discounts they achieve, we believe it is appropriate to more fully assess whether these mechanisms should be subject to greater scrutiny going forwards.

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[46] https://www.ofcom.org.uk/__data/assets/pdf_file/0021/226092/statement-openreach-proposed-fttp-offer.pdf, footnote 71
[47] Consultation, footnote 50
[48] WFTMR Volume 3, § 7.148, is but one of many examples.

The FSM fails to address the problems created by Order Mix Targets even on static basis

82. In this section we explain how the FSM fails to address the problems created by the OMTs in Equinox 2. We outline a stylised, but as explained likely, scenario in which even with the FSM in place ISPs may be disincentivised from using altnets. We also explain that the FSM cannot be compared to Openreach's VASO and that ex post regulation is not a solution to flaws in the design of the FSM.

The FSM fails to eliminate the possibility that Equinox 2 will impact ISPs incentives

83. Openreach claims[49] that the FSM has the aim of *"eliminating even a theoretical possibility"* of the Fibre Only performance measure *"having the effect of distorting the incentives to use alternative network suppliers in areas where CPs have a choice between Openreach FTTP and other suppliers"*. According to Openreach, the FSM would mean that *"any decisions to use an alternative network supplier…could not in any way affect…the level of discounts that the CP would receive"*[50] (emphasis added).

84. As set out above, Ofcom's own analysis shows that it is more than a theoretical possibility the OMTs create a barrier to using altnets, absent an effective corrective mechanism. Therefore, it is crucial that the FSM is effective in eliminating that possibility in all likely or realistically possible scenarios.

85. Ofcom's analysis of the FSM[51] – where it has simply sought to rebut concerns raised by altnets – is superficial at best. A full and thorough analysis of the characteristics of the mechanism would have enabled Ofcom to uncover the inadequacy of the FSM in resolving the distortion of competition inherent in the design of Openreach's Equinox schemes in a range of likely (i.e. more than plausible) scenarios. Our analysis shows that the FSM fails to achieve Openreach's stated aim without having to resort to "theoretical" scenarios.

86. The following example shows that there are realistically possible scenarios in which the FSM does not eliminate the barrier to using altnets created by the OMTs.

A stylised example

87. The inherent anti-competitive properties of Equinox 2 can be illustrated with a stylised example. Consider such an example with the following assumptions, reflecting a purchasing decision that may be faced by an ISP ahead of a particular quarter should Equinox 2 proceed:

[49] Openreach: "Equinox Failsafe Mechanism – Overview", 14 December 2022, p.2
[50] Ibid.
[51] Consultation, § 3.67 and § 3.83

- Acquisition of 100 lines in Openreach uncontested FTTP/C footprint;
- Acquisition of 100 lines in overlap area, with v (FTTP/C) and altnet (FTTP) present (representing an altnet overbuild of v's FTTP network in of 50% of its footprint, in line with Ofcom's expectations of the extent of overlap in its consultation document);
- Equinox 2 price only effective if Order Mix ≥ 80%;
- Equinox 2 prices apply across stock of existing lines and new lines if triggered;
- Demand for legacy Openreach products (FTTC) in uncontested Openreach area = 25%;
- Demand for legacy Openreach products (FTTC) in overbuild area = 10%; and
- ISP can choose to define an "Overbuild Area" and trigger the FSM to exclude relevant overlap area sales (FTTP/C) from the order mix calculation.

88. The ISP's overall order mix – and hence whether it qualifies for the Equinox discounts – will depend on the extent to which it consumes altnet FTTP products in the overbuild area as shown in the table below.

	If ISP sources from altnet in overbuild area		If ISP sources from Openreach in overbuild area	
	Non-overlap area	Overlap area	Non-overlap area	Overlap area
Openreach FTTP	75	0	75	90
Openreach FTTC	25	10	25	10
Altnet FTTP	0	90	0	0
Order Mix	=**68.2%** [75/(75+25+10)]		=**82.5%** [(75+90)/ (75+25+10+90)]	
Order Mix with FSM	=**75%** [75/(75+25)]		No need to invoke, as ISP is not sourcing from the altnet	

89. In such a scenario, the ISP is faced with the choice of sourcing from Openreach or an altnet in the overlap area. As the table shows, if the ISP chooses to source from the altnet, it would not hit the 80% Fibre Only Threshold, the lower of the two OMTs, losing access to the Equinox discounts across both its new orders and existing installed base. **The FSM does not help in such a situation, as removing orders in the overlap area does not change the issue that the order mix within the standalone non-overlap area is under the Fibre Only Threshold**.

90. Fundamentally, removing orders in the overlap (i.e. FSM) will not result in a higher order mix in the non-overlapping (i.e. non-FSM) area. Therefore, activating the FSM will not help

the ISP hit the Fibre Only Threshold. The only way of hitting the Fibre Only Threshold is to increase Openreach FTTP orders in the non-FSM area.

91. The examples Ofcom uses in Annex 8 of the Consultation only relate to scenarios where the ISP is comfortably exceeding the Fibre Only Threshold and the Fibre Only Target (i.e. both OMTs) to start with (i.e. 92% and 95% order mix).[52] Ofcom does not explain why it has chosen these examples or established that they are relevant to its analysis. Where there is no risk of an ISP missing the OMTs irrespective of whether it chooses to use altnet FTTP services either now or in the future, the risks of anti-competitive effects arising from the OMTs are more limited. However, that is not the most relevant scenario for Ofcom to focus on in this case.

92. For Ofcom to be confident that Equinox 2 will not result in harm to competition it needs to be able to rule out there being realistic scenarios where the OMTs can result in anti-competitive effects. As set out below, Ofcom has itself recognised the difficulties ISPs face in meeting the OMTs - so this is the appropriate starting point for any analysis of the potential anti-competitive effects of the scheme.

93. In our example, the ISP faces a significant cliff-edge if it sources from the altnet in the overlap area as it will continue to be reliant on Openreach in a material part of the country and the Equinox 2 discounts are substantial. Therefore, the financial consequences for the ISP missing the 80% OMT will mean it will be highly incentivised to meet it. Furthermore, as ISPs respond to such incentives and install more and more customers on Openreach FTTP over time, the financial consequences of missing the targets grow thereby increasing the incentives to ensure that they meet the OMTs.

94. The only way to overcome this cliff-edge loss of the discount would be for the ISP to source at least some, if not all, of its FTTP lines from Openreach in the overlap area. The table shows that if the ISP switched all its 90 orders from the altnet to Openreach in the overlap area, it would achieve an Order Mix of 82.5%, enabling it to avoid losing the discounts. To just meet the 80% OMT, the ISP in this example would need to switch 85 orders in the overlap area, leaving only 5 orders with the altnet.

95. As Ofcom recognises, ISPs are "*likely to be strongly incentivised to meet the OMT*" given the "*substantial*" discounts on offer, and so ISPs could be deterred from *"moving volumes from Openreach to altnets"*[53]. While Ofcom considers that an ISP at risk of missing the OMTs could activate the FSM, in the example above the FSM is of no use. An ISP in this situation would clearly be deterred from purchasing FTTP access from an altnet in the overlap area.

96. While in our example the ISP can mitigate the risk of not hitting the OMT by diverting the majority of its orders from altnets to Openreach, in practice, altnets are competing primarily to secure long-term volume commitments from ISPs. Under such agreements, the ISP may face penalties for missing the altnet commitment. Such penalties are

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[52] This is also the case for the examples that Ofcom uses in § 3.53 of the Consultation.
[53] Consultation, § 3.84.

necessary for altnets as the volume commitments enable a degree of security, and therefore play an important role in underpinning risky FTTP investments. Therefore, the ISP may face a penalty from the altnet if it moves demand to Openreach to secure the Equinox discount.

Such a scenario is not just 'plausible', it is likely

97. Abstracting away from the precise numbers in the example above, in general the FSM is ineffective in remedying the anti-competitive nature of the OMT in scenarios where:

- An ISP is not hitting the OMTs in the non-overlap area; and
- The ISP would exceed the OMT in the overlap area by a sufficient margin to allow it to compensate for the non-overlap area.

98. Ofcom dismisses the relevance of such a scenario; it did not consider a scenario in which an ISP places a materially higher proportion of FTTP orders in the Overbuild Area than outside this area to be "*plausible in practice*"[54]. However, Ofcom has not presented evidence to demonstrate that this conclusion holds across ISPs and across time. Given the gravity of the impact of an ineffective FSM, it is inappropriate for Ofcom to rely on an assertion. To do so would not withstand profound and rigorous scrutiny. In fact, not only is such a scenario 'plausible', it is likely, as we explain below.

Ofcom recognises the difficulties faced by ISPs in hitting the OMTs

99. Ofcom's assessment at the time of its decision on the original Equinox offer[55] was that it expected "*ISPs to surpass the Order Mix Targets*" over the "*medium term*" as a result of its insight into and assessment of ISP strategies. Any difficulties with meeting the targets were expected to be due to "*temporary challenges*". However, not even 18 months later, Ofcom appears to have reversed course on what was, it is now clear, an overly strong conclusion based on insufficient evidence. Despite what the main ISPs told Ofcom at the time of Equinox 1, Ofcom's position now is that the "*practical experience now that the Equinox 1 Offer is in place*"[56] has led it to conclude that there is a risk that at least two major ISPs "*might face difficulties*"[57] in meeting the OMTs. Furthermore, as Ofcom notes,[58] Openreach issued a formal waiver only one year into the Equinox 1 scheme to disapply OMT requirements associated with connections. This waiver remains in force today and we surmise this action would only have been taken if a broader array of ISPs were experiencing difficulties achieving the OMTs.

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[54] Consultation, § 3.82.
[55] Ofcom Equinox 1 statement, § 3.78.
[56] Consultation, footnote 53.
[57] Consultation §§ 3.64-3.65. While the extensive redactions in the document make it difficult to draw a firm conclusion about Ofcom's assessment of the major ISPs' ability to perform against the OMTs, our understanding of the text in this paragraph is that Ofcom considers that at least two ISPs are expected to face such difficulties.
[58] Consultation, footnote 13

100. Unfortunately extensive redactions in the consultation document mean that we are not able to establish the precise factual position (see Procedural failures section below). However, what we can see from Ofcom's analysis is that it is not only plausible that ISPs may be below the OMTs, but it is, in fact, likely to be the case.

101. Furthermore, while Ofcom's analysis in the consultation focuses on Sky, TalkTalk and Vodafone, we understand that c.49 ISPs are participating in Equinox 1.[59]. As far as we can tell, it is not clear that Ofcom's analysis and the conclusions it draws are based on the experience of the other c.46 ISPs currently participating in the scheme. While the associated volumes for the remaining ISPs may be less material, analysis of the full range of participants would provide a broader evidence base to assess the achievability of the OMTs. If those participants were performing in a similar way, then those firms would also be the source of further demand tied to Openreach and not available in the competitive market. To allow Openreach to tie-in this demand with a loyalty inducing scheme would be a failure to promote competition for the business of those ISPs, no matter what the size of the ISPs in question.

There is good reason to believe the Order Mix will be higher in the overlap areas

102. The second condition for the FSM not to be effective in the above example is that ISP would exceed the OMT in the overlap area by a sufficient margin to allow it to compensate for the non-overlap area. We set out below that there are good commercial reasons why overlap areas in fact exhibit higher order mixes than non-overlap areas.

103. Ofcom asserts that there is no reason to believe a scenario where there is significant variation in Order Mix across overlap and non-overlap areas to be "*plausible in practice*", by appealing to the role ISP sales systems and practices play in determining whether customers take up FTTP products.

104. Ofcom does not undertake any analysis of how the current Order Mix varies across the overlap and non-overlap areas. This is surprising given that:

- Its proposal to clear the Equinox 2 Offer hinges on its acceptance of the FSM as sufficient to remedy its concerns around the potential barriers to using altnets created by the OMTs. We would have expected Ofcom to have used the period since Openreach notified the offer to gather information on whether Order Mix differs in a systematic manner across overlap and non-overlap areas. While rollout is still at an early stage, and Order Mix is likely to change as rollout reaches more advanced stages, this could have provided Ofcom with a valuable data on which it could base its assessment, rather than rely on an assertion (see above).

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[59] Whilst Ofcom claims to have monitored compliance with OMTs at § 3.54, it only appears to have surveyed 3 of the 49 participating firms, beyond aggregated data from Openreach.

- Ofcom accepts that there will be "*natural variation*" across the areas (which we discuss further below).

- Ofcom appears to have access to the necessary data to assess how Order Mix varies between the overlap and non-overlap areas given the analysis it has undertaken in Annex 9.

105. Notwithstanding this, we disagree with Ofcom's conclusions as we explain further below.

106. First, while we agree that ISP sales systems and practices could play some role in influencing their Order Mix (e.g. by targeting parts of their installed base that are more likely to take fibre products), as Ofcom recognises, there is a *"natural variation in the sales of legacy services within the Openreach FTTP footprint"*[60]. This natural variation reflects underlying variation in the level of latent demand for full fibre in different areas, which can be influenced by numerous exogenous factors outside of the control of ISPs, including variation in the reliability/quality of copper-based broadband, demographic differences (e.g. age, income).

107. This natural variation means that there are distributions underlying the average Order Mix both inside and outside the overlap areas. Therefore, even if the Order Mix in both the overlap and non-overlap areas are the same on average, there will be specific parts of the overlap area with higher Order Mixes. These parts of the overlap area could therefore be used either now or in the future by the ISP to increase the likelihood of it hitting the OMTs (i.e. by using Openreach for FTTP in them) even if the FSM is triggered by the ISP for the remainder of the overlap area. This raises the likelihood that either now, or in some future quarter, using an altnet in those parts of the overlap area with higher Order Mixes would increase the risk of the ISP missing the OMTs. This will make ISPs reluctant to sign up with altnets.

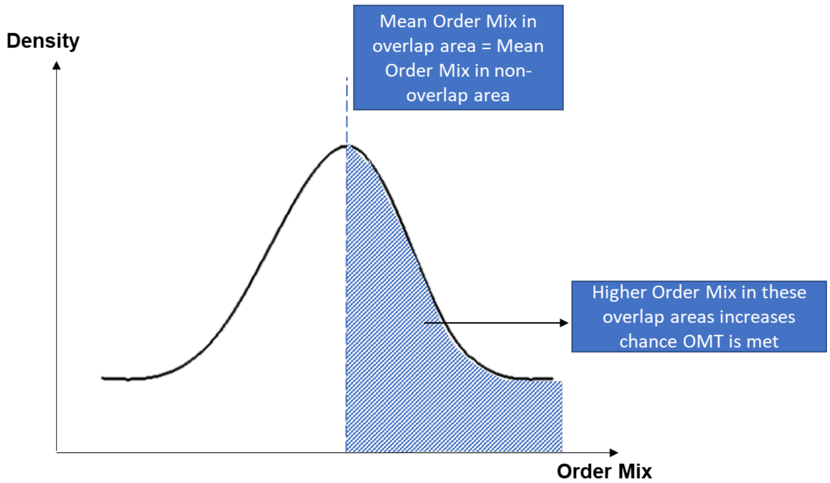

Figure 1: Stylistic distribution of ISP Order Mix in overlap areas

[60] Consultation, § 3.80.

108. Further, while ISPs are sophisticated entities with significant volumes of data on their actual and target customers, there is a considerable uncertainty about the precise shape of the Order Mix distribution – and whether and how it shifts over time given changes in the external context, including macroeconomic shocks. This uncertainty will reinforce ISP reluctance to sign up with altnets.

109. ISPs need to hit the OMTs on average across the areas in which they are sourcing FTTP from Openreach, to access the substantial discounts on offer in Equinox. An ISP's footprint will cover a mix of areas with different Order Mixes, but this is not known ex ante. The removal of certain overlap areas (by defining Overbuild Areas when the FSM is invoked) presents the ISPs with a risk that they *could* be removing areas that are more likely to have a higher than average Order Mix. This introduces a risk that is difficult for ISPs to adequately predict or mitigate, creating a deterrent effect to switch away from Openreach in overlap areas.

110. Second, there are good commercial reasons to believe why overlap areas are in fact likely to have systematically higher fibre take-up rates (and hence potential Order Mixes).

- While Openreach's footprint is relatively large and therefore covers a broad range of types of area – with a commitment to deployment that is "*as balanced as possible across urban and rural areas and all nations and regions*".[61], altnets have a more targeted approach to build. Overlap areas are therefore likely to have a higher number of FTTP orders than the "average" of Openreach's total build;

- One of the key drivers of any altnet fibre business case is expected take-up. Therefore, an important factor in planning deployments is focussing on areas where there is likely to be the greatest underlying demand for fibre (as penetration will be highest all else being equal). Therefore, it is likely that the underlying demand in overlap areas would involve a higher proportion of demand for fibre than copper. This underlying demand will then translate into a higher Order Mix.

- In addition to the 'pull' factor of higher latent demand, the presence of wholesale competition in overlap areas can result in increased marketing of fibre services in such areas – a 'push' factor. For example, CityFibre regularly undertakes consumer marketing in its footprint areas (e.g. billboard adverts highlighting the availability of full-fibre). We would expect the increased FTTP awareness in such areas to drive increased demand for FTTP, thereby leading to higher Order Mix.

- Finally, as Openreach is likely to focus on overbuilding VMO2's current footprint, it will be deploying in areas where there are already large cohorts of customers used to the benefits of gigabit capable products, leading to higher order mixes than the average.

[61] Openreach letter to Ofcom, 29 June 2020

111. On this basis, the risk of the FSM being undermined is more than "*plausible in practice*" – it is likely.

Ofcom must be certain that the FSM prevents anti-competitive effects

112. Ofcom's position is that because it is "*unclear*" if the scenario in which the FSM will be undermined is "*plausible in practice*"[62], Ofcom proposes not to take action against Equinox 2.

113. This is not the right approach when assessing a pricing proposal from a dominant operator that has a clear incentive to foreclose competition (particularly at such a crucial stage in the window to secure network investment)[63]. The bar for intervention must not be set so high. If foreclosure of entry is the risk, which it is in this case, then a precautionary approach is the most reasonable to adopt.

114. Ofcom's current approach is particularly dangerous in light of how the Equinox 1 assessment has not stood up well to the test of time, with Ofcom changing its view on key assumptions (ISP strategies and the extent of network overlaps) in less than 18 months. It is clear that given the inherent uncertainty in such markets, a cautious approach to the assessment of future scenarios is necessary, as disincentives to invest cannot be reversed once the investment window has passed, as we set out further in §§ 44-47.

115. The responsibility for proving that there is no plausible risk of such effects should be borne by Openreach and Ofcom – not the altnets to prove otherwise. This is particularly the case given that the altnets do not have access to the key evidence to underpin such assessments (as is clear from the extensive redactions Ofcom has made to the consultation document). In addition, ISPs may have little incentive to proactively highlight these risks if a possible consequence is disruption to the operation of the scheme and reversion to list prices.

The FSM cannot be compared to Openreach's VASO

116. We show above, based on a static analysis, that there are flaws in the FSM. VMO2 has managed to find these even within the 30 days allowed for this consultation. There may be many more.

117. Another problem identified with the FSM is the vagueness of the term, its conditionality and the need for the use of an expert third party determinator. Ofcom relies on ISPs' use of VASO[64] as showing that the FSM is fit for purpose, notwithstanding the defects. However, this is not an apples with apples comparison.

118. Openreach included a term (i.e. the VTR) in its 2018 VASO[65]. This mechanism was designed to avoid disincentivising ISPs from sourcing FTTP from altnets. **Under the VTR,**

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[62] Consultation, § 3.82.
[63] See §§ 52-53 above
[64] Consultation, § 3.71 and § 3.75.
[65] Openreach Volume Agreement Special Offer on GEA-FTTC, Gfast and GEA-FTTP (2018).

altnet FTTP orders were treated the same as Openreach orders for the purpose of assessing whether the discount criteria were met, i.e. the VTR adds-in altnet orders so as to assess compliance with a "destination neutral" copper to fibre migration objective.

119. In contrast, the FSM works by removing areas from the calculation where Openreach is in competition with an altnet. The two are mathematically different and also differ in that one is effective in avoiding an anti-competitive outcome and the other is not.

120. An equivalent approach to the VTR for Equinox 2 would mean that ISPs could purchase FTTP from altnets in the overlap area without being concerned about missing the OMT.[66] ISPs would be rewarded for migrating their orders to fibre, but without tying the mix to the orders placed with just one of the potential suppliers of wholesale fibre in the market. A VTR type mechanism would also appear to remove the discriminatory effects that we see in OMTs. The VTR acts symmetrically on BT Retail and ISPs with regard to their orders of FTTP – from whatever source.

121. In our stylised example noted above, if the Equinox 2 OMTs were calculated using a mechanism akin to the VTR contained in VASO, the ISP would achieve 82.5% even with its use of an altnet in overlap areas and as a result would not be deterred from using an altnet in order to maximise its achievable discount.

122. The VTR has other benefits, for example:

- The information requirements in VTR are explicitly defined whereas in FSM they are vague;
- There is friction created by spurious and undefined IT integration requirements in the FSM; and
- Unlike the FSM, the VTR calculation cannot be withdrawn by Openreach.

123. If Openreach's objective is, as it claims, to incentivise ISPs to migrate customers away from its copper network but not distort fibre competition, there is a clear question as to why Openreach has not proposed a similar mechanism to VTR for Equinox 2? Openreach had a workable term, well understood by ISPs and which has passed regulatory scrutiny, yet Openreach chose to do something else which would lead to uncertainty for ISPs and have a negative effect on its only scale competitor.

124. Finally, Ofcom admits (at § 3.86) that it cannot be sure that the FSM will remove the anti-competitive effect of the Order Mix Target in all circumstances.

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[66] Although, while a VTR-like mechanism would be more effective in its aim than the FSM, it would not completely resolve the anti-competitive properties of the OMTs as it would not remove the distortion to incentives in areas where the ISP has committed, or intends to commit, to use an altnet but that altnet has not yet deployed. The ISP would still be bound by the OMT in the period before altnet deployment with no mechanism to mute the incentives to order Openreach FTTP, should that be desirable to optimise its future use of an altnet.

"We cannot rule out the possibility that our assessment above is overtaken by changing circumstances in the future (for example, because the Failsafe Mechanism not working as we expect it to). If this were to happen, it would be open to us to intervene to prevent terms which create a barrier to using altnets, including through our direction making powers under SMP Conditions."

125. In terms Ofcom is therefore accepting that the FSM is not sufficient to protect against the anti-competitive effects of the OMTs.

Ex post regulation is not a solution to addressing problems with the FSM

126. The FSM does not work in all circumstances and is not sufficiently well defined for ISPs to rely on it, when attempting today to enter into committed future volume agreements with altnets. Ofcom has therefore sought to comfort altnets and ISPs with a promise to use its ex ante powers in the future to resolve any failings that come to light.

127. In particular, Ofcom accepts in terms at § 3.86 that the FSM *might* not be sufficient to overcome the negative effects of the OMTs, i.e. that ISPs still have residual uncertainty that they will not be able to secure Equinox discounts in the future if they choose to contract a large share of their volumes with VMO2 today. A reasonable and rational regulator would act now, ex ante, to remove the risk of anti-competitive effects by requiring either a better "fix" through a new FSM, or by requiring the removal of OMTs such that the risk of anti-competitive effects never arises. Ex post regulation is not a solution to addressing problems with the FSM for the following reasons.

128. First, the promise of ex post action is a poor substitute for precautionary ex ante regulatory action today. For example, under its proposed approach, Ofcom could not compensate VMO2 for the loss of business caused by delayed or failed contracting. ISPs would not be compensated for the loss of competition in the wholesale market. Whilst [✂], this is of no solace to consumers (whose interests Ofcom is bound to promote), who will have foregone the downstream benefits in the retail market of wholesale competition.

129. The *Whistl* case[67] should have already highlighted to Ofcom the risks of relying on ex post enforcement to promote competition. Acting after the fact may extract a fine from the perpetrator, but as in the case of Whistl, that fine was but cold comfort to the eliminated entrant.

130. Second, Ofcom's promise does not provide sufficient comfort and certainty to ISPs considering whether to contract and/or commit volumes to altnets (i.e. when considering the impact of Equinox 2 on dynamic competition). [✂].

131. Third, what Ofcom appears to be saying in §3.86 is that it will act ex post (i.e. after the successful pre-emption of VMO2) to amend the terms of the FSM to correct for a regulatory error, using its ex ante powers. Obviously, this is ineffective in stopping the

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[67] https://www.ofcom.org.uk/news-centre/2022/supreme-court-rejects-royal-mail-appeal-against-ofcom-fine

pre-emption. It is also a misappreciation of the role of Ofcom's ex ante powers. They exist to forestall future problems today not just to fix regulatory errors in the future.

132. Fourth, and in any event, Ofcom cannot make the promise it does in §3.86. To do so would fetter Ofcom's discretion. It cannot give a cast iron guarantee to any ISP that any defect in the FSM will be rectified in some hypothetical future regulatory procedure. It cannot fetter BT's right of appeal in that decision process either. Ofcom cannot guarantee to ISPs what a court will find in any appeal of its hypothetical SMP condition procedure.

Ofcom has failed to consider the dynamic competition effects of Equinox 2

Dynamic competition considerations are especially relevant when foreclosure of market entry is a concern

133. The focus of Ofcom's analysis in relation to both Equinox 1 and Equinox 2 has been on ISPs incentives to use an altnet once a contract has already been entered into. This is a purely static analysis, i.e. Ofcom has only considered the impact on incentives at a particular point in time not the impact on incentives to make long-term decisions.

134. [✂].

135. It follows that there may be several types of barriers that might arise from the terms of the Equinox offer:

   a. removal of the ability and incentive for ISPs to contract with altnets in a way which enables altnets to secure/underwrite their investment (e.g. minimum share of volume) such that altnets are unable to contract with ISPs;

   b. creation of uncertainty as to how the Equinox offer terms might operate in practice, such that ISPs will not risk entering into a contract with altnets; and

   c. barriers to making use of a contract once it has been entered into.

136. Only barrier (c) has been considered by Ofcom. Barriers (a) and (b) require a dynamic analysis to be undertaken. Ofcom's failure to consider the dynamic effect on incentives is particularly concerning when foreclosure effects are much more likely to be dynamic in nature.

Promotion of competition is forward looking and requires a dynamic assessment

137. Ofcom has a duty to act in the interest of citizens and consumers, where appropriate by promoting competition. It has already set out that, through the decisions set out in the WFTMR, it is promoting competition in the wholesale fibre market.

138. "Promotion" is fundamentally a forward-looking concept (as opposed to the concept of "preservation" which is the foundation of ex post competition law). Promotion of

competition in a forward-looking sense would ensure that, for example, commercial terms do not foreclose competitive entry by any plausible firm or business strategy.

139. In order to underwrite the deployment of their networks, altnets are dependent on significant commitments from ISPs in order to enter the wholesale market and to enable network competition to flourish[68]. Ofcom must therefore not only be concerned with the ability for ISPs to switch to altnets already established today, but also be concerned about the ability and incentive for nascent wholesale competitors, including VMO2 and Nexfibre, to enter the market.

140. When applying its analytical framework derived from the WFTMR, in order for it to be both accurate and effective, Ofcom's approach must take account of the dynamic, not just static, effects on competition. By dynamic effects we include the ability and incentive of ISPs to contract with a wholesale entrant for future volumes, so as to underpin its entry and future expansion.

141. Question 1 requires Ofcom to consider whether the "*Equinox Offer potentially creates a barrier to using altnets*"[69]. As we have established above, the WFTMR already casts this term broadly, so Ofcom must not just consider "use" of altnets through the narrow lens of whether ISPs will utilise existing contracts, but also whether Openreach's loyalty-inducing commercial terms create barriers to ISPs being able to use altnets in the future by virtue of them being disincentivised from entering into wholesale arrangements with those nascent wholesalers today. Without the ability of the nascent wholesalers to get a foothold in the market, the true benefits of network competition will be lost and Openreach will entrench the monopoly position it holds in copper once again in relation to FTTP.

142. When assessing the dynamic effects on competition, Ofcom should also look to how loyalty inducing incentives may change /increase over time e.g. as an ISP's FTTP base with Openreach grows over time, it will have an increasingly entrenched incentive to purchase from Openreach rather than risk the significant level of discounts over an increasingly large base.

The ineffective FSM also has dynamic competition implications

143. Our analysis of the FSM shows that there are realistically possible and predictable risks associated with ISPs relying on the FSM to secure their Equinox discounts. This is only fully addressable under the current OMT definition, if the ISP uses Openreach in preference to an altnet.

144. If ISPs perceive a risk that they may need flexibility over future orders to ensure that they hit the OMTs, they will be reluctant to sign up to long-term volume commitments with altnets (or do so for materially lower volume commitments). For the reasons set out above, this can inhibit such rollout from occurring in the first place because such

[68] [✂].
[69] Consultation, § 3.35

commitments are either not forthcoming at all such that the network is never built, or the commitment is so small that the expansion is limited.

145. By undermining competing FTTP deployment, the OMT mechanism clearly distorts competition on the merits and is anti-competitive. The FSM does not remove these anti-competitive properties.

VMO2's 'Future Overlap Scenario' is another example of dynamic effects

146. Ofcom dismisses VMO2's concerns about the impact of the OMTs in, what it refers to as, the Future Overlap Scenario we discussed with it in advance of the Consultation.[70] Ofcom argues that:

- Under this scenario, it is not considering whether ISPs are deterred from switching to using altnets where they are available.
- Equinox 2 does not contain terms which lock in ISPs, to prevent them switching to using an altnet if one later becomes available.
- There is a 'race to invest' and Equinox 2 does not tilt the playing field between Openreach and altnets in an anti-competitive manner.
- In any event, Ofcom questions the credibility of the scenario, and in particular, whether ISPs would wait for altnet deployment rather than use Openreach FTTP. It argues that waiting means that the ISP will risk losing customers to other ISPs that are selling FTTP

147. For the avoidance of doubt, the purpose of raising the Future Overlap Scenario with Ofcom was to illustrate the broader point made above that the anti-competitive effect of Equinox 2 is not limited to circumstances where there is existing network overlap. Rather, it provides a further illustration of how Equinox 2 can distort ISP decisions about making long-term volume commitments to altnets as a result of its loyalty-inducing effect. As set out above, such commitments are important to enable altnets to deploy FTTP.

148. Therefore, the fundamental point that the Future Overlap Scenario illustrates is that Equinox 2 risks preventing future switching by undermining the likelihood that the altnet deployment takes place and, therefore, there is a network to switch to in the future.

149. VMO2 agrees that there is a 'race to invest'. However, it is critical that the race is based on competition on the merits and that it is not undermined by anti-competitive behaviour by the dominant operator with an incentive to foreclose competition. For the reasons set out above, Equinox 2 is anti-competitive and therefore risks undermining competition on the merits at a critical stage in the race.

150. Finally, VMO2 disagrees with Ofcom's overly dismissive assessment of the credibility of such a scenario. While under the stylised example we discussed with Ofcom the ISP

[70] Consultation, §§ 3.42-3.46

would, absent Equinox 2, retain its entire existing base on FTTC while waiting for the altnet to deploy, our conclusion does not rest on it doing so.

151. The disincentive effect that the stylised scenario illustrates, which arises from the risk of the ISP losing valuable 'degrees of freedom' for ensuring it hits the OMT in future periods, still holds under alternative assumptions about what the ISP does in the period before the altnet network is available.

152. For example, absent Equinox, ISPs may choose to use Openreach FTTP to defend against the loss of their most at risk FTTC customers while they wait for altnets to deploy, thereby mitigating the competitive risk Ofcom identifies. But they may also choose not to actively promote FTTP services to the remainder of their installed base during this period to provide greater ability to commit volumes to altnets. While such a strategy may still have a higher risk of losing some customers, it also has the benefit of allowing it access in the future to a second supplier (which can provide competitive tension with Openreach), and potentially lower wholesale charges from that altnet.

153. However, as set out above, in this scenario Equinox 2 still disincentivises the ISP from committing to use the altnet in the future (or creates an incentive to commit to a lower level of volume) because of the increased risk of not meeting the OMT in future quarters. But, it also may require the ISP to divert more lines to Openreach FTTP in the short-term than would otherwise be the case in order to meet the OMT. The FSM does not address the risk of such distortions as it only applies where altnets have already deployed.

The anti-competitive effects of Equinox 2 are not limited to new FTTP networks

154. The OMTs' anti-competitive properties threaten to undermine the deployment of new FTTP networks such as those planned by Nexfibre. [✂].

155. [✂].

156. This point is important not just in the current case; it is also important in terms of the signal it sends to investors in the sector more generally. If Ofcom's assessment is based on the idea that there is no effect or concern so long as currently planned, and to some extent committed, investments go ahead, that signal will have a chilling effect on future investments. The rule signalled by Ofcom would be that anti-competitive behaviour is acceptable so long as it does not drive competitors' returns below the cost of capital. This would be an inappropriate signal for an authority with concurrent competition powers to send.

157. Furthermore, such an approach ignores the reality of how investment decisions are made. A regulatory environment in which investors believe they will be protected from the effects of anti-competitive behaviour only to the extent that their returns would not be driven below the cost of capital would not encourage new investment. While such a regulatory environment may enable Openreach to achieve its strategic objectives, it is not conducive to meeting Ofcom's objectives, as set out in the WFTMR.

158. That approach to assessing anti-competitive behaviour reflects a very different approach by Ofcom from that which it took in its Competition Act investigation against Royal Mail following the complaint from Whistl. In that case, Ofcom's infringement decision did not require a finding that Royal Mail's conduct would render Whistl's entry and expansion totally unprofitable – the fact that Royal Mail's behaviour distorted competition on the merits was sufficient. Ofcom should take a similar approach in relation to Equinox and not allow any version of it that distorts competition on the merits.

The problems with the FSM are compounded when considering dynamic investment incentives

159. The analysis presented above demonstrates that, even on a static analysis at certain points in time, the FSM does not remedy the anti-competitive properties of Equinox 2. The result is, if permitted by Ofcom, Equinox 2 is likely to distort ISP purchasing decisions and undermine ISP willingness to make long-term volume commitments to altnets. ISPs will be highly reluctant to give up valuable 'degrees of freedom' that might otherwise enable them to hit OMTs in the future by signing up with altnets.

160. [✂].

161. Ofcom seems to provide at least a limited acknowledgement of this dynamic consideration in text that was unredacted following publication of the consultation. In §3.64 Ofcom's confirms that in its current judgement, one or more major ISPs may find that use of altnets could affect the Equinox 2 discounts received. If this plausible outcome is evident to Ofcom based on the analysis conducted as part of this review, it is clearly a risk that will be at the forefront of ISPs minds when considering whether to make long-term commitments to altnets.

162. Therefore, to fully understand the barriers to altnets raised by Equinox 2, Ofcom must also examine the dynamic effect on competition and undertake a full assessment of the potential consequences in any conclusions it draws.

163. First, as set out above, the financial consequences for ISPs of missing the OMTs in future quarters grows as the base of Openreach FTTP lines grows over time. This means that the disincentive to commit long-term volumes to altnets will also grow over time. This reinforces the loyalty-inducing effect of Equinox 2. Contrary to Ofcom's view that Equinox 2 does not "*contain terms which lock in ISPs*", de facto the scheme has this effect.[71]

164. Second, the FSM contributes to ISPs' uncertainty as to whether they will be able to meet OMTs in future, which inhibits their use of altnets. We have already seen how quickly static forecasts and assumptions can go out of date (as demonstrated by the way Ofcom's decision to clear Equinox 1 has aged).

[71] Similar to Ofcom's careful characterisation of Equinox 2 as not being "an overt loyalty discount scheme" (our emphasis), Consultation, §§ 3.50-3.51.

165. ISPs need to ensure that they meet the OMT on a quarterly basis and over an extended period of time – if it is adopted, Openreach says that Equinox 2 will be in place for 10 years. To be eligible for the significant Equinox 2 discounts applying across the stock of existing lines sourced from Openreach and the flow of new Openreach FTTP orders, ISPs need to meet the OMT in a particular quarter. But this is not enough – ISPs need to continue meeting the OMT, quarter after quarter, or risk losing the discounts across the entire installed base. Any uncertainty about the effectiveness of the FSM[72], however small, is likely to undermine the willingness of ISPs to commit volumes to altnets right from the outset. As noted above, this effect will increase over time as the ISPs grow the number of Openreach FTTP lines they have as the financial penalty of losing the discounts will also grow.[73]

166. While it may be conceivable that ISPs could adopt short-term mitigation strategies to reduce the risk of missing the OMT in a given quarter, ISPs cannot be confident that such strategies would be available, and in sufficiently timely manner, in all cases. This is particularly the case if they risk missing the OMT over a longer period of time. Therefore, such strategies are unlikely to materially impact the longer-term disincentive effect – ISPs are likely to continue to conclude that signing up with an altnet carries with it an unacceptable and potentially unquantifiable degree of risk.

167. For Ofcom to conclude that the FSM is effective, it needs to be confident that ISPs have sufficient certainty, comfort and confidence in the operation of the FSM, so that by signing up to a given volume commitment with an altnet they would not be removing a potentially important degree of freedom in ensuring that they hit the OMT in the future. This would require:

- ISPs to be confident that they will always be able to meet the OMT; or

- ISPs to be confident that diverting orders to altnets (and therefore away from Openreach), at least in one/some quarter(s), will not have a material impact on their ability to meet the OMTs.

168. Ofcom cannot be confident of either of these:

[72] Which may need to change on a quarter-to-quarter basis – indeed, the potential uncertainty for an ISP that it will be able to secure an appropriately specified FSM in each quarter will also add to the risk it faces and therefore its reluctance to sign up with an altnet.
[73] As Ofcom recognises in Consultation § 3.59

- it appears from Ofcom's analysis that at least two major ISPs face challenges in meeting the OMTs; and

- It cannot be ruled out that there will be circumstances where ISPs that divert orders to altnets fail to meet the OMT in the future as a result. The uncertainties that ISPs face in relation to a broad range of factors that can influence their ability to meet the OMT mean that neither the ISPs (nor Ofcom) can be certain that signing up with an altnet will not undermine their ability to meet the OMT in the future, particularly given that Equinox 2 is a 10-year offer.

169. On this basis, ISPs can be expected to be more reluctant about signing up to volume commitments with altnets as a result of the OMTs and the ineffective FSM, leaving the anti-competitive nature of the OMTs unremedied.

Approach to assessing Questions 2 and 3

170. We have demonstrated that the Equinox 2 has a clear potential to deter the use of altnets by ISPs, despite the presence of the FSM. This means that, under Ofcom's analytical framework, it would not take action against the discount scheme only if:

a) the impact on nascent network competitors is unlikely to be material; and

b) the arrangements will generate clear and demonstrable benefits, such as:

i) the arrangements are essential to Openreach's business case for fibre roll-out; or

ii) the arrangements are necessary to offer more efficient prices that would deliver benefits for consumers.

The impact on network competitors will be material

171. As discussed above, investment in full-fibre infrastructure involves investing large amounts upfront in order to access a long-term stream of revenues. Our shareholders' plans for Nexfibre involve a £5bn investment. The level of risk to the future stream of revenue is critical to the investment decision. In order to manage the investment risks, it is essential that Openreach's wholesale competitors, including VMO2, can attract sufficient long-term committed demand from scale ISPs to justify investing. These long-term commitments represent a form of co-investment where demand risk is shared between the altnet and ISP.

172. The Equinox 2 scheme is likely to incentivise ISPs, at the very least, to keep their options open, inhibiting them from making the significant volume commitments to altnets that are required to make the economics of widespread competitive build viable. The precise impact on ISP commitments to altnets will depend on a number of factors, but will be informed by a trade-off ISPs will have to make – volume commitments to ISPs will come with an increasing risk of missing OMTs in a future quarter. While some ISPs may be able to make a sophisticated calculation and make some (lower) volume commitment to the altnet, many ISPs may simply decide such a calculation is outside their risk tolerance and choose to avoid giving any commitments to altnets, at least in some areas.

173. Each altnet's business case is different and will have a breakeven expected/target level of penetration that the altnet would need to achieve to ensure the NPV of the network investment is positive. The precise impact on altnets will vary as their target penetration levels will depend on a number of individual factors (such as type of area, network topology, expected ARPU). For most altnets, the significant reduction (or total loss of) volume commitments will reduce the stream of expected cashflows for the investment project. Even in those cases where the altnet is able to achieve its threshold penetration rate and target cashflows, this will have to be achieved under more risky conditions. This may mean that the inability to share risk jeopardises the investment. While some altnets may be able to proceed with their business case, it is very likely that some altnets will be forced to curtail their ambitions (to focus on e.g. higher density areas that require a lower breakeven penetration) or abandon them entirely, if commitments fall below a critical level.

174. It is not possible for VMO2 to quantify the precise harm Equinox 2 will inflict on all altnet investment plans, [✂]. However, in order to conclude that there is no need for action,

Ofcom's analytical framework requires there to be evidence that the impact of a discount scheme on nascent network competitors is unlikely to be material. It is clear that there is no such evidence. To the contrary, VMO2 is confident that analysis of the sensitivity of altnet build plans to penetration rates, and the volume commitments that play an important role in delivering that penetration, will show that the effect of Equinox 2 on nascent network competition is likely to be highly material.

175. Furthermore, if the effect of the Order Mix Target is a foreclosure of competition, what could be more harmful? The absence of competitors will lead to worse outcome for consumers than the case where they enter – irrespective of whether they subsequently fail or consolidate.

176. As Ofcom set out in the WFTMR, there is a small window of opportunity to foster FTTP network competition in the UK. Equinox 2 poses a serious threat to realizing that competition and Ofcom's regulatory strategy which rests on it. If the current opportunity to foster competing deployments by altnets is lost by Ofcom, there is significant risk that it will be lost for the long-term.

The scheme has no objective justification

177. While there is no need to consider whether the scheme generates "*clear and demonstrable benefits*" under the second limb of the test in Ofcom's analytical framework if the first limb (materiality test) is failed, we do so below in the interests of completeness.

178. The context for considering whether there is a valid objective justification in this case is that UK broadband consumers will be harmed for an extended period of time, if Ofcom allows Openreach's anti-competitive pricing strategy to harm the development of network competition. Ofcom's regulatory strategy rests on such competition because fostering effective network competition can: a) play a key role in driving widespread deployment of full-fibre infrastructure across the UK; and b) deliver a wide range of price and non-price benefits to consumers for many years to come.

179. Any claimed short-term pricing benefits from the Equinox discounts need to seen in this broader strategic context. Reduced or lost altnet deployment ambitions will ultimately harm the interests of UK consumers. Some consumers will miss out on commercially deployed full-fibre services, while others can expect to pay more and receive worse services if Openreach is not exposed to effective competition.

180. Openreach's stated purpose for the scheme is to encourage further FTTP migration by providing "*further incentives to support CPs in migrating their existing bases of end customers to FTTP*".[74]. In our view, it is important that Ofcom does exercise preferences between two different objectives: rapid migration away from legacy copper products, and fair competition in the wholesale fibre market. Irrespective of whether Equinox 2 potentially assists with the first objective, it seriously risks the second.

[74] Openreach: "Equinox Failsafe Mechanism – Overview", 14 December 2022, p.2

181. Equinox 2 falls short of delivering competition on the merits. It is possible to achieve the goal of promoting migration away from copper – an entirely legitimate goal – in a way that does not fall foul of competition on the merits in fibre markets and, thereby, risk undermining Ofcom's vision for widespread competitive full-fibre build.

182. The Equinox 2 scheme is not essential to achieving rapid migration. Rather, the incentives provided through other changes to the relative prices of wholesale fibre and legacy products (which do not rely on the OMT mechanism), combined with the regulated copper stop-sell process, should provide strong incentives for ISPs to migrate their customer base from copper to fibre products without inducing anti-competitive effects. For example, Openreach notified a substantial increase in FTTC rental and connection charges at the same time as it notified the Equinox 2 offer[75]. There is no evidence to justify why the anti-competitive Equinox 2 scheme is necessary over and above these other changes.

183. Even if Openreach was able to demonstrate the benefits for migration of further discounting fibre, it is not necessary for those discounts to be contingent on the anti-competitive OMT mechanism.

Drip-feed pricing

Ofcom's approach to this issue

184. VMO2 welcomes Ofcom's willingness to gather evidence on the question of whether there is an Openreach practice of repeatedly amending its prices such that this practice could act as a barrier to altnet entry and expansion.

185. However, our concerns go beyond the periodic nature of price changes. In particular, they relate to the protracted nature of the engagement with a few ISPs, not just its periodicity. It is unclear whether the information gathering that Ofcom foresees at §§ 3.133-3.134, relate to the nature of the engagements themselves, or just their timing?

Equinox 2 is part of a strategy of drip-feed pricing

186. Our understanding of the process Openreach has adopted in relation to both Equinox 1 and Equinox 2 is that it involves Openreach engaging in repeated and extended discussions with a small number of large ISPs about the nature of new pricing offers. For example, publicly available information suggests that Openreach has been discussing Equinox 2 with ISPs since at least July 2022, less than a year after Equinox 1 came into force. This strategy of signalling forthcoming updated offers/pricing to its customers well in advance of their publication, acts as an additional barrier to ISPs making commitments to altnets. ISPs fear that entering into agreements with altnets would endanger their ability to meet future Equinox terms and thus risk their current and future discounts.

187. Equinox 2 must be seen within the context of that sustained and continuing dialogue between those market participants. This dialogue goes beyond normal price discovery in a

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[75] ACCN:OR826

competitive process i.e. beyond competition on the merits. Instead, Openreach appears to be gaming the regulatory process by adopting a "bait and tease" approach towards ISPs, keeping them on the hook by drip-feeding details of the next, even better Equinox offer, which has a chilling effect on network competition.

Drip-feed pricing creates uncertainty and discourages investment

188. This pattern of repeated and extended discussions with ISPs about new pricing offers (i.e. the continual drip-feeding of new offers and information into the market) is creating uncertainty and removing incentives for ISPs to enter into long-term commitments with altnets [✂].

189. By creating this strong "wait and see" option value, Openreach's drip-feed pricing strategy has a strong loyalty inducing effect. As Ofcom notes in the WFTMR, pricing conduct by Openreach that could induce loyalty is "*a particular concern because this could deter access seekers from switching demand to new alternative networks*"[76]. Furthermore, as Ofcom also sets out:

> *"[N]ew network builders that operate a wholesale model rely on selling ultrafast services to access seekers, If Openreach uses commercial terms to induce loyalty from access seekers, meaning they purchase all or most of their ultrafast requirements from Openreach, then it will deprive these network operators of demand. Ultimately this could undermine alternative operators' FTTP investment plans."*[77]

190. This loyalty inducing effect does not just have to depend on (i.e. can be independent of) the effects of the specific discount scheme Openreach seeks to introduce at a given point in time, although the specific terms can and do reinforce the effect (e.g. both specifically or by what they signal about future discounts[78]). The nature of Openreach engagement with the market does, in and of itself, have a loyalty inducing effect.

[76] WFTMR Statement, Volume 3, § 7.29
[77] WFTMR Statement, Volume 3, § 7.32
[78] https://www.catribunal.org.uk/sites/default/files/2019-11/1299_RoyalMail_Judgment_Non_Confidential_Version_%5BCAT_27%5D_121119.pdf § 389 et seq., regarding the power of signalling a strategy through the pricing process.

An expectation of future price adjustments is recognised as an important element in a foreclosure strategy

191. Through constant interaction with the market, Openreach is creating a “reputation” with its customers, which now expect there to be continued changes to the offer. Altnets also expect there to be repeated refinements to prices and terms, aimed at making it progressively more difficult for them to enter.

192. Such a “reputation”, whilst costly to achieve, has been shown to have a deterrent effect on market entrants[79]. This is also true for ISPs, as the “reputation” creates a disincentive for them committing volumes to altnets – lest they miss out on the next iteration of terms. If such a reputation is allowed to grow, its dynamic impact could be profound on the UK market for decades to come:

- Market entrants today would be foreclosed through successful implementation of the strategy;
- Future entrants would be deterred, because they know Openreach will incur the costs of foreclosure to retain market share; and
- If the ex ante regime gains a reputation for being ineffective in stopping foreclosure strategies, then future investors will remain wary of entering the UK market in the long run, no matter what changes Ofcom makes in the next market review.

There is already evidence of drip-feed pricing affecting ISPs’ decisions

193. [✂].

194. [✂].

195. [✂].

196. [✂].

197. We welcome Ofcom’s statement that it is seeking evidence from market participants and is considering whether to address drip-feed pricing on a standalone basis. However, we also note that the effects of drip-feed pricing aggravate the anti-competitive effects of Equinox 2 as ISPs not only have uncertainty as to whether they are going to be able meet the OMTs and achieve the Equinox 2 discounts but the continued drip-feed of pricing also generates uncertainty as to how Equinox scheme will operate in the future and the potential extent of further discounts an ISP could be foregoing (e.g. under a potential Equinox 3) if they should switch to an altnet.

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[79] “Predation, Reputation and Entry Deterrence”; Paul Milgrom & John Roberts. Journal of Economic Theory 27, 280-312 (1982)

198. In addition, we note that in the consultation Ofcom says:[80]

> *"contemporaneous documents from ISPs and altnets could provide evidence on whether Openreach's pricing conduct (including the pattern of FTTP price amendments and how prices may change in the future) is creating uncertainty for ISPs, such that they are being deterred from using altnets"*

199. It is not apparent from the above that Ofcom has or intends to gather information from Openreach directly, which we believe would be a procedural omission and a failure to satisfy Ofcom's duty of inquiry.

Procedural failures

200. In this section, we set out the procedural failures which we are concerned have already arisen as part of the consultation process or may arise as part of the final decision if further actions are not taken by Ofcom. These failures are:

- Failure to have regard to relevant considerations;
- Failure to undertake sufficient enquiry or evidence gathering;
- Failure to provide sufficient clarity for consultees; and
- Failure to provide due consideration to consultation responses.

Ofcom has failed to have regard to relevant considerations

201. We note that Ofcom has a common law duty to act rationally/reasonably and to ensure that it sets out its reasoning in a clear and transparent manner including that to which it has given relevant consideration. Indeed, a decision by an authority may not be robust if "*there is a demonstrable flaw in the reasoning which led to it – for example, that significant reliance was placed on an irrelevant consideration, or that there was no evidence to support an important step in the reasoning, or that the reasoning involved a serious logical or methodological error*".[81]

202. As VMO2 has demonstrated in the sections above, Ofcom has failed in a number of places in its provisional decision to have regard to all relevant considerations. Not only has Ofcom failed to consider the effects of Equinox 2 on a dynamic basis (which is inherently required as part of its duties and objectives), but Ofcom has also failed to undertake an analysis as set out in the WFTMR of the materiality and objective justifications for the Openreach's OMTs. In addition, whilst drip-feed pricing has an anti-competitive effect that is not limited to the Equinox 2 offer alone, Ofcom has not as part of its Equinox 2 analytical framework taken account of the impact of drip-feed pricing.

[80] Consultation, § 3.133
[81] R (Law Society) v Lord Chancellor [2018] EWHC 2094, p.98

203. VMO2 therefore urges Ofcom to take all points set out above into consideration as part of its final decision which aligns with Ofcom's duty to give due consideration to all responses to the consultation (see §§ 216-226 below).

Even in respect of issues considered, Ofcom has undertaken insufficient enquiry / evidence gathering

204. In order to meet its duty of enquiry, Ofcom has significant information gathering powers at its disposal. VMO2 is concerned, however, that Ofcom has not to date, within the current Equinox 2 process, made sufficient use of those powers in order to gather the evidence necessary to form a rational conclusion.

205. We highlight, by way of example of our concern, the use of speculative language and number of assumptions or assertions that Ofcom appear to be relying on with respect to the efficacy and reliability of the FSM. For example, Ofcom states in paragraph 3.71 of the Consultation that "*we anticipate that sophisticated entities such as the main ISPs and Openreach should be capable of complying with these steps*"… "*we do not consider that ISPs will consider that applying the Failsafe Mechanism is unworkable in practice*". In § 3.75, Ofcom simply states that an ISP's use of a completely separate and distinct Openreach scheme "*indicates that ISPs are likely to regard these contractual safeguards as adequate and acceptable*" – implying that the provisional decision has not been founded on factual evidence as provided by the ISPs. The above are just some examples of assumptions being made by Ofcom in the Consultation document. There are many more examples where unquantified speculation or assertion are posited as the basis for a conclusion.[82]

206. For the purposes of its final decision, Ofcom must not rely on such assertions and assumptions where they are not supported by underlying evidence provided by the ISPs. If the ISPs do not volunteer this information, Ofcom should seek to use its formal information gathering powers to require the ISPs to adduce evidence to ensure Ofcom's has undertaken sufficient enquiry to deliver a robust decision.

207. We would also observe that similar assertion and speculation in the Equinox 1 decision has been proven not to be accurate. For example:

- the degree of overlap between Openreach and altnets is far higher than it was considered to be in Equinox 1 moving from 2-5% overlap to between 15-25% (and increasing to over 60% once VMO2 and Nexfibre are taken into account); and

[82] Further examples include Ofcom's assumption that an ISP's order from Openreach will be between 92-95% FTTP (in section A8.5) and assumptions that in areas where an ISP contracts with VMO2 and another ISP, only half or three quarters of orders in overlap areas will be switched (in section A8.5(c))based on a potential desire to use multiple suppliers in any one area (despite ISPs providing evidence to the contrary due to the complexity and cost to integrate systems with multiple altnets plus Openreach).

- the speed by which altnets would no longer seek to use legacy Openreach products and therefore the ability to meet the OMTs was clearly overstated in the Equinox 1 decision.

208. Ofcom's final decision in respect of Equinox 2 therefore needs to be made on robust evidence not assertion to avoid the risk of similar errors arising.

209. In respect of drip-feed pricing, Ofcom only refers to the fact that it is seeking contemporaneous documents from ISPs and altnets to provide evidence on whether Openreach's pricing conduct is creating uncertainty for ISPs, such that they are being deterred from using altnets. It is not apparent, however, whether Ofcom has gathered, or intends to gather, internal documents from Openreach directly to satisfy itself as to Openreach's true intent behind its pricing conduct. Whilst intent alone would not negate the effects brought about by the drip-feed pricing, if Openreach were to have the intent to bring about distortive effects on the market this would be compelling evidence for Ofcom. We would therefore encourage Ofcom not to assume Openreach's intent and instead to use its formal information gathering powers to require Openreach to produce contemporaneous evidence.

Extensive redactions mean VMO2 is impeded in its provision of a fully considered response

210. As set out above, when issuing a consultation and inviting responses from interested parties, Ofcom is obliged to follow the *Gunning/Sedley* criteria which includes the principle that "*the proposer must give sufficient reasons for any proposal to permit of intelligent consideration and response*".

211. VMO2 notes that the Court of Appeal has previously held that a "public body doing the consulting must put a consultee into a position properly to consider and respond to the consultation request, without which the consultation process would be defeated. Consultees must be told enough – and in sufficiently clear terms – to enable them to make an intelligent response."[83]

212. As cited by the CAT in CityFibre's Equinox 1 appeal[84], the High Court has established, on the question of sufficiency of a consultation, that *"it is important to bear in mind that one of the principal purposes, [if] not the principal purpose, of any consultation exercise is to enable consultees to identify and draw to the attention of the decision maker relevant factors which the decision maker may, either by accident or design, have overlooked when deciding upon a preferred option for consultation*"[85].

213. In order for a consultee to be afforded the opportunity to provide an intelligible response, it is necessary for the public authority to provide sufficient information. *"[S]ufficient information to enable an intelligible response requires the consultee to know not just what the proposal is in whatever detail is necessary, but also the factors likely to be of substantial importance to the decision, or the basis upon which the decision if likely to be taken*"[86]. Ouseley J went on to state that if a decision maker were to set out its crucial criteria and precisely such criteria would be used as part of the decision-making process "*this would, as intended, affect what topics were covered by consultees, in what depth or with what focus, and would affect what is omitted*"[87].

214. In its Consultation document, Ofcom has presented a degree of reasoning underpinning its provisional decision but VMO2 is concerned that Ofcom has not provided, in sufficient detail, all factors on which it seeks to rely. In part, this is due to the significant level of redactions set out in the Consultation document which means some of Ofcom's "reasoning" is opaque but, in other cases, it appears that Ofcom has included only part of its analysis. For example, Ofcom has presented its analysis of the FSM based only on the scenario in which all ISPs' orders will achieve between 92-95% FTTP but has not included any of its analysis in which ISPs may be closer to the OMTs as it otherwise alludes to in §§ 3.64-3.65.

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[83] R (Help Refugees Ltd) v the Secretary of State for the Home Department [2018] EWCA Civ 2098, p.90
[84] CityFibre Limited v Ofcom [2022] CAT 33, p.76
[85] R (Baird) v Environment Agency [2011] EWHC 939, p.41
[86] R (Devon CC) v Secretary of State for Communities and Local Government [2010] EWHC 1456, p.68
[87] Ibid, p.69

215. As such, VMO2 has only been able to respond to that which it is able to discern from the unredacted material in the Consultation document and what appears to be lacking in Ofcom's analysis. VMO2 is therefore concerned that it has not had an opportunity to understand fully all the evidence on which Ofcom seeks to rely and therefore be able to provide a truly comprehensive consideration and response to Ofcom's provisional decision.

Ofcom must give due consideration to consultation responses

216. One of the purposes of consultation is to lead to better decision-making, "by ensuring that the decision-maker receives all relevant information and that it is properly tested".[88]

217. As set out above, when issuing a consultation and inviting responses from interested parties, Ofcom is obliged to follow the *Gunning/Sedley* criteria which includes, as the first principle that, "*that consultation must be at a time when proposals are still at a formative stage*" and the fourth principle, that "*the product of consultation must be conscientiously taken into account in finalising any statutory proposals*". It is therefore not enough for any authority, including Ofcom, simply to pay lip service to the principle of consultation, the consultees must be consulted sufficiently early such that their responses must be given full and proper regard and be able to influence the final decision.

218. Ofcom also states that the Consultation comprises an impact assessment in accordance with Section 7 of the Act[89]. By virtue of Ofcom recognising the need for an impact assessment, it is acknowledging the importance of its decision. Section 7(1) of the Act states that Ofcom's duty to conduct an impact assessment applies when Ofcom is carrying out its functions and "*it appears to them that the proposal is important*". A proposal is important if its implementation were likely:

> *"(a)to involve a major change in the activities carried on by OFCOM;*
>
> *(b)to have a significant impact on persons carrying on businesses in the markets for any of the services, facilities, apparatus or directories in relation to which OFCOM have functions; or*
>
> *(c)to have a significant impact on the general public in the United Kingdom or in a part of the United Kingdom."*

219. Whilst (a) does not appear to be relevant in the present circumstances, the proposal is likely to have a significant impact on market participants and potentially end consumers. This being true, Ofcom has an obligation (under section 7(7)(c) of the Act) not to implement their proposals until they have "*considered all the representations made in that period*".

220. In its Consultation document, Ofcom has expressed its intention to publish its final decision by the end of March 2023. Given that the deadline for interested third parties to respond to the Consultation is not until 4 March 2023, VMO2 is concerned that Ofcom is

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[88] Moseley, p.24
[89] Consultation, § 2.8

not affording itself sufficient time to take due account of all consultation responses, including the need for collation of further evidence (as we have demonstrated the need to do above), in order to substantiate and arrive at a reasoned decision. A failure by Ofcom to undertake a proper review and analysis of all responses, would in turn be a failure by Ofcom to meet its duty to consult properly.

221. As we have demonstrated in our response to this Consultation, Ofcom's final decision will be critical to the future of network competition in terms of affording altnets the ability and incentive to invest in the future roll out of FTTP across the UK. It will also likely be determinative as to VMO2's competitive entry, at scale, in the wholesale market and thereby determine whether VMO2 can act as a true competitive constraint on Openreach.

222. Given the overwhelming importance of Ofcom's final decision and the degree of scrutiny any such decision is likely to face by all market participants, we assume that Ofcom will need to ensure it has followed a rigorous internal peer review and governance process. If Ofcom is to publish its final decision on or before the 31 March, we are concerned that this will mean that Ofcom will have at most 20 working days to review all responses, conduct necessary evidence gathering and draft its reasoned decision.

223. Ofcom is, however, under no obligation to issue its final decision by the end of March. This is particularly true if the responses to the Consultation raise concerns regarding the analysis already undertaken or adduce additional evidence regarding the anti-competitive effects of Equinox 2 that would require further investigation.

224. SMP Condition 8.6 only obligates Openreach to notify Ofcom of its commercial terms which are conditional on a range of services being purchased no less than 90 days before it proposes to implement the commercial terms. SMP Condition 8.6 places no time restrictions on Ofcom's review, nor could it. Whilst there is a desire by Ofcom to deliver market certainty in a timely manner, this should not outweigh its obligation to conduct a fair and robust consultation which takes account of all submitted responses.

225. In Annex 11 of the WFTMR, Ofcom refers to the process for consultation lasting one month. Ofcom then goes on to state that "*At the end of the consultation period we would consider stakeholder responses and aim to issue a final decision (and where appropriate direction) shortly after the consultation period (<u>clearly this would depend on the nature and extent of responses</u>)*" (emphasis added). Ofcom therefore has accepted the potential for the need to extend the process to take account of the nature and extent of responses.

226. VMO2 therefore urges Ofcom to take the time it needs to conduct the required thorough and comprehensive review of all the responses it receives, including from VMO2, and give proper consideration to the arguments and evidence presented to it regarding the anti-competitive effects of Equinox 2. Ofcom has a statutory duty to promote competition and a common law duty to consult properly, such that it must take the time to ensure it is meeting its duty and objectives and not being rushed into a decision by an arbitrary date set by Openreach. Whilst Openreach may have a desire to launch this product on 1 April, citizens and consumers would be better served, in the short- and long-term, if Ofcom's final decision was issued at a more appropriate juncture after allowing itself the proper time for due consideration, rather than risk the certainty that is the weakening of

wholesale competition in this “small window of opportunity” to foster genuine competition to Openreach by rushing through a poor, unfounded decision.

The actions Ofcom should take

227. This section sets out the actions Ofcom should take to address the concerns with Equinox 2 set out above.

OMTs and FSM: Efficacy of any “remedy”

228. It is a relatively uncontroversial statement that if a regulator identifies a behaviour which is bringing about an anti-competitive effect in contravention of a regulatory requirement, any remedy it sought to impose or undertaking it chose to accept would need to be adequate to address the competition concerns in full. Indeed, in Ofcom’s Regulatory Enforcement Guidelines, if a subject of an investigation is found to have contravened one or more regulatory requirements, Ofcom state that they “*generally expect the subject of an investigation to take steps to bring itself into compliance and remedy the consequences of any contravention to the fullest extent possible*”.[90]

229. Therefore, given that Ofcom has identified in §§ 3.64-3.65 of the consultation that the OMTs are capable of creating a barrier to ISPs using altnets and is reliant on a contractual mechanism to mitigate such anti-competitive effects by removing any disincentive effect the OMTs may have - it is incumbent upon Ofcom to ensure that any such “remedy” is adequate to address the identified harm.

230. As set out above, VMO2 considers that the FSM is not fit for purpose and does not adequately address the exclusionary anti-competitive effects Ofcom has identified. In light of this, Ofcom must reject the Equinox 2 Offer in its current form.

231. When launching the Equinox 2 Offer, [✂].[91] Furthermore, in its supporting documentation for the offer, Openreach characterised the inclusion of the FSM as being to mitigate the “theoretical” problems with the OMTs. Problems which are now shown to be very real.

232. Therefore, in light of Ofcom’s reported influence in the process for developing such offers, it may be prudent for Ofcom, in its decision, to highlight alternative approaches to ensuring that incentives to migrate customers from copper to fibre do not also distort competition on the merits in the wholesale market.

The FSM can be made effective

233. Without a contractual mechanism that is designed to provide clear and unambiguous protection against the significant anti-competitive effects brought about by the OMTs, Ofcom should not allow the Equinox 2 Offer as currently proposed to be implemented.

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[90] Regulatory Enforcement Guidelines for investigations (ofcom.org.uk), § 5.8
[91] [✂]

234. Should Openreach wish to subsequently correct the issue with OMT/FSM we have the following observations regarding a workable solution.

235. A mechanism like the VTR set out in the VASO could be used to remove the problems we identify for the FSM in plausible scenarios whereby ISPs are underperforming against the OMT.

236. A mechanism akin to the VTR would introduce a simple, network-agnostic copper to gigabit network migration measurement mechanism along the lines of:

$$\frac{\text{All Gigabit capable network}^{92}\text{ Orders (from whichever supplier)}}{\text{All Orders}}$$

237. In addition, we have also highlighted the discriminatory nature of the risks created by the OMTs / FSM combination. There is no such risk for BT Retail as it will not use altnets, instead all the risk lies with the third-party ISPs who are more likely/would want to source from altnets. VTR treats BT Retail and ISPs equally, in that it takes account of all their demand. So again, in that respect it appears to be a superior solution to FSM.

238. As we identify above, for the FSM's replacement to be truly effective, all conditionality and uncertainty should be removed so as to provide certainty for the ISPs and remove the disincentive to switch to altnets. We believe that this alternative approach removes all the problems inherent in the FSM as currently specified, since the:

- VASO/VTR is already established and ISPs already have experience of this term (as Ofcom notes at § 3.75);
- It protects all altnets, including future scale entrants;
- It does not require overly complicated or burdensome assessments (which include subjective judgement e.g. definitions of overlap areas) to be undertaken by an independent verifier; and
- Based on the above, imposition of an approach akin to the VTR would be entirely proportionate. It will not be unduly burdensome on Openreach to make the necessary adjustments to its proposal and bring forward a condition substantially similar to GEA-VA for regulatory scrutiny.

239. However, because of the demonstrated impact of the effect of cliff-edged or saw-toothed discounts of the Equinox offers on VMO2's future business, we also call upon Ofcom to impose a new SMP condition to ensure this type of term can be properly assessed in future. Any revised Equinox offer should then be subject to this assessment.

[92] The technology neutral construction allows for migration to a wholesale cable network, for example.

SMP condition which “Per se” prohibits cliff-edged discounts

240. Openreach has a special responsibility, as a dominant firm, not to abuse its position by distorting or foreclosing competition through its pricing and/or other conduct.

241. Whilst Ofcom were reluctant in the WFTMR to impose a broad-brush prohibition on all commercial terms which Openreach seek to introduce on the grounds of proportionality, this was in part due to the “*practical difficulties in identifying in advance all the structures that could deter alternative network build and specifically prohibiting these with the potential for Openreach to game the rules designing structures to get around any specific prohibition*”[93].

242. In light of the concerns set out above, Ofcom should take a precautionary approach for the future and issue a direction creating an SMP Condition prohibiting offers which contain cliff edge arrangements and requiring Ofcom consent (akin to the effect of the SMP Condition in relation to geographic discounts which were introduced by the WFTMR).

243. In an ex ante context such as this, the burden of proof should sit with the provider designated with SMP to justify their behaviour rather than rely on the smaller market participants, or indeed nascent market entrants such as VMO2, to continually defend themselves against anti-competitive effects of harmful pricing mechanisms particularly in circumstance where much of the evidence or information rests with the dominant provider and its customers.

244. Only in this way can regulatory errors like those exhibited in Equinox 1 be avoided in future, at least in respect of the cliff-edge discounts/OMTs.

Measures to address drip-feed pricing

245. In order to remove the chilling effect of protracted negotiations between Openreach and the largest ISPs, we propose below a workable SMP condition which would meet all the criteria set out in section 49(2) of the Act[94] and in relation to which Ofcom should consult. This does not constrain Openreach’s ability to set prices, rather it focusses on providing periods of pricing stability to the market, such that ISPs can make informed switching decisions. Our proposal is based on similar provisions that exist today in the "Takeover Code"[95] (the “Code”).

246. The Code operates in the UK market for tradable securities and is administered by the Takeover Panel. The Code has been developed based on a number of general principles that were first established nearly forty years ago. It therefore represents a good example of best practice on issues such as transparency of information, engagement with counterparties and avoiding price instability during a transaction. The Code has a number

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[93] WFTMR, § 7.152.

[94] Directions should be (i) objectively justifiable; (ii) not unduly discriminate; (iii) proportionate to what it is intended to achieve; and (iv) transparent in relation to what it is intended to achieve.

[95] https://www.thetakeoverpanel.org.uk/wp-content/uploads/2022/07/343427_001_The-Take-Over_Bookmarked_13.07.22.pdf?v=14Jul2022

of objectives some of which are of particular relevance to the problem we identify with drip-feed pricing:

> *"The Code [also] provides an orderly framework within which takeovers are conducted. In addition, it is designed to promote, in conjunction with other regulatory regimes, the integrity of the financial markets.*
>
> *The Code is not concerned with the financial or commercial advantages or disadvantages of a takeover. These are matters for the offeree company and its shareholders. In addition, it is not the purpose of the Code either to facilitate or to impede takeovers."*[96]

247. Of particular relevance to the drip-feed pricing problem are General Principles five and six of the Code:

> *"5. An offeror must announce a takeover bid only after:*
>
> *(a) ensuring that the offeror can fulfil in full any cash consideration, if such is offered; and*
>
> *(b) taking all reasonable measures to secure the implementation of any other type of consideration.*
>
> *6. An offeree company must not be hindered in the conduct of its affairs for longer than is reasonable by a takeover bid for its securities."*

248. In traded securities, it is important that prices are not distorted by the disclosure of inaccurate information, or information being disclosed to a limited number of market participants as this distorts the level-playing field. There should also not be protracted periods of uncertainty as to a potential acquirer's intentions. In this way, financial market integrity is maintained and takeovers can be "priced in" by market participants on an equitable footing.

249. The Code includes disclosure requirements that force buyers and sellers to disclose to the markets when offers have been made[97] and also precludes possible acquirers from making future offers for a "closed period" once they have stated that they do not intend to make an offer[98]. The negative effects of "*rumour and speculation*"[99] are dealt with by requiring buyers and sellers to make announcements such that the market has transparency.

250. The UK wholesale fibre market is not functioning well partly because of information problems. Our evidence demonstrates, in particular, the destabilising effect protracted pricing discussions between the SMP operator and a few ISPs. The flow of information between those market participants appears to be having a negative effect on the action of competition in the market itself. VMO2 believes that the particular nature of the market

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[96] Ibid., p.31
[97] Ibid., Rule 2.7
[98] Ibid., Rule 2.8
[99] Ibid., Rule 2.2 note 3

structure (comprising a dominant wholesale supplier coupled with downstream ISPs reflective of an oligopsony) warrants a bespoke solution to the information problems it exhibits.

251. Although Ofcom considers, and we agree, it is not bounded by BT's 90 day notification process to consider this issue as part of Equinox 2, it remains an issue that needs to be urgently addressed. Ofcom should open an investigation and then consult with a view to issuing a direction creating an SMP condition which provides a "closed period" after any Openreach GEA-FTTP offer is approved. Such an SMP condition would provide certainty for ISPs and enable competition to operate undistorted by the continued signalling of future prices by Openreach. The SMP condition should also ensure that a dominant firm's engagement with ISPs about the nature of new prices must also take place in a short, regulated timeframe.