

([REDACTED]) Redacted for publication)

Ofcom

By email only

23 January 2019

Dear ([REDACTED]) Redacted for publication),

**Passive Access Group – 2018 BCMR consultation response**

1. The Passive Access Group or PAG (TalkTalk, Vodafone, Colt and Sky) write in response to Ofcom's consultation published on 2 November 2018 *Business Connectivity Market Review* ('BCMR') (the 'consultation').
2. The PAG is a group of the UK's major alternative communications providers. As fierce competitors, each of us has our own, individual ambitions and plans to secure the benefits that passive access will bring to our customers – and help us win new ones. PAG members are united in their view that more and better access to BT's passive infrastructure (i.e. dark fibre, ducts and poles) is what is required in order for UK communications providers to meet the demands of consumers and business alike.
3. This response is, in the main, limited to issues that either directly or indirectly impact on gaining access to BT's passive network and is supplementary to any responses that PAG members provide individually to Ofcom.
4. We note that individual PAG members will be providing their own responses, and in the event of any conflict between this letter and individual responses, individual responses will take precedence.
5. In the consultation, Ofcom have proposed to find that BT has Significant Market Power ('SMP') in CI Access Services in each of the geographic markets, except the Central London area and Hull area. Ofcom have also proposed to find that BT have SMP in the CI Inter-Exchange Connectivity Market where it faces competition from fewer than two operators. Finally, Ofcom have proposed to deregulate Traditional Interface ('TI') services throughout the UK.
6. In general Ofcom proposes the following remedies in its consultation:

- a. CI Access Services: where BT faces competition from two or more rivals, Ofcom are not proposing charge controls or quality of service standards.
  - b. In CI Access and Inter-exchange connectivity markets: Ofcom proposed to keep prices flat in nominal terms and impose quality of service standards at all bandwidths.
  - c. BT only inter-exchange connectivity market: Ofcom propose that BT provides access to dark fibre at cost.
7. The PAG's submission in response to the consultation is that there are some significant aspects of the consultation that are a cause for concern, and encourage Ofcom to consider more thoroughly, set out below.

***Ofcom should ensure that the BCMR review remains separate from the PIMR proposals***

8. The PAG is concerned Ofcom is basing its BCMR regulation on regulation it *anticipates* it will impose in the Physical Infrastructure Market Review (PIMR). We consider this may breach Ofcom's public law duty to consult and to do so whilst decisions are at a formative stage. Ofcom has told us that PIMR will come out at the same time as, or before, the BCMR, avoiding any concerns over prejudice. However this seems unlikely to address the concern and could provide a weak foundation for both the BCMR and the PIMR which may potentially make either or both vulnerable to legal challenge.

***Flat prices for circuits above 1Gbit/s despite an SMP finding***

9. The PAG considers it incoherent that Ofcom recognises BT has SMP in the Very High Bandwidth ('VHB') market, that prices are distorted and significantly above FAC, BT makes high profit margins and that volumes are forecast to rise significantly, and yet Ofcom proposes to maintain price caps at current levels (CPI-CPI)<sup>1</sup>. Therefore, the PAG considers that Ofcom has failed to properly consider its responsibilities to protect consumers' interests by promoting competition through pricing that addresses BT's SMP in this area of the market. The PAG invites Ofcom to reconsider this proposal.

***No SMP finding in CLA***

10. It is unclear why Ofcom continues to find no SMP in the CLA, despite BT having a market share of over 60% of new connections in 2017. This is inconsistent with Ofcom's and the EC's approach to SMP analysis in other markets, where market shares in excess of 50% create a presumption of dominance. The PAG is unconvinced by Ofcom's attempts to justify this by arguing that there is greater network density and weaker market power than elsewhere in the UK, which says nothing about whether BT has SMP in CLA. Ofcom has not demonstrated that the presumption of dominance is rebutted based on factors other than market share. On the contrary the figures from FY16 (the last ones published by BT), show Openreach was earning a ROCE of c.50% in the CLA.

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<sup>1</sup> Ofcom BCMR consultation para 4.23, A7.5

11. Ofcom is wrong in its approach to SMP in this area, despite a number of indicators that Ofcom should have found SMP in the CLA.

**Limited Dark Fibre access**

12. Ofcom talks at length, in this consultation<sup>2</sup> and others, about the benefits of dark fibre, which the PAG fully agrees with. However, Ofcom then somewhat inexplicably proposes that the best thing to do is to be 'conservative' and severely restrict the availability of dark fibre access to inter-exchange routes to or from a BT only exchange, resulting in no dark fibre remedy for mobile backhaul and dark fibre for only about 5% of all circuits. Ofcom's conservative approach is therefore unjustified and warrants additional scrutiny.
13. First, the PAG see no proper explanation for why the benefits of dark fibre would not accrue wherever it is offered. It appears that the main reason for imposing the restriction is that Ofcom considers that allowing dark fibre *could* deter rival network investment once unrestricted duct and pole access is offered. However, Ofcom ignores the fact that when/if successfully available some OCPs may still rather use dark fibre in those areas where DPA is available since dark fibre delivers the vast majority of the benefits at a fraction of the cost – using dark fibre is also superior for consumers. DPA is more expensive to rollout than dark fibre and in highly competitive downstream markets OCPs should be able to decide what type of access they want to use.
14. Secondly, Ofcom is overstepping its role by determining the technologies and methodologies that are available for OCPs to deploy to compete with *other* OCPs, thereby artificially shaping the market structure. Any remedy imposed must be focussed on facilitating greater competition between OCPs and BT to address the competition issues related to BT's SMP, not between OCPs. Ofcom has not identified in its consultation any advantages which would accrue to consumers from OCPs using DPA rather than dark fibre; in the absence of such advantages, Ofcom's position preferring DPA to dark fibre could be seen as prejudiced.
15. Thirdly, it is illegal for Ofcom to decide not to impose a remedy in this market review on the basis that a remedy in some future market review might be successful and make this (dark fibre) remedy redundant.
16. Fourthly, the idea that the remedy should be restricted around BT's network footprint is inconsistent with Ofcom's own strategy in the PIMR that future network investment must not be shackled to BT's legacy footprint.
17. Finally, Ofcom appears to fail to consider the needs of both fixed and mobile access operators in relation to dark fibre which may raise issues around technological neutrality and non-discrimination. Ofcom has failed to recognise that without dark fibre for mobile

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<sup>2</sup>Section 12 generally and paragraph 12.76 of the BCMR – Volume 1 Market analysis, proposed SMP findings and remedies.

backhaul, the effectiveness of 5G is being put at risk if mobile operators cannot dramatically increase their backhaul capacity.

Flawed legal instrument or incoherent consultation

18. As the PAG have identified to you separately<sup>3</sup>, Condition 2 of the Draft Legal Instrument currently states:

*2.1 Without prejudice to the generality of Condition 1, the provision of network access under Condition 1 shall include the following specific forms of network access—*

*(c) Dark Fibre Access in Backhaul Segments, **where one or more circuit end(s) terminate(s) at a BT exchange which is identified as a “BT Only” exchange in Schedule 6 of this notification.** [our emphasis]*

19. This clearly sets out that only one end of backhaul segment must originate from a BT Only exchange. Consistent with this in the consultation Ofcom states that dark fibre will be available to “inter-exchange routes **from** BT-only exchanges”.

20. However, on 19 December 2018 Ofcom published a ‘corrections and clarifications’ internet page update where it states:

*“Our proposal, as set out in the consultation, is for the dark fibre remedy to apply along routes from a BT Only exchange to another BT exchange, rather than to another network node.”*

21. Ofcom’s internet page update is clearly inconsistent with the legal instrument and consultation document which is that dark fibre is available provided the backhaul segment runs **from** a BT Only exchange. This is an obvious error. The PAG strongly recommends Ofcom address this in the Statement before it leads to further uncertainty and legal challenges.

**No separate mobile for backhaul market**

22. Despite finding that there are differences between mobile backhaul and enterprise customers, Ofcom have assessed that competition conditions are similar so mobile access has been included in CI Access, denying mobile operators’ access to dark fibre. Mobile backhaul has significantly different demand and supply side characteristics to the enterprise market and are significant purchasers of leased lines, warranting a separate market definition finding.

23. Crucially, by ignoring MNOs’ urgent need/demand for dark fibre because it does not fit with Ofcom’s current paradigm, Ofcom will seriously compromise the ability of MNO’s capacity requirements who require dark fibre access to roll out 5G technologies.

<sup>3</sup> Email of 4 January 2019 from ([Redacted for publication]), Towerhouse LLP to ([Redacted for publication]), Ofcom.

***Ofcom's proposal to abandon cost-based charge controls in favour of CPI-CPI***

24. The PAG notes Ofcom proposes to abandon cost-based charge controls in this market review, by implication, by keeping prices flat, despite:
- a. its decision to abandon cost-based price controls is a significant policy change, to the detriment of consumers, and has not been supported by any cost benefit analysis;
  - b. accepting that higher prices will not stimulate investment in this control period;
  - c. acknowledging that it needs to make some significant starting charge adjustments due to BT significantly over-recovering under the charge control; and
  - d. flat prices would include a "likely" £50 - £60m over-recovery and "possibly" a £135m over-recovery for 1G and below products, with more for VHB products.
25. Ofcom's well-established policy is to set prices based on central cost forecasts not (say) a high cost scenario – thus it is irrelevant that the CPI-CPI cap falls within the upper end of Ofcom's cost range. Further, the PAG is concerned that Ofcom's choice of scenarios is significantly out of balance with the low-cost scenario of £10m under-recovery, which Ofcom knows very well is unlikely to eventuate given Ofcom's overall approach to BT's cost recovery which has historically seen significant over-recovery. However, Ofcom is willing risk possible additional over-recovery of £135m and likely over-recovery of £60m. This is grossly disproportionate and hands BT further windfall which has flow on negative effects for competition and consumers.

***No regulation/ transition to no regulation for TI***

26. Though not strictly a passive access issue, Ofcom's proposal to de-regulate TI leased lines services but keep regulation in place for the upstream wholesale low bandwidth TI market creates a problem for CPs who have 'sticky' customers currently on TI. The PAG does not agree that BT should be given such freedom considering that it is likely to result in significant windfalls for BT and potentially cause TI consumers significant additional costs to stay or switch to ethernet. The PAG submits that as a minimum requirement BT should be held to transitional arrangements to ease the transition.
27. Although OCPs may not be directly affected by this, Ofcom's failure to give CPs adequate regulation notification and its decision to deregulate without consultation creates uncertainty and leaves Ofcom open to challenge.

**Conclusion**

28. The infrastructure markets that Ofcom is attempting to promote competition within are at a crucial point where demand for bandwidth is vastly outstripping supply. As technology contributes more and more to the welfare of consumers and the UK economy Ofcom faces significant challenges to be both agile and robust in the regulatory framework it lays down for the BCMR. With this in mind, the PAG is keen to understand why Ofcom is determined

to raise prices above costs at such a crucial period, and how this can be reconciled with its duty to consumers.

29. The PAG trusts Ofcom understands our comments, in particular that they are provided by market participants that are uniquely placed to implement Ofcom's strategy and that Ofcom will take them into account and update its final statement to reflect them.

Yours sincerely,

A handwritten signature in blue ink that reads "Towerhouse LLP". The signature is written in a cursive, slightly slanted style. To the right of the signature is a vertical line.

**Towerhouse LLP**