

BCMR Preliminary consultation on passive remedies

Response by Colt Technology Services

1 INTRODUCTION

Colt has already provided its input on the majority of the issues raised in the present consultation, in its reply to the Call for Inputs (CFI). Colt is also a member of the “Passive Access Group” (PAG) which is providing a more substantial reply to this consultation. Therefore, this response will be a relatively limited one. On some issues, we refer to the material and evidence already submitted in our CFI reply.

We strongly welcome Ofcom’s decision to run a consultation on passive remedies. We also welcome Ofcom’s acceptance of the benefits passive remedies can bring in terms of innovation and product differentiation.

However, there are parts of the consultation paper that leave us a little disappointed. This is because we do not feel that Ofcom has fully taken on board much of the evidence we have submitted to date on how passive remedies are used or the benefits they yield. Most particularly, despite substantial evidence of the benefits of passive remedies both in the UK and internationally, the lack of any evidence of the materiality of the risks, together with the substantial and detailed evidence contained in our CFI reply, Ofcom’s thinking does not appear to have moved on in quite the way one would expect.

At some points, Ofcom’s approach appears to read a little tendentiously. For example, Ofcom indicates a preliminary view that duct access and dark fibre are alternatives with the former offering little advantage over the latter. These discussions seem to have ignored (or summarily dismissed) the evidence that Colt has submitted. Colt has submitted a substantial amount of evidence into how duct access has been used in other countries and would be used in the UK if available. These are quite clearly usage models in which dark fibre is not a substitute.

In some places, the consultation paper leave the reader with the view that evidence and arguments have been presented with the objective of rationalising a pre-determined outcome, namely, to exclude duct access as a remedy. While we acknowledge that duct access would require greater changes to cost allocation and pricing mechanisms than dark fibre, we believe that would be entirely the wrong outcome for this BCMR and represent another lost opportunity for the UK.

At no point does Ofcom discuss Colt’s approach, described extensively in our CFI response, to use duct access to build city fibre rings and whether it would offer tangible benefits in the UK market context. A truly open and inquiring approach would have investigated the potential benefits of this model, firstly for different types of business customers in different regions, and for adjacent markets (such as mobile and residential broadband). However, there is very little discussion around those topics. Given the level of negative press in recent months surrounding the poor quality of infrastructure available to business

parks in the UK, we find it curious that Ofcom does not appear to see the potential in unlocking the market to parties willing to invest, besides than the incumbent.

In a similar vein, Ofcom appear to us to have retained its (in our view) over-stated view of the risks. That regulatory intervention is able to create distorted incentives including cherry picking, arbitrage and incorrect build/buy decisions is straightforwardly obvious. This is true of any regulatory intervention. The task is to calibrate the regulatory intervention correctly, involving the right absolute and relative prices. Unless there are powerful reasons why the existing wholesale price controls are unequivocally welfare optimising (and Ofcom has not sought to establish that there are), the presumption should surely be in favour of the form of intervention that gives competitors the greater scope for differentiation at the product, service and geographic levels, exploiting any economies (of scale, scope or density) that the competitor can find, not that Ofcom determines in advance is rational to pursue.

A further drawback of Ofcom's approach (which again we mentioned in our CFI response), is its tacit acceptance of its role as "market micro-manager". It is in effect, weighing up the pros and cons of a particular regulatory intervention on the basis of a priori reasoning about the market outcomes that will arise as a result of that intervention. We argue that this involves Ofcom significantly overstepping its remit, which is to provide the right framework for the market to achieve whatever outcomes it deems desirable. The end result of this approach is that the services on offer and all their variants – in their product and geographic dimensions – end up being regulatory prescriptions and not market outcomes. This approach plays into the hands of BT, which retains its ability to divide and rule the market, and is precisely the opposite of what the UK market needs.

One example of this is Ofcom's evaluation of Colt's contention that duct access enables operators to introduce innovations in network architecture, each different architecture offering quite different economic, technical and performance characteristics. In assessing this submission Ofcom argued that any such benefits must be "assessed against the practical challenges" of implementing network architectures that differ from that of BT. If there are any such practical challenges, it is not for the regulator to assert up front, that this would be relevant to assessing the desirability of a particular remedy. It should be obvious to Ofcom that each time Colt has implemented an alternative network architecture (and it has done so many times), it has successfully overcome any practical challenges of doing so. Furthermore, one would have hoped that prior to making such a statement, Ofcom would have consulted Colt (who have extensive experience of implementing alternative network architectures outside the UK) about whether any such practical challenges exist and to the extent that they do, how easily they can be overcome.

2 COMMENTS ON VARIOUS ASPECTS OF THE CONSULTATION

Question 1: Do you agree with our preliminary framework for considering the case for passive remedies?

We broadly agree with this framework for evaluating passive remedies with one significant reservation. The framework entirely ignores the cost of regulatory error in defining product and geographic markets. As we made clear in our CFI response, there are several niche markets that the current business connectivity market does not serve. Distinctions exist:

- At the product market level. In our CFI response we showed how Colt is able to offer specialist services to customers such as low-latency services, superior SLAs and advanced network monitoring services. These are available on-net but not off-net. Due to the lack of passive infrastructure access in the UK, the geographic availability of different grades of service is fixed in time and in place. They are available in Central London and parts of East London, and not elsewhere. Ofcom has not taken account of the possible demand for such services outside London.
- At the geographic market level. There are many fibre not-spots in the UK. Indeed, there is some evidence to suggest that BT has deliberately avoided rolling out its FTTC network to certain areas (particularly business parks) to avoid leased lines market cannibalisation. BT has therefore created a major gap in the market. In other EU countries Colt specialises in exploiting these gaps, but is unable to do in the UK. In other EU countries, Colt offers contended FTTO solutions over fibre rings to business parks that are cheaper (by far) than leased lines and better quality (by far) than residential grade FTTC.

We believe the framework contains a significant methodological weakness, namely, the assumption that the regulator is able to foresee all the types of demand that exist in the market and design a single, one-size-fits-all, solution that satisfies all of them. A far better approach would be to introduce a presumption of intervention at lower network layers on the grounds that the market is then able to respond dynamically to different demand characteristics in a way that a regulator should never attempt.

We of course recognise the wider issues outlined in the paper, for example that remedies take time to develop. Fortunately, being relatively late to the game, the UK has the ability to observe best and worst practice from elsewhere.

Civil Infrastructure Directive

The Civil Infrastructure Directive (CID) should make Ofcom even more determined to implement duct access correctly under the SMP framework because duct access is coming anyway. If Ofcom's concerns about the potential for duct access to lead to worse outcomes if not implemented correctly have any validity, then the worst of all worlds is for it to enter the suite of remedies by means of a process over which it has less control. This makes it even more important that Ofcom takes control over duct access using 1) the tried and tested mechanisms of the SMP framework; 2) in the context of the BCMR where Ofcom can ensure that all elements in the cost stack are compatible.

As a consequence of the CID, duct access will enter the portfolio of remedies by the back door. Pricing considerations will be determined in the context of a few narrowly defined disputes and without regard to compatibility with existing remedies. If Ofcom really do believe duct access has the potential to be as disruptive as they say, then by NOT taking control of the manner of its implementation in the BCMR, Ofcom would justifiably stand accused of abandoning the business connectivity market to the chaos that – on Ofcom's own reasoning – would undoubtedly ensue.

Question 2: Do you agree with our preliminary views on the potential benefits of passive remedies? Please provide evidence to support your view.

We are of the view that, while not entirely ignoring, Ofcom has somewhat skipped over a substantial portion of the potential benefits of passive access. All of these were described extensively in our reply

to the CFI. The most important benefit is that passive remedies allow CPs to address market segments that are unaddressable otherwise. These include:

- product market segments with niche requirements (like low latency) or “category busting” products that bear some characteristics of both higher quality leased lines and residential services
- geographic market segments where BT has chosen not to deploy its own infrastructure

We find it peculiar to say the least, that Ofcom is apparently so keen to defend a market in which a high proportion of customers effectively only has a choice of two products (residential broadband or leased line). Still worse is Ofcom’s defence of a market where: both products are creations of BT; are at prices set (or largely determined) by BT; and are available in locations pre-determined by BT. When such a tried and tested alternative exists, this would seem to us a dereliction of Ofcom’s duty to promote innovation, investment and competition.

In Ofcom’s statement: “based on the CFI responses, we consider that the majority of the potential innovation benefits appear to be related to changes/configurations or upgrades to electronic network equipment” we would add the following further benefits:

- offer products to hitherto unaddressed market segments by means of innovation in the service layer and the configuration of the physical layer. This is an important economic benefit which we believe Ofcom has not adequately considered
- offer products to hitherto unaddressed geographies by means of efficient leverage of existing network infrastructure

As for Ofcom’s appraisal of Colt’s contention that “passive remedies could give CPs the flexibility to configure their networks in a different way to BT. For example, Colt stated that a duct access remedy would allow the deployment of local fibre rings, instead of following BT’s traditional tree and branch network architecture...”, we find this to be summarily dismissive and wholly inadequate. Rather than make the theoretically trite remark that any such benefits need to be assessed against practical challenges, we would urge Ofcom simply to observe. Ofcom appear to give the impression that they believe Colt’s contention to be speculative. At no point does Ofcom reflect the fact that this is a tried and tested business model that has been implemented (by Colt and others) in many continental European cities and, given the right policy framework in the UK would lead to substantial new fibre investment in the UK.

Given the extent of the evidence we submitted to Ofcom in our call for inputs, we are a little disappointed that the business models set out in our CFI reply barely register a mention in Ofcom’s discussion, particularly as Ofcom has dedicated ample space to discussing how passive remedies can be used to construct C-RAN networks.

Ofcom is correct in arguing that duct access would provide a competitive stimulus to Openreach’s quality of service in a way that dark fibre would not. It is also correct in observing that it would not address all potential sources of provisioning delay. Nevertheless, our view is that, once provisioning issues have been resolved they are more or less resolved once and for all (just as they are when we dig). From a service level point of view Colt considers a network constructed using third party duct in the same way as a network constructed using own infrastructure. In other words, Colt considers such

network to be on-net, allowing us to offer our on-net SLA, which is superior to our off-net SLA. Given that we also provided Ofcom evidence of our on-net and off-net service levels in our CFI response, we would have hoped Ofcom's summary in this consultation to be a little less equivocal and vague.

Question 3: Do you agree with our preliminary views on the impacts and risks of passive remedies? Please provide evidence to support your view.

Question 4: What are your views about the potential impact of passive remedies on the pattern of common cost recovery and the associated distributional impacts?

Much of Question 3 is about the risk that passive remedies will deliver outcomes that differ from the economically optimal outcome. Inefficient investment and cherry picking are cited as two unhappy outcomes that could follow. It is true, they are. But this is also true of any remedy where the price is wrong.

Only if such an outcome is necessary rather than contingent on being wrongly implemented, should Ofcom consider this argument decisive. As for whether it is necessary, we argue that Ofcom should simply observe and ask itself the question: in markets where passive remedies have been implemented, have they in fact resulted in inefficiencies that are so visibly serious as to justify such a level of caution for this length of time?

Our experience tells us that they have not, and that Ofcom's concerns are over-stated.

Our views on the risks and impacts of passive remedies are mainly reflected in the submission by the PAG, to which we are a contributor. We will therefore not elaborate further here, except to say that the risks, while theoretically plausible, are eminently resolvable. The fact that passive remedies have played a significant role in business connectivity regulation in many countries outside the UK for a long time, is all the proof we need.

Question 5: Do you agree with our initial view that mobile backhaul and fixed broadband backhaul are likely to be the primary applications with significant demand for passive remedies?

We strongly disagree with this statement. As extensively detailed in our CFI reply, the primary application of passive remedies will be the construction of new fibre networks covering broad areas such as city centres and outlying business parks. Once in place, the fibre network can be used for any purpose including business connectivity and fixed/mobile backhaul. We are somewhat perplexed, given the amount of detail we have submitted to Ofcom on how we have used passive remedies, that this has barely warranted a mention by Ofcom.

To re-state this point, we simply refer Ofcom to our CFI response.

This point is a critically important one because this business model we advocate is not subject to the criticism levelled against passive access in the past, that it is a straightforward arbitrage. The reason is that the creation of a new fibre network is not directly substitutional with any BT downstream product. Fibre networks constructed in this way have different:

- technical characteristics in that they are able to offer different features and levels of performance (eg for higher-end markets offering low latency and network monitoring, and lower end markets involving contended services)

- service characteristics in that we are able to offer our on-net SLA (superior by far to our offnet SLA where the service level is constrained by the underlying inputs from Openreach)
- geographic characteristics in that Colt plans to target geographic markets that are untouched by other operators (particularly business parks) – just as we do in continental Europe
- economic characteristics in that our ring architecture allows incremental expansion in a way that a tree and branch architecture does not

The new model of network competition that would be facilitated by duct access is entirely value creating and not substitutional.

We also find Ofcom's discussion of the potential uses of passive remedies in paragraph 6.5 to have mostly ignored Colt's CFI submission. The paragraph on business connectivity covers only a very small subset of the ways in which we propose to use passive remedies and our motivations for doing so.

Question 6: What benefits might duct access offer over dark fibre and vice versa? Is there a case for having both remedies?

As explained in our CFI response, duct access and dark fibre are not substitutes, they are complements. The value of each is enhanced by the existence of the other. The full range of benefits from passive remedies absolutely requires that both are available.

Our CFI response explains how dark fibre and duct access are used together in a complementary way. Typically, when building fibre networks, Colt:

- uses duct access to construct the fibre ring;
- uses dark fibre to connect the fibre rings where they are not adjacent

Dark fibre cannot generally be used to construct fibre rings unless all the routes required already exist. If they already exist, there is mostly likely no case for constructing new network. Dark fibre therefore cannot be used for strategic network expansion in the same way that duct access is able to be so used.

In paragraph 6.9, Ofcom state that "we are not clear whether in practice [duct access allowing CPs to deploy their own fibres and to adopt different architectures or configurations] delivers a significant degree of innovation potential over that which could be realised through access to dark fibre. Overall, the incremental benefits offered by duct access appear relatively small, particularly in the context of backhaul for the fixed access and mobile applications that appear to be of most interest".

We agree with this statement insofar as it applies to fixed and mobile backhaul. However, as stated above, we do not believe this is the most important, significant or transformative use of passive remedies. We believe that Ofcom cannot make the assertion that duct access offers only minor incremental benefits without at least making a reference to the benefits that Colt claimed for fibre networks constructed using duct access, described in detail in its CFI response. Ofcom has barely mentioned these, let alone attempted any kind of evaluation.

Overall, we feel the discussion around question 6 has failed to show that Ofcom has fully grasped or understood the main applications of passive remedies that are in use where they exist. Furthermore, we feel the evaluation contained here to be inadequate and tendentious. We also believe that it is here that the main methodological flaw in Ofcom's approach reveals itself. According to Ofcom's approach, it is for Ofcom to be convinced of the possible benefits flowing from liberalising the market (when those

benefits are inherently unpredictable and dynamic in nature) before liberalising the market. This is a very peculiarly administrative and technocratic approach that stands in stark contrast to Ofcom's historic role as a regulator that favours market outcomes rather than regulated ones. By intervening at – and only at – the active level, we believe that Ofcom is allowing BT, to an unacceptable degree, to dictate the what, the where and the how. Such a market can never be efficient or serve the needs of UK customers.

Question 7: If passive remedies were restricted to particular product types or geographic areas how might this affect the usefulness and benefits of the passive remedy?

This question is covered in the "PAG" submission and we do not propose to discuss further here, except to note that the obvious (and legally necessary) point that passive remedies should only apply in geographic markets in which SMP is found to exist in downstream markets. Further, we recognise the scope for geographic deregulation in zones in downstream markets that have achieved a requisite level of upstream competition.

Question 8: What arrangements would be appropriate for the supply of new infrastructure for passive remedies? Question 9: Do you agree with our initial views about the non-discrimination arrangements for passive remedies?

Colt's views on these questions are covered in the PAG submission.

Question 10: In light of the trade-offs identified, which broad options on pricing do you consider would be most appropriate for passive remedies and why? Please also provide details if there is another pricing approach you consider would be appropriate in light of the considerations identified in this section.

Question 11: If a value-based (active minus) approach to pricing dark fibre were adopted, what do you think would be an appropriate active wholesale product (or products) to reference?

Colt's views on these questions are covered in the PAG submission. Our comments here are limited to two points about arbitrage and cherry picking.

- The extent to which Ofcom should be concerned about arbitrage is reduced in direct proportion to the degree of product differentiation. Since Colt's use of passive remedies is targeted at exploiting gaps in product and geographic markets that are unserved by BT, Ofcom should not be concerned about arbitrage with this usage model. Rather than being concerned about arbitrage, Ofcom should be supportive of this type of use as a value adding, efficiency enhancing measure
- As Ofcom acknowledges in 7.5, its concerns about cherry picking are effectively an issue with infrastructure competition in general, and not with passive remedies in particular. If infrastructure competition has not developed to the point where cherry picking becomes worrisome, this can only be considered a lucky accident. Ofcom has not even attempted to establish the fact that passive-access-based-competition imposes a different kind of constraint on BT's pricing from infrastructure competition in general. If a hypothetical new form of infrastructure access were to become available that allowed the cheap deployment of alternative facilities, the issues would be similar in kind, the only difference being that Ofcom would be unable to prevent its use. Passive-access-based-competition is effectively nothing

other than a form of infrastructure competition that makes efficient use of existing facilities.
Seen this way, it is hard to see how Ofcom can be so cautious about it.

We are, of course, fully supportive of the over-riding constraint that BT must be able to recover its common costs.