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# Three's response to Ofcom's BCMR Consultation

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## Non-confidential

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# Executive Summary

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1. This is Three's response to Ofcom's Business Connectivity Market Review (BCMR) Consultation.
2. Three has two specific concerns with Ofcom's proposals in the BCMR as they currently stand:
  - a. The scope of the dark fibre inter-exchange remedy is unduly limited to BT-only exchanges. This should be expanded to all BT exchanges.
    - i. The limited scope of the proposed remedy does not reflect BT's enduring SMP in the inter-exchange market (given its ubiquity and potentially differing competitive conditions in BT+2, BT+3, and BT+4 or more exchanges).
    - ii. The remedy is of limited use for operators upgrading their networks to rollout 5G (and will provide very limited benefits to end users).  
[X]
    - iii. Expanding the remedy to all BT exchanges should have a limited impact on investment incentives for alternative providers using DPA (duct and pole access) remedies as these investments will mostly target the access tail market.
  - b. Ofcom's proposal to impose a CPI-CPI price cap on all Active Ethernet services should also apply to High Network Reach (HNR) areas given BT has SMP in this market.
    - i. This will provide BT customers certainty to plan their network using Ethernet connections in the short to medium-term without the risk of targeted price increases by BT.
    - ii. It should not reduce the investment incentives of alternative infrastructure providers as the prices of high bandwidth circuits in HNR areas are currently above FAC (fully allocated costs).
3. We acknowledge that Ofcom has a difficult task in striking the right balance between incentivising investment in alternative infrastructure and providing certainty to existing wholesale customers through its proposals in the PIMR and BCMR consultations. Our response is mindful of this delicate balancing act that Ofcom has to perform, and is premised on the assumption that Ofcom's proposed DPA remedies in the PIMR will be implemented. We note that if Ofcom does not mandate regulated access to BT's ducts and poles, our position on Ofcom's BCMR proposals would also change.

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# 1. Dark Fibre Access

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## 1. Introduction

- 1.1. We acknowledge Ofcom's argument that the implementation of a dark fibre remedy in both the access and inter-exchange markets and PIA (Physical Infrastructure Access) remedies simultaneously is not straightforward, as it may discourage investment by alternative infrastructure operators. Given this, we agree that the imposition of a dark fibre access remedy in the inter-exchange market (in combination with the unrestricted duct and pole access as proposed in the PIMR) should be prioritised over a nationwide dark fibre remedy since it:
- provides greater scope for differentiation in network architecture, allowing innovative network solutions (for example, network architecture based on loops rather than point-to-point could enable more efficient 5G deployment);
  - is consistent with Ofcom's strategy to introduce competition as far upstream as possible;<sup>1</sup> and
  - reduces the industry's reliance on BT, a direct competitor at the retail level, leading to potentially more effective competition at the retail level for both fixed and mobile services.
- 1.2. We also agree with Ofcom that applying a dark fibre remedy to the inter-exchange market will not affect the investment incentives of potential users of the PIA remedy. It is our understanding that the access tails of the backhaul network are more attractive to infrastructure providers using a PIA remedy than inter-exchange lines, as there is a larger market for these lines (they are more numerous than inter-exchange lines) and access tail line lengths are much shorter, reducing the costs to operators of deploying their own fibre.
- 1.3. We strongly support Ofcom's proposal to impose a dark fibre remedy in the inter-exchange market since, as Ofcom recognises in its Consultation document,<sup>2</sup> the imposition of the remedy would significantly reduce (or limit the increase in) the industry's backhaul costs compared to today, given the increase in backhaul capacity required with the rollout of 5G.<sup>3</sup>
- 1.4. However, as we discuss below, we believe Ofcom has erred in its assessment of BT's SMP in the inter-exchange leased lines market and has unduly limited the dark fibre access remedy to BT-only exchanges. In particular:

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<sup>1</sup> As set out in Ofcom's Strategic Review of Digital Communications: [Making Communications Work for Everyone: Initial conclusions from the Strategic Review of Communications, Ofcom 2016](#), Section 4.

<sup>2</sup> [Ofcom BCMR 2018, Volume 1](#) paragraph 10.17.

<sup>3</sup> Paragraph 4.10-4.11 of our response illustrate why this would be the case.

- Ofcom has failed to consider access-seekers need for ubiquity of service in the inter-exchange market.<sup>4</sup> This, combined with the limited prospect of effective competition in the inter-exchange market, means that the dark fibre inter-exchange remedy should be expanded to all BT exchanges.
  - Ofcom has failed to explain why it considers the competitive conditions in BT+2 exchanges to be the same as those in BT+3 or more exchanges. The reliance on bid data to argue that exchanges where 2 or more PCOs (Principal Core Operators) are present is competitive is not borne out by Three's market experience.
- 1.5. We also note that the scope of Ofcom's current proposed inter-exchange remedy has limited use for operators in upgrading their networks to rollout 5G (and hence will provide very limited benefits to end users). [3<]
- 1.6. Finally, by not proposing to impose quality of service requirements until the second year of the remedy, Ofcom runs the risk of allowing BT to degrade its quality so that it is not fit for purpose when it is most needed to construct 5G networks.
- 1.7. In the rest of this section, we set out our reasoning and evidence in support of these arguments.
- 1.8. We support the product market definition for inter-exchange connectivity as proposed by Ofcom. This should include CI services at all bandwidths following the product market definition for active CI services which we discuss this in more detail in Section 2.
- 2. BT has SMP in the provision of inter-exchange CI circuits nationwide, not just at BT-only and BT+1 exchanges**
- 2.1. We agree with Ofcom's assessment that BT has SMP in BT-only and BT+ 1 exchanges.
- BT, by definition, has a monopoly on the provision of inter-exchange lines in BT-only exchanges, allowing it to operate outside the constraints of competition. We agree that these exchanges are not prospectively competitive since other PCOs will not bear the considerable costs of extending their networks out to these exchanges (given the smaller number of these lines and longer line lengths which increase the costs to operators of deploying their own fibre.)
  - For BT+1 exchanges, the presence of vertically-integrated PCOs also risks discrimination against access-seekers given the incentive of these operators to favour their downstream arms. Similar to the case for BT-only exchanges,

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<sup>4</sup> We note that Ofcom does consider ubiquity to be an important factor in the CI market (see section 2) and in the market for physical infrastructure.

we also consider that additional PCOs will not bear the considerable costs of extending their networks out to these exchanges.

- 2.2. However, Ofcom has erred in its SMP assessment by not also considering the necessity for ubiquity of supply in inter-exchange circuits. This contrasts with Ofcom's analysis in its PIMR Consultation where it finds BT to have nationwide SMP based, in part, on the fact that operators require ubiquity of service to compete with BT in the provision of leased lines.
  - 2.3. When operators procure contracts for inter-exchange services, they do not make decisions on an exchange-by-exchange basis. Instead, they will look to purchase solutions in bulk, effectively contracting with an operator to connect a significant number of exchanges in one contract.
  - 2.4. Contracting with as few providers as possible reduces the operational difficulty associated with negotiating contracts and managing relationships with a number of different operators. In an ideal world, where all operators priced competitively, we might expect an operator to contract with only one service provider to eliminate this complexity. In reality, this does not happen since alternative operators tend to offer cheaper solutions to BT but do not have the same geographic reach. So, many operators, such as ourselves, must rely on a multi-provider arrangement.
  - 2.5. In this context, it is clear that the presence of multiple operators at a particular exchange is not sufficient for it to be considered effectively competitive. If these alternative operators only offered services from a limited number of exchanges, they would not represent an effective constraint on BT's market power since BT knows that it is not in danger of losing access customers at a significant number of exchanges to these alternative operators even if it increases prices and/or reduces quality of service beyond competitive levels.
  - 2.6. In its analysis, Ofcom finds that BT is the only PCO present in 78% of its exchanges (4,327 of its 5,573 exchanges). This indicates that other operators will only impose a very weak nationwide competitive constraint on BT. The presence of multiple PCOs in individual exchanges does not provide sufficient competitive constraint on BT nationally.
  - 2.7. Ofcom should, therefore, find BT to have SMP in the market for inter-exchange services in all of its exchanges.
- 3. Ofcom has failed to explain why it considers the competitive conditions in BT+2 exchanges to be the same as those in BT+3 or more exchanges**
- 3.1. We also note that the competitive conditions in BT+2 and BT+3 or more exchanges will likely be different and find that Ofcom has not sufficiently justified its conclusion, to the contrary, that these competitive conditions will be the same.

- 3.2. In its 2017 Temporary Conditions<sup>5</sup>, Ofcom considered the inter-exchange market to be effectively competitive at exchanges where:
  - BT plus three or more PCOs (either directly or indirectly connected) are present; or
  - BT plus two directly connected PCOs are present.
- 3.3. Ofcom gives no reason for deviating from this approach in this Consultation and not explicitly comparing the competitive conditions in BT+2 exchanges with BT+3 exchanges. We would expect Ofcom to justify such a change of approach.
- 3.4. We do not have access to the information to carry out our own assessment of the competitive conditions in BT+2 versus BT+3 exchanges. However, Ofcom's reasoning for considering BT+2 exchanges to be effectively competitive in the market for inter-exchange lines is not persuasive and lacks evidentiary basis.
- 3.5. Ofcom argues that where more PCOs are present in an exchange, BT faces more competitive pressure from increased choice of supplier and a reduced chance of collusion. As we discuss above, we do not believe this to be true since access-seekers require ubiquity of service and, therefore, BT's SMP is not constrained by PCOs which connect to a very limited number of exchanges.
- 3.6. We also see no evidence to suggest that the presence of two alternative providers is necessarily the threshold at which an exchange becomes effectively competitive. Ofcom does not explain why the threshold could not, instead, be at three or four PCOs.
- 3.7. The evidence which Ofcom appears to exclusively rely on to place the threshold at BT+2 rather than BT+3 providers is that access-seekers typically seek three bids to obtain a competitive price. This is not our experience. When tendering for a contract, there is no specific number of bids we aim to receive, and receiving three bids does not mean that the price obtained is competitive.
- 3.8. What is important is that the responses are relevant (for example the bids cover multiple exchanges) and that, where possible, we have a choice of operators. We, therefore, do not agree with Ofcom's assessment that exchanges where two or more PCOs are present are effectively competitive based on the number of bids that could be received for services provided in that exchange.
- 3.9. Ofcom should undertake analysis of BT+2 exchanges to determine whether, as before, BT has SMP in the provision of inter-exchange lines from these exchanges. A finding of SMP in these exchanges would, at a minimum, justify Ofcom extending the inter-exchange dark fibre remedy to include these exchanges for the same reasons for BT+1 exchanges as discussed below.

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<sup>5</sup> [BCMR Temporary Conditions](#)

### 4. The scope of Ofcom's dark fibre remedy should be expanded beyond BT-only exchanges

- 4.1. As we discuss above, we consider that BT has SMP in the provision of inter-exchange circuits in all exchanges. As such, the inter-exchange remedy should be expanded to apply to all BT exchanges.
- 4.2. Even if Ofcom were to continue in its view that BT+2 or more exchanges were effectively competitive, we still consider that it should expand the remedy to include BT+1 exchanges.
- 4.3. In not applying its proposed dark fibre remedy to exchanges where it has found BT to have SMP, Ofcom appears to instead rely on the DPA remedy to bring competition to these exchanges in the future or, failing that, wait for the conclusion of the two-year market review period to assess whether it should impose the remedy at a later date in the event that infrastructure competition does not arise.
- 4.4. Ofcom recognises that it is being conservative in its approach<sup>6</sup>. We find the approach to be unnecessarily cautious for two reasons:
  - There is no prospect of effective competition in the inter-exchange market.
  - Expansion of the remedy would allow operators to use dark fibre in their aggregation networks.
- 4.5. Ofcom's current approach also has limited use for operators in upgrading their networks to rollout 5G (and hence will provide very limited benefits to end users). For example, [§<].

#### *There is no prospect of effective competition in the inter-exchange market*

- 4.6. Our assessment is that the DPA remedy will not have the effect of bringing effective competition to the inter-exchange market, at least in the short to medium-term, since effective competition depends on alternative providers being able to offer ubiquity of service. We also understand that infrastructure providers are likely to focus their deployment on the more lucrative access tails of the network rather than invest substantial amounts of money in deploying fibre over large distances as would be required to enter the inter-exchange market.
- 4.7. Ofcom's analysis of BT+1 exchanges shows that the average straight line from these exchanges to the nearest unconnected rival is over 1.5km. Given the substantial costs involved in deploying fibre, this cost is likely to be prohibitive and restrict entry, even with a DPA remedy. Although rival networks in BT+2 and more areas are likely to be closer to the exchanges on average, there will

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<sup>6</sup> [Ofcom BCMR 2018](#), paragraph 12.77.



remain substantial barriers to entry for additional PCOs which might try to connect to these exchanges as well.

*Expansion of the remedy would allow operators to use dark fibre in their aggregation networks as they re-plan their networks to allow for the increased data requirements of 5G technologies*

- 4.8. We are currently re-planning our transmission network so that it better suits the requirements of 5G. In doing so, we are in the process of:
- [REDACTED]
  - [REDACTED]
- 4.9. Figure 1, below, gives a high-level illustration of how these different elements of our transmission network fit together. The area highlighted in grey, our 'Aggregation Network', is that which is relevant to Ofcom's proposed inter-exchange dark fibre remedy.

Figure 1: [REDACTED]

- 4.10. The motivation behind unbundling BT exchanges in our aggregation network is that it will allow us to move away from relying on BT's managed MEAS product for our transmission services. This will mean that our backhaul costs would no longer be directly determined by traffic levels, leading to cost reductions as well as technical benefits.
- 4.11. An appropriately applied dark fibre remedy could decouple our costs from the capacity on our network and eliminate the ability of BT to set excessive prices for inter-exchange dark fibre. This is particularly important to all mobile operators in the context of 5G since network traffic is predicted to increase substantially with its deployment<sup>7</sup>. For example, [REDACTED].
- 4.12. This gives an illustration of the substantial cost savings we can achieve from access to dark fibre for our backhaul services compared to a managed product. This reduction in costs could allow us to increase investments elsewhere and pass-on some of these cost savings to our customers.
- 4.13. Greater control over our aggregation network would also result in technical benefits. It would give us greater control over the traffic on our network and allow us to make changes to our network structure more quickly and efficiently than we are currently able to.
- 4.14. [REDACTED]

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<sup>7</sup> Ofcom estimates in its [Mobile Data Strategy](#) document that mobile data usage will be approximately 13 times as large in 2025 as it was in 2017

4.15. However, as set out in Table 1 below, the proposed inter-exchange remedy has limited usefulness in its current form. [X]

4.16. [X]

**Table 2:** [X]

4.17. Therefore, Ofcom's proposal to not impose a dark fibre remedy on inter-exchange services more widely, despite BT having SMP and there being no prospect of effective competition in the foreseeable future, would substantially increase our 5G rollout costs relative to the case where it did impose regulation in these areas. This will affect our ability to offer a viable 5G proposition as it will make it more difficult for us to move away from our current arrangements (relying on managed services) in which costs are more closely determined by traffic levels.

4.18. To maximise the effectiveness of the remedy, Ofcom should expand it to include all BT exchanges where it finds BT to have SMP. Our view is that this should be all exchanges.

### **5. We agree with Ofcom's assessment that the risks of the dark fibre remedy are outweighed by the benefits**

5.1. We strongly support Ofcom's decision to impose a dark fibre remedy on inter-exchange services as it is clear to us that the benefits of the remedy easily outweigh any risks.

5.2. We agree with all of Ofcom's identified benefits of dark fibre. In particular, the costs to us of purchasing a dark fibre remedy from BT compared to a managed service are substantially lower as we have set out above in paragraph 4.11.

5.3. Similarly, we agree with Ofcom's assessment that the potential risks associated with imposing a dark fibre remedy are limited. However, we consider that the potential risk in relation to investment in competing infrastructure is overstated.

5.4. In particular, Ofcom overstates the risk that a dark fibre remedy could deter competitors from investing in their own networks to connect to exchanges. We discuss our view that Ofcom has been overly cautious in its assessment on this above in paragraphs 4.6-4.7.

5.5. As we discuss below, in paragraphs 6.4-6.5, we also agree that maintaining BT's bandwidth gradient is not necessary for it to recover its common costs so the dark fibre remedy has no impact on BT's ability to recover its costs.

### **6. We agree that the price of the Dark Fibre remedy should be charge-controlled**

6.1. We agree that Ofcom's approach to charge controlling the price of inter-exchange services to FAC where the remedy is imposed to be reasonable. As

discussed above this dark fibre remedy should be expanded to include all BT exchanges.

- 6.2. As Ofcom recognises, BT has both the incentive and ability to set excessive prices in areas where it has SMP. Other measures to restrict its ability, such as requirements to not unduly discriminate, would be insufficient and could possibly lead to costly and time-consuming disputes. We, therefore, welcome Ofcom's decision to impose a charge control and believe it should be expanded to all BT exchanges as BT will have SMP in all exchanges in the inter-exchange market.
- 6.3. We also agree with Ofcom that a cost-based charge control should be imposed rather than one based on the prices of active products. This will promote allocative efficiency by ensuring that prices are kept close to costs and, as Ofcom recognises, a future move away from active regulation would mean that an active-minus approach would only be a short-term solution as there would potentially be no active product to reference in the future.
- 6.4. Furthermore, we support Ofcom's view that, in setting a price control on inter-exchange services, it is unnecessary to preserve the bandwidth gradient for BT to recover its common costs. We see no evidence to suggest that the current bandwidth gradient allows BT to recover its common costs more efficiently than any other cost allocation.
- 6.5. Even if returns on high bandwidth circuits were required for BT to recover its costs, we do not consider that the inter-exchange dark fibre remedy would affect this. This is because the extra capacity required to carry 5G traffic means that all mobile operators will be migrating from [3x] leased lines to at least [2x] in many parts of their access networks. We would, therefore, expect volumes of higher bandwidth services to substantially increase in the future. BT earns greater returns on these lines so we would expect this migration to maintain, or even increase, the returns BT makes on the sale of high bandwidth services, even if it were to lose the revenues from some active services to a limited number of dark fibre access seekers in inter-exchange markets.
- 6.6. We also note that maintaining prices above FAC in the inter-exchange market will not be useful because, as Ofcom identifies, there is no prospect of infrastructure competition in these markets.

### **7. The imposition of quality of service requirements should not be delayed**

- 7.1. We welcome Ofcom's proposal to impose quality of service requirements on BT's inter-exchange dark fibre product to ensure that BT does not degrade its quality for all access purchasers. However, given the potential importance of the dark fibre remedy to the network structure of 5G networks (particularly if it is expanded to include further exchanges), quality of service requirements should be imposed right from the outset, rather than in the second year of implementation.

- 7.2. Given its SMP in inter-exchange services and retail operations (in both mobile and fixed markets), BT has both the incentive and ability to degrade the dark fibre product either for all purchasers or for some direct competitors. The no undue discrimination requirement that Ofcom is proposing will not remedy BT's ability and incentive to degrade the dark fibre product for all purchasers.
- 7.3. If Ofcom considers that it would be burdensome to impose quality of service penalties on BT in the early stages of the dark fibre remedy as it is a nascent product, then a more appropriate approach is to reduce the financial penalties in the early months of implementation and increase them gradually over time. This would help to deter BT from degrading the quality of the dark fibre product while ensuring that it is not unfairly punished for unavoidable quality of service transgressions while the remedy is still in its early stages.
- 7.4. We, however, question whether this dark fibre should be considered a 'new service' given the fact that BT should have been preparing to supply a dark fibre product for several years (given Ofcom's proposals in its previous consultation documents).

## 2. Regulated Access Services

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### 8. Introduction

- 8.1. As with dark fibre, we recognise that Ofcom's approach to regulating active services needs to ensure that investment incentives for alternative infrastructure providers are not harmed. At the same time, it is also clearly important that BT is unable to leverage its SMP to set excessive prices for operators like Three which rely on purchasing BT Ethernet services, at least in the short-medium term, while alternative infrastructure is being deployed.
- 8.2. Given this, we consider that Ofcom's proposed CPI-CPI safeguard cap on active services represents a reasonable trade-off between the interests of alternative infrastructure providers and access-seekers. However, we consider that Ofcom should:
  - expand the active remedy to HNR (High Network Reach) areas (with BT+2 or more PCOs) given that BT may have the incentive to selectively increase prices in areas where it is currently given flexibility (perhaps to subsidise a price cut elsewhere); and
  - Actively monitor that BT does not introduce targeted price reductions to deter potentially competitive entry, and be ready to intervene immediately if BT engages in anti-competitive price-setting.
- 8.3. The rest of this section sets out our assessment of Ofcom's proposals for Active Services.

### 9. We agree that there is a single product market for CI services at all bandwidths

- 9.1. We agree with Ofcom that there is supply-side substitution between leased lines services at all bandwidths. As Ofcom recognises, this is the case since the same physical infrastructure is used to provide leased lines services of all bandwidths and all that differs is the electronic equipment at the ends of the lines (and, sometimes, this equipment is the same for different bandwidths). Therefore, a competitor connected to a BT exchange should be able to respond quickly and cheaply and supply different bandwidths of the leased lines services were BT to increase prices of a particular bandwidth (following the SSNIP framework).
- 9.2. Where competing suppliers do not have an existing connection to a BT exchange, we also agree that the bandwidth of the leased line will not determine their incentives to dig to the exchange to offer their own services in response to a SSNIP.
- 9.3. We have previously provided evidence to Ofcom on demand-side substitution between different bandwidths<sup>8</sup>. [X] This indicates significant demand-side substitution between bandwidths in the market for Ethernet leased lines.

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<sup>8</sup> [X]

- 9.4. Based on these factors, we strongly agree with Ofcom that there is a chain of substitution linking leased lines of all bandwidths.

### **10. We also agree with Ofcom's assessment that BT has SMP outside of the CLA**

- 10.1. It is evident that BT has SMP in the provision of leased lines in BT-only and BT+1 areas for the following reasons:

- Ofcom's market share analysis indicates that BT holds a dominant position.
- Ofcom's analysis of the presence of rival infrastructure shows that it is insufficient to serve as a competitive constraint on BT in these areas.
- There are high and non-transitory barriers to entry derived from substantial sunk costs, switching costs and the ubiquity of BT's network. These mean that other operators will be prevented from entering these areas to constrain BT's SMP.
- The lack of alternative operators means that customers do not have sufficient choice to exert any countervailing buyer power on BT.

- 10.2. We also support Ofcom's finding that BT has SMP in the HNR areas of the UK based on the following reasons:

- BT's market share in these areas is above 40% and, in most cases, above 50%.
- BT's proximity to customer sites and customer sites being connected to existing BT ducts.
- High and non-transitory barriers to entry derived from substantial sunk costs, switching costs and the ubiquity of BT's network. These mean that other operators will be prevented from entering these areas to constrain BT's SMP.
- Insufficient countervailing market power as individual customers do not have sufficient volumes to exert a significant competitive constraint on BT even where alternative networks are available. This is particularly the case given that these customers will typically buy their circuits either nationwide or, at least, broader than at the postcode sector level.

- 10.3. We agree with Ofcom that BT does not have SMP in the CLA (Central London Area) given the level of infrastructure competition in this area and the density of customers.

### **11. Ofcom's proposal to impose a CPI-CPI safeguard cap on active products represents a reasonable trade-off**

- 11.1. We consider that Ofcom's proposal to impose a CPI-CPI safeguard cap on the prices BT can set for active products of all bandwidths in non-HNR areas is a reasonable measure which should preserve the investment incentives of alternative infrastructure providers while giving certainty to access-seekers that BT will not be able to increase these prices in the future.

- 11.2. We will continue to purchase active services from BT in the short to medium-term as we wait for operators to deploy their networks in response to Ofcom's DPA remedy. The bandwidths of many of these circuits will need to increase from [x] to [y], and potentially beyond, as the traffic demands of our customers do.

## Regulated Access Services continued

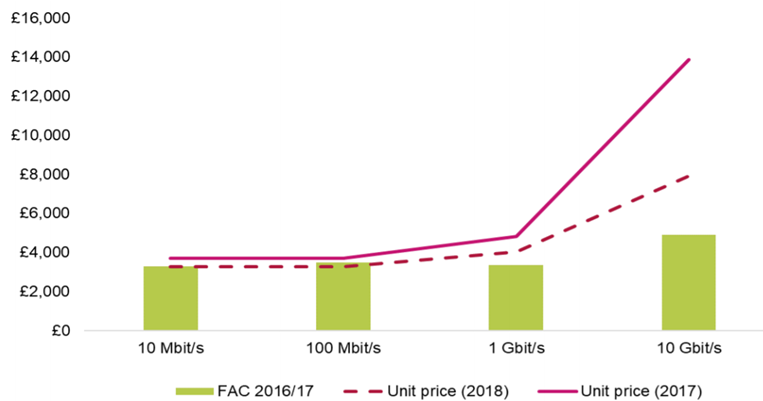
11.3. Although it is in our short-term interests for the prices of these circuits to be cost-reflective, we appreciate that this is unlikely to be consistent with the long-term aim of incentivising deployment of alternative infrastructure. We support this long-term aim as we consider competitive infrastructure deployment will:<sup>9</sup>

- decouple our costs from capacity by allowing us to purchase dark fibre from alternative operators;
- lead to a move away from point-to-point backhaul network architectures, allowing us to structure our 5G network more efficiently;
- reduce our transmission costs via competition;
- further reduce our transmission cost through equipment cost, power and space savings; and
- give us greater control over our network, potentially allowing us to offer improved and differentiated services to our customers.

11.4. We note that Ofcom's analysis (as shown in Figure 1, below) shows that the prices BT currently sets for its sub 1Gbit/s active products are close to its fully allocated costs. This is unsurprising as historic charge controls will have restricted BT's ability to price above cost.

11.5. We also note that there is a differential between prices and fully allocated costs for 10Gbit/s circuits, this differential has reduced over the past year. This gives us some confidence that the proposed CPI-CPI cap on high bandwidth services will not be set at a level which is excessively above cost.

**Figure 1: EAD prices and fully allocated costs**



Source: Ofcom BCMR 2018, Figure A7.2

<sup>9</sup> We discuss these factors in more detail in our response to Ofcom's PIMR Consultation.

### **12. Ofcom's proposed safeguard cap should be extended into HNR areas**

- 12.1. Although we consider Ofcom's proposed approach to setting a safeguard cap in non-HNR areas to be reasonable, it should be extended to also include HNR areas.
- 12.2. Ofcom has found BT to have SMP in HNR areas given its high market share and competitive advantage from being closer to a significant proportion of customer sites. It also considers that this position is unlikely to change over the market review period due to high barriers to entry and expansion and limited prospects for potential competition. We agree with this assessment.
- 12.3. Given this SMP, we would expect BT to have the ability to set excessive prices in these areas if it so wished. Although, in practice, BT may not always have the incentive to increase prices in all of these areas, there is still a risk that it may do so absent any regulation. For example, Ofcom recognises that it could do so to subsidise targeted price reductions in particularly competitive areas.
- 12.4. Extending Ofcom's proposed safeguard cap to HNR areas would eliminate the risk of BT pricing excessively and give BT customers certainty that they can plan their network using Ethernet connections in the short to medium-term without the risk of targeted price increases. At the same time as the prices of high bandwidth circuits in HNR areas are above cost (see Figure 1), extending a CPI-CPI safeguard cap to these areas should not reduce the investment incentives of alternative infrastructure providers.

### **13. Ofcom should provide guidance on what might constitute predatory pricing for leased lines circuits**

- 13.1. BT could set its prices in some areas to preclude market entry by prospective infrastructure providers. Such a targeted pricing strategy would ordinarily be dealt with under competition law if it was predatory pricing.
- 13.2. However, such an approach may not be effective in this instance as the time taken to assess and come to a decision on potential predatory activity which restricts market entry is complicated and can take a long time. Therefore, a targeted price reduction, or threat of such a reduction, can have the desired effect of preventing market entry or expansion while the matter is being investigated. Ofcom's investigation into Royal Mail's anti-competitive pricing activity illustrates this problem.<sup>10,11</sup>
- 13.3. Ofcom could respond to this by setting price floors on Ethernet products at a level that it considers to be reasonable. However, given the complexities in identifying the correct cost standard and then estimating an appropriate price floor, such an approach would be time consuming, might require a subsequent consultation, and, therefore, delay implementation of Ofcom's BCMR proposals to the detriment of 5G deployment in the UK.
- 13.4. An alternative would be, at this stage, for Ofcom to publish broad guidance on how it might assess any claims of predatory pricing in the future, and, what the appropriate cost standard would be to use in such an assessment.

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<sup>10</sup> Although Royal Mail was eventually found to have behaved anti-competitively, the uncertainty associated with Royal Mail's 2014 Contract Charge Notices lead to Whistl delaying planned investments and subsequently leaving the market.

<sup>11</sup> [Ofcom's Infringement Decision against Royal Mail, 2018](#)