



**Virgin Media's Response to Ofcom's Consultation on Non-Domestic Rates and the Price for Regulated Dark Fibre**

**22 May 2017**

**Non-Confidential version**



## INTRODUCTION AND SUMMARY

Virgin Media welcomes the opportunity to comment on Ofcom's consultation on Non-Domestic Rates (“NDRs”) (the “**Consultation**”) and the price for regulated Dark Fibre. As the second largest infrastructure provider in the UK, Virgin Media has an obvious interest in the outcome of this Consultation.

Virgin Media has consistently argued against the imposition of the Dark Fibre Access (DFA) Remedy on the basis that it will undermine existing and growing competition for high bandwidth leased lines [3<]. Virgin Media also intervened in support of BT's appeal of the Business Connectivity Market Review on this point.

Given Ofcom's decision to impose the DFA remedy, the price for regulated Dark Fibre is of key importance to Virgin Media. In Virgin Media's opinion the proposals in the consultation:

- are inadequate to address the issues identified in the CMA determination;
- introduce discrimination between different market participants; and
- do not adequately address the consequential impact of the CMA's determination on the reasoning in the BCMR and, in particular, the cost benefit analysis of imposing the DFA Remedy .

Virgin Media is concerned that Ofcom has rushed through the NDR consultation to allow the DFA Remedy to be introduced on the 1 October 2017. In its haste, Ofcom has failed to consider relevant issues and has failed to carry out a proper consultation.

We have chosen to focus on four key issues in this response:

- (a) Ofcom has failed to consider the incentives for different CPs to take up the DFA Remedy in light of the proposed NDR adjustment;
- (b) Ofcom has not considered whether Virgin Media will be disadvantaged by the proposed NDR adjustment;
- (c) Ofcom's analysis of the impact of the NDR adjustment on the benefits and risk of the DFA Remedy is clearly inadequate; and
- (d) any decision by Ofcom in relation to the NDR adjustment will represent a new decision in relation to the entirety of the BCMR statement. On this basis it is clearly inappropriate for the DFA Remedy to be introduced on 1 October 2017.

Each of these points is addressed in more detail below.



## INCENTIVES TO TAKE-UP THE DFA REMEDY

The CMA's determination in relation to TalkTalk's appeal of the BCMR Statement has found that Ofcom's original analysis of NDRs was flawed. In setting the DFA price with a deduction to reflect BT's NDRs, Ofcom failed to have regard for the different NDRs paid by other CPs.

Ofcom's current consultation aims to address the difference in NDRs by setting a new DFA price for those CPs whose NDRs are calculated using the Direct Rental Comparison Method.

However, Ofcom has failed to give proper consideration to the impact of this change on the incentives for different CPs to take-up the DFA Remedy. There are a number of situations where a CP taking the DFA Remedy will either be over or under compensated compared to the NDR they actually pay.

**First**, Ofcom has set the NDR adjustment on the basis of the median circuit length. This will distort CPs incentives to take-up dark fibre for different circuit lengths. In relation to circuits that are less than 1.9km in length CPs will have a greater incentive to take-up dark fibre as the NDR CPs actually pay will be less than the NDR adjustment included in the DFA price. However, for circuits in excess of 1.9km there will be a reduced incentive to take-up dark fibre as the NDR CPs actually pay will be greater than the NDR adjustment included in the DFA price.

**Second**, Ofcom has set the NDR adjustment on the basis of CPs with in excess of 1,000km of existing fibre. CPs with smaller networks of existing contiguous fibre will have a reduced incentive to take-up dark fibre as the NDRs they pay will be higher than the NDR adjustment included in the DFA price. Ofcom has claimed that *"several potential users of the dark fibre service already have networks of over 1,000km or are currently purchasing large volumes of active products from BT that could at some point in the future be converted to dark fibre."*<sup>1</sup> However, it is likely that there are CPs that currently have fibre networks smaller than 1,000km that will not be fully compensated for the NDRs.

**Third**, the revised NDR adjustment will increase CPs incentives to aggregate circuits using the DFA remedy. Under Ofcom's proposals CPs whose NDRs are calculated using the Direct Rental Comparison Method will pay a lower DFA price than forecast in the BCMR Statement. In addition, Ofcom has relaxed the LLCC to allow BT to recover its efficiently incurred costs, which will result in higher active prices across all bandwidths. Accordingly, if Ofcom goes ahead with its proposals the relative price difference between lower bandwidth circuits and dark fibre will reduce and CPs will have a greater incentive to aggregate multiple lower bandwidth circuits using a single DFA circuit.

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<sup>1</sup> Consultation Paragraph 2.16.



## **VIRGIN MEDIA MAY BE DISADVANTAGED**

Ofcom is only proposing to modify the DFA price for CPs whose NDRs are assessed under the Direct Rental Comparison Method. Therefore, CPs whose NDRs are assessed using the Receipts and Expenditure method (BT, Virgin Media and KCOM) will continue to pay the same price for dark fibre.

This is on the basis that Ofcom's original approach provides a reasonable proxy for NDRs payable by those CPs when they light new fibres.<sup>2</sup> However, this gives no consideration as to whether all CPs assessed using the Receipts and Expenditure method pay the same NDRs for lighting a fibre.

As Ofcom explains, under the Receipts and Expenditure method all contiguous rateable assets, including fibre, are valued together. Therefore, whilst BT and Virgin Media are assessed using the same methodology there is no reason to believe that they will pay the same NDRs. Ofcom has provided no analysis or evidence to support the conclusion that all CPs assessed under the Receipts and Expenditure method will pay the same NDRs.

In addition, there is no consideration given by Ofcom as to the reasons for the purchase of DFA. If a circuit is being purchased for resale as part of a wholesale solution, then Virgin Media is clearly disadvantaged as the supply of the wholesale DFA circuit to the end customer will be at a higher cost price than if that end user had purchased the identical circuit from a CP assessed under the Direct Rental Comparison method. If the liability for NDR falls on the end user, then this would appear to be a stark example of a competitive distortion in the market directly created by Ofcom's proposed approach to DFA pricing.

## **OFCOM'S ANALYSIS IS INADEQUATE**

The impact of the DFA is accepted by Ofcom as having distinct costs as well as identified benefits, as set out in the BCMR statement. In particular, the design of the DFA remedy is accepted as impacting investment incentives of network building CPs, including Virgin Media. The result of Ofcom's further review of DFA pricing following the CMA decision is to propose an additional reduction to the price of DFA for qualifying CPs. Despite the extensive consideration of the DFA remedy within the BCMR statement itself (which ran to over 800 pages, excluding its 35 annexes), and noting that this is sufficiently contentious to have resulted in appeals of the decision to the CAT, the proposed adjustment to DFA pricing is considered in just 12 pages of Section 2 to the consultation (which include setting out the background as to how NDRs are charged to various CPs).

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<sup>2</sup> Consultation Paragraph 2.10.



It is notable in its lack of detail; as a consequence of Ofcom's intent to only make adjustments that are "simple and practical"<sup>3</sup>, Virgin Media considers that Ofcom has proposed an over simplistic approach which does not address the CMA's concerns or properly consider relevant consequential effects. On a number of occasions Ofcom simply refers to assumptions that are not adequately reasoned, "no reason to expect a material change"<sup>4</sup>; "we believe this represents an efficient scale"<sup>5</sup>; "we believe that the median is more representative than the mean"<sup>6</sup>; "for simplicity we propose to assume"<sup>7</sup>; we do not believe there should be a systemic difference"<sup>8</sup>.

The analysis in the BCMR statement was based on the underlying assumption that it would be cost neutral for a CP to switch between a 1Gbit/s active product and the DFA Remedy. Ofcom has given no consideration as to whether this assumption is still appropriate where a CP taking the DFA Remedy will be either over or under compensated as outlined above. The potential for a CP to be over or under compensated should have caused Ofcom to revisit other assumptions in the LLCC<sup>9</sup>, and in particular, the assumptions as regard the expected uptake of dark fibre as set out in the BCMR statement.

The short period to respond to a consultation with a notable lack of detail leaves stakeholders in the dark about the appropriateness or otherwise of the proposal, something which is unacceptable given the acknowledged risks in introducing new and disruptive regulation to a market.

It is notable that the CMA in their determination considered that Ofcom may well not be able to achieve the task of appropriately considering the determination and proposing amendments to the regime to ensure that it was fully reflective<sup>10</sup>, especially given that the remedy continued to be under review in the wider CAT proceedings from which the original reference to the CMA was made.

In light of the CMA's comments it seems wholly inappropriate to attempt a quick fix simply to maintain the 1 October 2017 launch date for the DFA Remedy.

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<sup>3</sup> Consultation Paragraph 2.13

<sup>4</sup> Consultation Paragraph 2.61 : in relation to the balance of benefits and risk

<sup>5</sup> Consultation Paragraph 2.16

<sup>6</sup> Consultation Paragraph 2.27 : in relation to circuit lengths

<sup>7</sup> Consultation Paragraph 2.35

<sup>8</sup> Consultation Paragraph 2.37

<sup>9</sup> Consultation Paragraph 2.44

<sup>10</sup> CMA Final Determination para 6.19 "...it may not be feasible for Ofcom to complete the process of redesigning the DFA remedy prior to 1 October 2017, in particular given that the DFA remedy is subject to separate review in the CAT"



## **NDR DECISION IS A NEW DECISION FOR THE BCMR REVIEW**

Virgin Media considers that Ofcom has failed to take account of the consequences of making a new decision which arises from the CMA determination.

The new decision that Ofcom proposes to make following the CMA's determination is one that would itself be appealable under the Communications Act, and would leave the industry in a further state of uncertainty regarding the DFA remedy.

Further, the rushed nature of Ofcom's proposed approach is inconsistent with the original appeal that generated the need for a reassessment. The appeal by TalkTalk in relation to the NDR adjustment was made to the CAT, as an appeal against Ofcom's BCMR statement. TalkTalk's appeal was made alongside other appeals by BT and CityFibre. TalkTalk's element of the appeal, as a price control issue, was referred to the CMA. The CMA remittal is to the CAT, and the CAT has yet to issue any form of judgment or direction in relation to the appeals such that Ofcom is carrying out its Consultation in the absence of any remittal by the CAT.

The introduction of DFA is a highly controversial remedy, and the current appeals before the CAT could give rise to a requirement for it to be withdrawn or reconsidered. In circumstances where the DFA Remedy had already started to be implemented prior to such an outcome, this would be a highly complex and difficult task, with no guarantee that the competitive landscape that existed prior to DFA could be restored.

## **CONCLUSION**

In conclusion, Virgin Media considers that the proposals put forward by Ofcom (i) do not adequately address the issues identified in the CMA determination (ii) introduce discrimination between different market participants (iii) do not adequately address the consequential impact of the CMA's determination on the reasoning in the BCMR and (iv) would result in further uncertainty in relation to the DFA Remedy. Virgin Media considers that whilst the determination of the CMA does require action on the part of Ofcom, it is not appropriate to rush this through (particularly in the absence of any express direction from the Tribunal), and this, in turn, calls into question the appropriateness of the introduction of DFA on 1 October 2017. In light of the concerns expressed here in relation to the NDR adjustment; the on-going uncertainty that surrounds the nature of the DFA remedy (both from any proposed adjustment to the NDR, and in the context of the wider appeal), it must only be appropriate for the introduction to be delayed to



a time when more stable regulatory underpinnings exist, in order that industry can know what they are buying, and what will be available to buy.

**Virgin Media**

**22 May 2017**