Response to Ofcom consultation:
Existing Openreach FTTP offers with geographic pricing

INCA, Zzoomm, County Broadband, Full Fibre, Truespeed, WightFibre, and Airband.

April 2021

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1 Executive summary

1. The respondents[1] are pleased to present their response to Ofcom's consultation on existing Openreach discount offers[2], namely:

- The GEA Volume Offer
- The FTTP Only Offer V2, and
- The Local Marketing Offer

2. In the WFTMR, Ofcom has introduced a new and strengthened *ex-ante* competition framework to prevent Openreach from engaging in pricing and other commercial terms that could cause harm to the investment in and deployment of competitive fibre networks. That framework addresses two categories of commercial terms:

- geographic pricing, and
- other commercial terms (OCTs)

3. We are disappointed and very concerned at the cursory nature of Ofcom's assessment of the three offers. Ofcom's assessment of all three offers takes up a total of less than 5 full pages in the consultation document and, essentially, appears to consider Openreach's justifications only. And that without any critical assessment.

4. In the wholesale fixed telecoms market review final statement (WFTMR), Ofcom states clearly that, for provision of consent to geographic pricing (which is the exception against a general rule of prohibition), it will consider two parameters:

- whether Openreach can objectively justify the offer, **and**
- whether the offer is consistent with Ofcom's overarching objective of encouraging investment in competing fibre networks. [Emphasis added]

[1] INCA, County Broadband, Zzoomm, Full Fibre, Truespeed, Wight Fibre and Airband.
[2] The three offers.

5. This consultation does neither!

Transparency and certainty

6. Ofcom argues in the WFTMR that an *ex-ante* competition framework is essential to provide transparency and certainty, but this consultation provides neither. If anything, it increases uncertainty and regulatory risk by granting consents to offers that appear able to have clear and significant negative impacts on investment in and development of competitive fibre networks.

7. We have developed a transparent assessment framework, that is consistent with Ofcom's WFTMR statement and which would provide clear and transparent analysis of the relevant offers to justify the granting of consent, or not.

8. Our assessment framework is anchored in international good practice, accepted and accredited academic research, and decisions by the European Court of First Instance (CFI).

9. Applying our framework to the three offers, we identify significant concerns, but we cannot perform a full analysis as we do not have access to the necessary data. Ofcom does and Ofcom must apply a transparent analytical framework, or its promise of transparency and certainty will prove empty and meaningless.

Separate analyses for individual relevant markets

10. Further, in the WFTMR, Ofcom identified a number of different product and geographic markets. For the services covered by the three offers, there are two geographic markets (Area 2 and Area 3), which Ofcom has identified due to its conclusion that the competitive conditions in the two areas vary sufficiently to justify different regulatory approaches.

11. For the assessment of the three offers, however, Ofcom has not performed separate assessments for each of these markets. We consider this to be a significant error at both the substantive and procedural level. We urge Ofcom to redo its analyses and present them for each relevant market.

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No analysis of 'other commercial terms'

12. We are also very disappointed to see that Ofcom has only reviewed whether the three offers are in breach of Ofcom's new rules on geographic pricing ignoring whether those offers may be in breach of the conditions relevant to OCTs.

13. In response to a query, Ofcom has stated that it has undertaken the geographic pricing analysis only as that is the only criterion under which the offers would be prohibited in the absence of express consent by Ofcom. Ofcom stated that any concerns in relation to the OCT rules should be submitted to Ofcom separately.

14. We disagree strongly with Ofcom's approach and, in this response, we have included an assessment framework for the review of OCTs. We have also assessed the three offers against Ofcom's OCT criteria, using our transparent assessment framework, and found that there are very significant concerns that the three offers are in fact in breach of those criteria and should be discontinued.

15. As we do not have access to the detailed data to perform a full analysis of the OCTs, we urge Ofcom to do so as quickly as possible so that the significant investment deterrent effects we have identified can be stopped before they cause further harm.

Significant error on duration of two offers

16. In the consultation Ofcom states that the FTTP Only Offer v2, discounts run until 30 September 2022,[3] and that the Local Marketing Offer discounts run until 30th September 2022.[4]

17. However, on reading the description we note that it provides for prices to be adjusted by CPI after those expiration dates – not a reversal to standard list prices. We queried this with Ofcom; it became clear that Ofcom was not aware of this and had to consult Openreach before being able to respond. Below is the email text received from Ofcom on April 29th 2021 (the formal deadline for responding to the consultation):

[3] Consultation paragraph 3.16.
[4] Consultation paragraph 3.24.

"Having been in contact with Openreach, we can confirm that to be eligible for inclusion in the Local Marketing Offer or FTTP only offer v2, FTTP orders need to be placed by 30 September 2022. For the period until 30 September 2022, the rental prices under each offer are specified on Openreach's website. After this point, rental prices for FTTP connections included under either offer are subject to a maximum CPI increase up to 31 March 2025 for FTTP only offer v2, and up to 30 September 2026 for Local Marketing Offer respectively."[5]

18. This is very significant and effectively means that both offers will run for the duration of this 5-year review period. We believe that Ofcom must retract its proposal to grant consent for both of these offers and redo its analysis to take account of the much longer duration of the offers.

<u>Ofcom's analyses and recommendations are unsound and must be retracted</u>

19. It is our hope that this consultation is an exception and that it does not set a precedent for how Ofcom plans to undertake assessments of Openreach proposals for geographic pricing and/or OCTs in the future. We urge Ofcom to retract its proposal to consent to the continuation of the three offers, redo its analysis and present its recommendations in a transparent manner that can provide the transparency and certainty promised in the WFTMR.

[5] email from Keith Hatfield to Gita Sorensen , dated and timestamped 29th April 2021 1500.

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2 Introduction and background

20. This response set out the collective reaction of a group of operators and the Independent Networks Cooperative Association (INCA).

21. The respondents are deeply concerned at Ofcom's approach to this consultation, the lack of transparent analysis (or indeed any substantive analysis at all), the absence of separate analyses for individual relevant markets and the absence of any analysis of compliance with the WFTMR rules on OCTs.

2.1 The respondents

22. This document presents the response for the following operators:

2.1.1 INCA

23. INCA is a trade association. Its members are supporting, planning, building and operating sustainable, independent and interconnected full fibre and wireless networks that advance the economic and social development of the communities they serve and permit the provision of applications and services through open competition, innovation and diversity.

24. INCA's aims are to:

- support the development of sustainable independent networks through collaboration on the provision and procurement of products and services and adoption of common standards.
- support collaboration between members to create new, independent digital infrastructure that can be shared by operators and suppliers.
- support mutual trading between members.
- represent the interests of independent networks.
- promote the advantages and successes of independent networks.

25. INCA has more than 150 members, including: network owners, operators and managers; access and middle mile networks; public sector organisations actively promoting the development of 21st century digital infrastructure; vendors, equipment suppliers, and providers of services that support the sector.

2.1.2 County Broadband

26. County Broadband - Established in 2003, County Broadband has transitioned over the past two years from a wireless operator, to a predominantly fibre operator. The company received £46m investment in late 2018 to support the deployment of circa 36,000 homes passed and is now preparing for its next funding round in 2021 to support deployment to a further 150,000 rural premises in the East Anglian region. The company employs substantial use of Passive Infrastructure Access (PIA), as well as its own installation of ducts and poles.

2.1.3 Zzoomm

27. Zzoomm - Zzoomm is designing, building, and operating new full fibre networks, where the fibre runs into the property to serve the family or business. Zzoomm is building out this network in smaller towns and suburban areas across the UK where there is no existing full-fibre network. Zzoomm's ambition is to serve more than a million homes and businesses with full fibre over the next five years in underserved market towns across the UK. From company foundation by Matthew Hare OBE in December 2018 to construction start in September 2019, Zzoomm has moved at pace to realise this ambition. Zzoomm completed the construction of its first network in Henley-On-Thames in 2020, has started construction of its second network in Hereford and is rated Excellent on Trustpilot and Google by customers.

2.1.4 Full Fibre

28. Full Fibre - Full Fibre are building Fibre Only, Wholesale Only, Gigabit Broadband networks in the UK's under-served market towns. Funded by Basalt Infrastructure, we will build to at least 500,000 homes and business by 2025. This new infrastructure will unlock economic growth, fuel social mobility, and unlock the flexible

working economy as well as providing extensive dark fibre networks to support mobile cell sites.

2.1.5 Truespeed

29. Truespeed is based in Bath and delivers full fibre broadband to hard to reach homes and businesses. By building a brand new infrastructure, Truespeed is able to deliver gigabit-capable full fibre broadband directly into premises, providing a high-performance, highly reliable connection, and future-proofed connectivity.

2.1.6 WightFibre

30. WightFibre - WightFibre provides phone, TV and broadband services to homes and businesses on the Isle of Wight. The WightFibre Gigabit Island Project, a £90M+ project, will see full-fibre broadband deployed to around 60,000 homes and business across the Island by 2022 and to a total of 72,000 homes by 2025. Already (Nov 2020) 23,000 homes can receive full-fibre broadband. WightFibre is owned by Infracapital Partners and was the first company to receive funding from the government's Digital Infrastructure Investment Fund in 2017.

2.1.7 Airband

31. Airband - Founded in 2009, Airband is an independent internet service provider bringing high speed broadband to homes, business, and industry in rural and hard-to-reach areas. Airband works closely with the Department for Digital, Culture, Media & Sport, BDUK, local authorities and communities to build high availability fibre infrastructure that residents, businesses, and other ISPs can access to help overcome the UK's digital divide. https://www.airband.co.uk/

2.2 Background

32. In the wholesale fixed telecoms market review (WFTMR)[6], Ofcom imposed restrictions on BT's pricing freedom with regards to geographic pricing and what Ofcom refers to as other commercial terms (OCTs)[7]. An outright prohibition of geographic pricing and discounts is now in place (subject to ad-hoc approval by Ofcom) and a pre-notification obligation exists for OCTs.

33. In its rationale for imposing these restrictions on Openreach, Ofcom states:

"*Competition law, insofar as is relevant, prohibits the abuse of a dominant position – it does not seek to promote competition …. [and] …. Our concerns go beyond Openreach setting potentially anti-competitive prices within the meaning of competition law, and extend to the broader impact that commercial terms may have on alternative network operators' incentives to invest in FTTP*.[8] [Emphasis added]

34. And Ofcom further states:

"*If Openreach is able to deprive new networks of demand, they will fail*"[9]

35. It therefore seems that the application of the ex-ante restrictions on geographic pricing and OCTs are critical to the successful achievement of Ofcom's strategic objective, which Ofcom describes as follows:

"we want to promote investment in such networks by BT and other companies in order to promote network-based competition. We want to encourage BT's competitors to build their own networks, rather than relying on network access from Openreach" [10] [emphasis added].

36. When explaining the need for ex-ante remedies, Ofcom states:

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[6] Published on March 18th 2021.
[7] OTS includes commercial terms such as volume discounts, loyalty arrangements, tying of products and other terms and discounts that are not solely geographic discounts and which could harm competition.
[8] WFTMR V3 paragraph 7.53. Please note that, unless otherwise stated, all paragraph references in this document refer to the WFTMR Volume 3 section 7.
[9] Paragraph 7.50.
[10] WFTMR V1 paragraph 2.8.

"*We consider that ex ante regulation makes it clearer to Openreach and others what conduct is not permitted. This ensures transparency, promotes regulatory certainty and provides alternative networks investors with confidence to invest" [emphasis added].*[11]

37. As illustrated by the quotes above, Ofcom has communicated clearly to industry that it intends to apply the new framework for preventing the introduction (or continued use) of anti-competitive pricing and other commercial terms from causing harm to the deployment of new fibre networks by competitors to Openreach. Our analysis, as presented in this response, uses that overall principle as its starting point and, in particular considers how Ofcom's application of the new ex-ante competition framework should ensure transparency and promote regulatory certainty.

38. This consultation presents Ofcom's analysis of whether three specific existing Openreach offers are compliant with the new rules. Those offers are:

- The GEA Volume Offer
- The FTTP Only Offer V2, and
- The Local Marketing Offer

39. We note in the consultation document, that Ofcom is only reviewing whether the three offers are compliant with the new ex-ante competition framework with regards to geographic pricing, no analysis is presented in relation to whether the offers are compliant with the framework for OCTs[12]. We have asked Ofcom whether it intends to consult separately on those matters and have received the following reply:

"As we have stated in the consultation document at paragraph 2.6, our assessment is focused on the geographic rental pricing element of these offers.

Annex 11 to the WFTMR statement sets out our general approach to considering notified commercial terms where the price or other contractual conditions are

[11] Paragraph 7.57.

[12] Consultation paragraph 2.6.

conditional on the volume and/or range of services purchased. If you have standalone concerns with the commercial terms of the existing offers that are relevant to our regulation, please write to us separately on this point." [13]

40. We do not understand Ofcom's rationale for only consulting on whether the current offers comply with the geographic pricing rules, as it is clear that Openreach's pricing would have to comply with the OCT rules in order to be compliant under the WFTMR remedies. Although there is not a prohibition on OCTs, there is a pre-notification requirement, and it is clear from the WFTMR that Ofcom considers that BT would be in breach of the no undue discrimination remedy if it engages in OCTs that have the effect of deterring competitive network investment.

41. This response covers both the geographic pricing and the OCT aspects of the three offers. Our proposed analytical frameworks and analyses of the three offers are separate for geographic pricing and OCTs, so the section relevant to OCTs can be extracted and provided separately to Ofcom if required. We believe that it is critical that the two sets of tests be applied together, however, and that is why they are both included in this response document.

42. We believe that Ofcom has a duty to undertake a full analysis of the three offers, addressing all facets of those offers and their potential impact on competition and investment.

43. In this response we do not purport to present complete analyses of the three offers, as we do not have access to the necessary data to do so. Instead, we present what we believe to be a useful and transparent framework for such assessment, and we indicate where we have reason to believe that any of the three offers may be at risk of non-compliance.

[13] Email from Keith Hatfield dated 23rd April 2021

44. Ofcom's analysis appears to fall significantly short of the level of analysis we set out below[14]. We urge Ofcom to redo its analyses and present a transparent basis for its decisions (whether or not changed as a consequence of the revised analytical approach). It is important that Ofcom explains the bases for its decisions as doing otherwise creates uncertainty and increases regulatory risk to the detriment of investment and ultimately to consumers.

45. The current consultation document appears to offer little other justification for granting consent to the three offers, other than that Openreach itself has assured Ofcom that the intent and purpose of the three offers were not to deter competitive investment. This is an unacceptable approach by the regulator whose primary function is to protect consumer interests, and which has stated that the best way of doing so it to encourage the investment in and development of competing fibre networks across as much of the UK as possible.

[14] We say that it appears to fall short as Ofcom does not present any of its analysis, so we cannot say for sure what analysis Ofcom has performed. Had Ofcom performed the analysis we set out below, however, it would likely have arrived at different conclusions and, in any case, Ofcom should at least explain its analysis, if not present the detailed work and outcomes.

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3 The purpose and value of an *ex-ante* competition framework

46. Ofcom has correctly identified that reliance on competition law to prevent the use of pricing or other commercial terms by Openreach from deferring altnet investment in full-fibre networks would not serve Ofcom's objectives of promoting competition and investment in competing fibre networks.

47. In paragraph 7.53, Ofcom states as follows:

"Appropriate ex ante intervention at the upstream level can promote effective competition in downstream markets. It can also facilitate the emergence of effective competition at the upstream level itself. <u>Competition law, insofar as is relevant, prohibits the abuse of a dominant position – it does not seek to promote competition,</u> which is one of the aims of our package of ex ante remedies. <u>Our concerns go beyond Openreach setting potentially anti-competitive prices within the meaning of competition law, and extend to the broader impact that commercial terms may have on alternative network operators' incentives to invest in FTTP</u>." [emphasis added]

48. We agree with Ofcom's assessment and believe that Ofcom is right to consider potential commercial actions by Openreach as significant risks to competitive investment.

49. Ofcom, very significantly, comments further that:

"*If Openreach is able to deprive new networks of demand, they will fail*".[15]

50. A number of commercial arrangements, including geographic and volume discounts and non-price measures such as tying of products can create significant barriers to switching, slowing down demand and take-up of connections on new competitive networks. The significant up-front and sunk costs involved in network deployment means that telecoms operators are particularly sensitive to the rate of take up and revenue-generation.

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[15] Paragraph 7.50.

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51. A further complexity in the UK fixed telecoms market is that significant barriers to switching exist (and can be created by Openreach behaviour) at both retail and wholesale market levels.

52. At the wholesale level, the market is dominated by a small number of large ISPs, all of whom have existing commercial and operational relationships with Openreach. The creation of pricing structures or other forms of incentives and/or loyalty arrangements by Openreach to incentivise those ISPs to not do business with competing network operators would almost without a doubt have a very significant impact on the viability of those competing networks.

53. The retail market is also characterised by the existence of significant barriers to switching. Although a new switching platform, that should make switching easier for end users, is planned for implementation in the next two years, it is clear from research presented in Ofcom's recent consultation on that subject that end users consider switching telecoms provider to be a significant event and one that is associated with risks. Having to understand complex charging structures to be able to select the best solution and to make arrangements to be present for physical installation of the new service in homes and businesses represent considerable barriers to switching.

54. If the pricing incentives offered by Openreach to ISPs at the wholesale level enables those ISPs to offer retail customers reduced price connectivity, then that will significantly add to the difficulties new network operators face in attracting customers onto their networks.

55. It is therefore our view that a robust ex-ante competition framework is critical to the achievement of Ofcom's objectives of incentivising investment in fast deployment of full-fibre networks across the UK, by Openreach and other providers.

56. In paragraph 7.56, Ofcom states:

"We have a relatively small window of opportunity to encourage new network build. If alternative operators are unable to secure sufficient access seekers/end users

over a reasonable time period, then it is unlikely they will be able to secure funds from investors for their FTTP rollout plans."

57. Again, we agree that Ofcom has correctly identified and highlighted the specific characteristics and risks in the telecoms market, which underscore the need for an ex-ante competition framework that provides transparency, and certainty to investors in new networks that Ofcom will not allow Openreach to engage in practices that will stifle demand on competing networks in a market already characterised by significant barriers to switching at both retail and wholesale levels.

3.1 Ofcom's new *ex-ante* competition framework

58. As described above, transparency and certainty are paramount for Ofcom's *ex-ante* competition framework to be effective. Ofcom highlights this[16]:

"We consider that ex ante regulation makes it clearer to Openreach and others what conduct is not permitted. This ensures transparency, promotes regulatory certainty and provides alternative networks investors with confidence to invest. In contrast, ex post enforcement, which may take longer to conclude in the event of enforcement activity, would not provide the same degree of regulatory certainty which is itself an important factor in any investment decision." [emphasis added]

59. It was therefore disappointing for those competing network operators and their investors to see that Ofcom's description of how it proposes to implement the geographic and OCT restrictions is remarkably void of clarity. This is matched by the current consultation, which offers no insight into any tests or analyses Ofcom may or may not have performed.

60. We comment below on Ofcom's actual assessment of the existing three offers, below we focus on the frameworks as described in the WFTMR Final Statement

[16] Paragraph 7.57.

rather than the individual offers. We comment separately on the framework for geographic pricing and on that for OCTs.

3.1.1 Geographic pricing

61. Under Ofcom's *ex-ante* competition framework, geographic pricing by Openreach is prohibited, unless it grants its consent. The two parameters Ofcom would consider before granting a geographic pricing consent are:

"Any objective justification provided by Openreach for the differential pricing: ***and***

Whether it is consistent with our overarching policy objectives (including our strategy to promote network competition)" (Para. 7.129. Emphasis added).

62. Clearly these parameters are neither quantifiable nor transparent. They also do not provide any form of certainty and clarity for operators of and investors in new competing networks.

63. Although Ofcom says it will consider objective justification provided by Openreach, it does not provide any indication of what kind of justification could be acceptable and enable Ofcom to grant its consent. We understand Ofcom's need for a certain amount of flexibility to avoid the framework being gamed or becoming out of date due to an unforeseen innovation, whether technical or commercial. But the complete lack of transparency of how Ofcom would reach its decision to grant or refuse consent renders the framework unpredictable and reduces its value considerably. This seems in direct conflict with Ofcom's self-professed objective of achieving transparency and predictability.

64. One way to overcome the lack of specificity of the actual evaluation framework as set out in the WFTMR would be to produce and publish guidelines and/or ensure that any decisions made are sufficiently transparent such as to start developing 'case law' which would help both Openreach and competitive providers. As set out below in our assessment of Ofcom's review of the three offers, Ofcom has not done that.

Copper retirement

65. Ofcom specifically states that it may grant consent to geographic pricing that supports migration to full fibre even if this has a geographic element due to the timing of FTTP build.[17]

66. We understand the benefits to Openreach of migrating customers from copper to fibre as quickly as possible,[18] but we are concerned that this could be used by Openreach as a blanket justification for FTTP discounts.

67. Although Ofcom states that it would expect such discounts to be offered in all FTTP areas (or those exchange areas that have reached 75% fibre coverage), the costs to Openreach of doing so at the early states would be relatively low. The timing would likely coincide with that of competitive provider fibre deployment, thus causing considerable harm by locking ISPs (and thus retail customers) into the Openreach discount scheme.

68. Although Openreach may be able to justify that it would offer migration incentives even if there were no rival networks (to accelerate savings from copper retirement), the harm to rival networks from such pricing schemes would likely be considerable and thus would not be consistent with Ofcom's overarching objectives.

Scope of consent

69. Ofcom's remedies are applied to individual relevant markets. Markets should be defined based on product and geographic characteristics that result in different competitive dynamics in the different relevant markets defined.

70. It therefore follows that Ofcom's assessment of requests for consent should be performed for each relevant market in which Openreach proposes to introduce the new geographic pricing. We note that Ofcom has not done that in the current consultation.

[17] Paragraph 7.134.
[18] Considerable cost savings can be realised once copper services and the copper network are retired.

3.1.2 Other commercial terms

71. In common with the geographic pricing restrictions, Ofcom declared that its *ex-ante* framework for evaluating what Ofcom describes as 'other commercial terms' (OCTs) would improve transparency and certainty and encourage investment in competitive networks. However, as for the geographic pricing assessment framework, the OCT framework is vague and provides very limited transparency.

72. For OCTs, Ofcom has not imposed a prohibition, but a 90-days pre-notification requirement. This is because (in Ofcom's view) it would be difficult to define exactly what kinds of commercial terms to prohibit and that a rigid framework could make it possible to game the remedy.

73. Ofcom's assessment criteria for the evaluation of OCT pre-notifications are whether:

    "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."*[19] [Emphasis added]

74. We note that both a) and b) must be satisfied for Ofcom to approve an OCT proposal by Openreach.

75. Whilst the criteria provided by Ofcom for OCTs are more specific that those provided for geographic pricing, they are still couched in in vague terminology, including the term 'material'. Given Ofcom's decision in the WFTMR to determine that competition by any other competitor than Virgin Media and CityFibre would not be material, investors in competitive networks have little confidence that Ofcom's interpretation of what constitutes a material impact on nascent networks would match the real-

[19] Paragraph 7.154.

world impact they would experience (and are currently experiencing) from OCTs offered by Openreach to large ISPs.

76. For example, a group of rival network providers are building a common wholesale platform that would act as an aggregator of small networks to offer a scalable proposition to the large national ISPs. OCTs that bind ISPs to the Openreach network would deny those rival networks access to the wholesale market and would likely cause an overall delay in the deployment of and migration to full fibre networks in the UK.

Scope of OCT approvals

77. As for geographic pricing, we consider it would be necessary for Ofcom to assess each OCT proposal for each relevant market defined by Ofcom. As with geographic pricing, we note that Ofcom has not done so.

4 Proposed assessment framework for geographic pricing

78. Each of the three offers has a geographic element to it, linked to where BT has deployed new fibre in a given period of time. This means that each of the three offers should be subject to a presumption that they are prohibited, subject to separate approval by Ofcom.

79. In the WFTMR Statement, Ofcom refers to its concern that Openreach could use geographically targeted price reductions to deter rollout by other operators, either where they have already started or where they have plans to rollout network infrastructure (paragraph. 7.8).

80. Ofcom begins its consideration of geographic discounts with a clear statement prohibiting such discounts on rental charges in:

- WLA Areas 2 & 3 for VULA (including FTTP)

- Leased Lines Area 2.[20]

81. However, it then states that Openreach can apply to Ofcom for consent to offer geographic discounts where this would otherwise be prohibited[21] . Ofcom later states that, when assessing whether a geographic discount is permitted, it will consider

- *"Any objective justification provided by Openreach for the differential pricing: and*
- *Whether it is consistent with our overarching policy objectives (including our strategy to promote network competition)"*[22]

82. The ability of Openreach to use geographic pricing to deter entry is a very real concern for investors in competing networks who fully understand that, in the absence of regulation, Openreach has the incentive and ability to deter potential rivals from entering the market and to deter existing rivals from further expansion. We are therefore pleased to see that Ofcom starts with a presumption that geographic pricing will not be permitted in most geographic markets. However, we are concerned that in its consultation paper Ofcom does not set out a clear framework for assessing whether a geographic price will be allowed. Therefore, there is no transparency on how Ofcom will assess the three current applications for geographic prices nor future applications. We address this concern in this Section of our response.

83. Ofcom recognises that Openreach's use of geographic prices can have a short-term (static) and long-term (dynamic) effect on competition (Para. 7.11).

84. In the short term, lower prices in a specific area can prevent entry or expansion as other networks may not then be in a position to compete with Openreach on price, which is always an important consideration of customers. In the WFTMR Statement, Ofcom makes this point clearly, when in states:

> *"Surveys undertaken for different ISPs suggest that price is the most important factor in the choice of broadband packages, followed by reliability and speed. A*

[20] Paragraph 7.3.
[21] Paragraph 7.4.
[22] Paragraph 7.129.

survey commissioned by Openreach found that the most important reason for switching provider is to save money, not to obtain a faster connection." [23]

85. In the longer term, a discount targeted against entry or expansion in one area at a specific point in time may also affect future investment decisions of Openreach's rival. If a discount is allowed in one area, this may signal to rivals that Openreach will seek to introduce a discount in another area, should a rival choose to invest there.

86. This behaviour is explored in a well-known game theory model of entry and deterrence: the chain store game[24]. In this game an incumbent national chain store faces entry in each local market where it operates and has a choice of accommodating or fighting the entrant. Under the normal game theory approach of "backward induction"[25], its best payoff from the last round of the game comes from accommodating entry and sharing profits with the entrant rather than fighting entry and competing away all profits. Knowing this, the incumbent then accommodates in all previous rounds.

87. However, if the incumbent adopts a deterrent strategy of fighting early entry, then potential entrants may decide not to enter and so not risk their investment, leaving the incumbent to earn monopoly profits in each local market. This is regarded as a paradox by game theorists as the accommodate strategy, determined by backward induction, should (according to game theory) be optimal. However, in this case it appears that a deterrence strategy is in fact optimal. Selten's response to this paradox is to argue that the idea of "deterrence", while irrational by the standards of Game Theory, is in fact an acceptable idea by the rationality that individuals actually employ. So, game theory does not correctly predict the behaviour of real-life players.

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[23] WFTMR V 2 paragraph 2.40.

[24] Selten, R. (1978). The chain store paradox. *Theory and decision*, 9(2), 127-159.

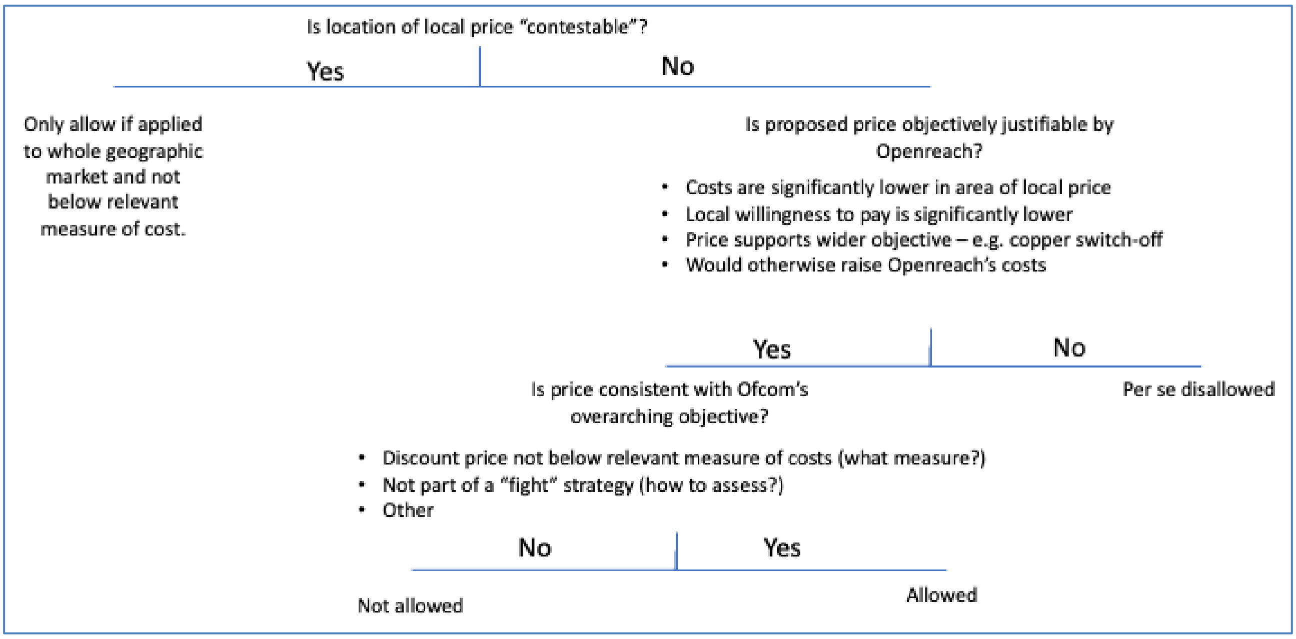
[25] Backward induction is the process of reasoning backwards in time, from the end of a problem or situation, to determine a sequence of optimal actions. It proceeds by examining the last point at which a decision is to be made and then identifying what action would be most optimal at that moment. Using this information, one can then determine what to do at the second-to-last time of decision. This process continues backwards until one has determined the best action for every possible situation at every point in time.

88. There are direct parallels between the chain store game and the strategic options facing an incumbent telecoms network operator. Openreach's network is ubiquitous, like the chain store, and faces local entry. It too, therefore, faces the choice of fighting or accommodating entry in each location, with the same likely payoffs as the chain store. Fighting early entry, through localised geographic discounts, could signal to later entrants that it is not worth competing with Openreach.

89. Given this, it is very important that, if Ofcom is to allow some local geographic pricing, it does so bearing in mind both the short term effects of the local price and the signals Openreach's behaviour sends to future entrants in other local areas.

90. To determine whether any applications for discounts by Openreach are permitted by Ofcom, it is important to set out a transparent framework that can be used to assess the potential for anticompetitive impact. We have therefore created a Decision Tree that is compatible with Ofcom's criteria set out in para. 7.129 and, in our opinion, provides greater clarity about the acceptability of the proposed geographic price than in the consultation. A larger version of the Decision Tree is presented in Annex 1

Figure 1: Geographic Price Decision Tree



91. The opening questions asks whether the area where the discount is to be applied is contestable or otherwise, i.e., whether Openreach faces actual or potential competition from entrants. This is an important opening question. If a geographic area is contestable then a discounted geographic price by Openreach is likely to exclude competition if set below potential entrants' costs, even if it is above Openreach's costs. Given Ofcom's objective of promoting network competition, then such discounts should be disallowed per se.

92. When determining whether a market is contestable it is important that Ofcom is transparent in its assessment of which markets are contestable. We believe that the level of planned investment in both Areas 2 and 3 demonstrates that they should both be classified as contestable. We are extremely concerned that Ofcom must not assume that only Area 2 is contestable. We are pleased that Ofcom agrees that the geographic pricing restrictions must apply in both Areas 2 and 3, as there is important and significant existing and planned competitive investment in both of those markets. For the evaluation of geographic pricing in Area 3, if Ofcom does not agree with us

that the vast majority of Area 3 is *de facto* contestable, it may be necessary for Ofcom to assess whether the pricing applies in any locations where competition exists or is likely to emerge during the period of this review. It is critical that Ofcom recognises that many parts of Area 3 are contestable.

93. However, if the area is not contestable, then further consideration can be given to the application. The next question is whether the proposed price is objectively justifiable by Openreach. We need here to consider the bases on which a geographic price could be objectively justified. Some potential objective justifications are set out below:

1) Costs are significantly lower in the location. If an area has significantly lower costs, then it may be appropriate for Openreach to lower its prices so that the benefits of lower cost can be passed on to wholesale customers and, ultimately, consumers. However, if this is the case, and assuming Openreach's prices are set at average cost across the rest of the geographic market then Ofcom would need to consider whether the price reduction in one area of the market would lead to a price increase elsewhere so that Openreach covers its costs across the whole market and what the impact of this is likely to be in economic efficiency.

2) End-consumer willingness to pay is significantly lower in the location. Where an area has, for example, a significantly lower average income, there may also be a lower willingness to pay, which could lead to a lower take up of broadband than is socially optimal. Openreach may seek to respond to this by lowering wholesale prices in the expectation that these will be passed on to consumers, leading to an increase in demand, although whether the price reduction is passed on to consumers is outside Openreach's control and it therefore cannot be assumed that this will happen. When assessing the likely benefits of Openreach pricing, Ofcom should therefore look to past experience to see the extent to which that has happened and only assume consumer benefits to the extent this can be substantiated. Therefore, it would again need to be asked whether a price reduction in such a region would have to lead to a price increase elsewhere and, further,

whether a price reduction by Openreach is the appropriate policy response in such circumstances. It may be that a lower willingness to pay in one area should be addressed through the Universal Service Obligation.

3) A price reduction supports a wider social objective. It may be that in the absence of a price reduction on FTTP relative to FTTC insufficient consumers in a geographic area would be prepared to switch to FTTP and thus a wider objective, such as phasing out the legacy copper network, may not be met. As with point (ii) above, this would raise the question of whether prices would have to rise elsewhere to compensate and whether a price reduction by Openreach is the appropriate policy response to lower demand for FTTP. From an economic perspective, if the price of FTTP has to be lowered to attract customers away from FTTC then there may be a loss of allocative efficiency as a sub-optimal (too high) level of FTTP is provided.

4) The volume to FTTP in an area is below *de minimis* level. In a given area of a geographic market the extent of FTTP is very small and there is unlikely to be any further investment. In this case a price reduction of wholesale FTTP in the area down to the level of FTTC may be justified to avoid confusion over consumer prices, provided that the price reduction is passed on to consumers.

94. If there is no objective reason for the price reduction, then to be consistent with para. 7.129, Ofcom should not permit Openreach to introduce the price reduction.

95. However, if the price reduction is objectively justified, then Ofcom would need to consider whether it is <u>also</u> consistent with its overarching objective including its strategy of promoting network competition, as set out in para. 7.129. We have set out below two potential tests to make this assessment.

1) Is the proposed price below a relevant measure of cost? A price below the long run average incremental cost (LRAIC) would almost certainly be regarded as anticompetitive and, given that Openreach is likely to have the lowest cost base, likely to exclude competition. It would therefore not be consistent with Ofcom's overarching objective. Other possible price benchmarks to be considered include:

a. Limit Price. The limit price is a price above the LRAIC of the dominant firm but lower than the cost of smaller entrants. The limit price may, therefore, be legal from a competition law perspective (as it is not predatory) but still has the effect to being exclusionary as it is below the cost of entrants. This price may also therefore be inconsistent with Ofcom's policy objective.

b. Below the level in a contestable market. If the proposed geographic price is below the level in a contestable market, then there is a strong case that the geographic area where the proposed price will be set should be considered contestable, regardless of which Area it is in. We would expect the price in a contestable market to be at or near the competitive level, as economic theory indicates that contestability is sufficient to discipline the prices of a dominant firm. Any price below that found in the contestable part of the market would likely be exclusionary.

2) Is the price part of a "fight" strategy designed to deter entry? As discussed above in relation to the chain store game, a national incumbent firm facing competition in local markets may adopt a fight strategy against early entrants to deter later entry. Ofcom appears to accept that this is likely to happen in the wholesale fixed telecoms market. For example, at para. 7.11[26] it states:

> *"We remain of the view that Openreach has an incentive to use geographically targeted price reductions to undermine alternative network rollout. If Openreach lowers its prices in an area where it faces competition, this may reduce its returns in that area. However, this strategy may still benefit Openreach in the longer term. If its actions deter new network build, then it will face reduced competition and benefit from a higher market share and the ability to charge higher prices over the longer term*."

[26] See also paragraphs. 7.8 and 7.12

We accept that it would be challenging to establish whether a response to entry in a particular local market is part of a fight strategy or simply has the effect of deterring entry. Nevertheless, it would be necessary to show that a local price reduction is unlikely to deter entry (whether deliberately or not) to show that it is consistent with Ofcom's second objective.

96. In 2004, OPTA, then the telecoms regulator in the Netherlands and subsequently superseded by ACM, published a policy note on strategic behaviour and foreclosure in telecoms markets[27]. OPTA set out an eight-point "decision framework" at the end of the document to help the Authority identify whether there is a risk of foreclosure by the dominant firm. The specific points set out by OPTA are not directly relevant to the matter addressed here. However, in our view it acts as a good precedent to show that regulators can set out clear step-by-step process to assess where a particular action is likely to be harmful to some wide objective.

[27] OPTA (2004) *Strategic Behaviour and foreclosure on telecommunications markets*

5 Assessing discount offers under geographic pricing framework

97. In this section we review each of the Openreach discount offers under consideration, summarising the most relevant aspects of each, and analysing how our proposed geographic pricing assessment framework might be applied. It should be noted that a full assessment of the offers is a significant task which is not possible without access to confidential information from the operators; only Ofcom can perform such an analysis, and our intention in this consultation response is only to outline the analysis that would be needed and to indicate, where appropriate, where we consider it likely that the three offers may not satisfy Ofcom's *ex-ante* competition framework.

98. For ease of assessment, we have chosen to make the assessment of each offer stand-alone and, as the same or very similar concerns are identified for the three offers, there is inevitably a level of repetition across the three offers.

5.1 GEA volume offer

99. Key features of the offer are:

Geographic scope	For FTTP/G.fast the geographic scope of the offer is limited to the legacy footprint prior to July 2018 plus BDUK locations and new sites, but FTTC discounts are available in all locations.
Offer expiry	September 2023
Rental discount expiry	November 2023
Rental discount levels	0-25% depending on volume tier

Volume criteria	Targets defined in 5 tiers; all of CP's fibre volumes are taken into account (not just those in the offer footprint) Volumes a CP acquires from an alternative network provider in the Openreach footprint are also taken into account.
Service mix criteria	A percentage of fibre base is required to be 80Mbps+, and a percentage FTTP/G.fast
Revenue criteria	None
Forecasting accuracy criteria	Discounts are reduced if forecasts not achieved.
Marketing criteria	None

100. We now attempt to apply the decision tree for geographic pricing to this offer.

101. Firstly, as Area 2 and Area 3 are separate markets, Ofcom must perform a separate analysis for each market. We note that Ofcom has not done so and we consider this to be a significant error that must be remedied through a follow-up consultation.

102. In this response we highlight where we consider that the analysis may differ between the two markets, but as we do not have access to detailed market information, this can only be indicative.

103. Is the location of local price "contestable"?

- Some parts of the offer footprint are in contestable areas. Here the analysis may differ between Areas 2 and 3. We believe that Ofcom would agree that Area 2 is, by definition, contestable. For Area 3, we believe that large parts are contestable (due to existing or planned fibre network build by altnets, for which Ofcom has collected detailed information). It may therefore be necessary to look at exactly which locations in Area 3 are affected by the price. Where a contestable market is confirmed, the discount should be analysed to determine whether it results in prices that are below a relevant measure of cost. The relevant measure of cost should be determined by a consideration of the costs of an efficient entrant.

104. For the non-contestable areas, the appropriate test is whether the proposed price is objectively justifiable by Openreach?

- Ofcom does not present any evidence, either from Openreach or elsewhere, that justifies the GEA Volume Offer.
- Openreach does note that the offer will:
    - benefit CPs which are Openreach customers, and their customers;
    - drive an increase in take-up of superfast and ultrafast services across the UK;
    - raise average speeds received by end customers.

105. It is unclear the extent to which the discounts have been passed on to end users. Ofcom would need to investigate that before determining that any benefits accrue to end users.

106. As the services effectively incentivise the use of FTTC services, it is unclear that it genuinely incentivises take-up of ultrafast services. It could in fact have the opposite effect.

107. The offer may have helped to raise the average speeds received by end users at the time it was introduced, but (given its focus on FTTC) it is unlikely that this is the case today and in the next 18 months.

108. There may be a risk that the widespread discounts on FTTC products impede migration to FTTP services, given that the discounts do not apply in Fibre First areas.

109. If, contrary to our assessment above, Ofcom determines that the discount is objectively justifiable, then a further assessment should be made of whether the price is consistent with Ofcom's overarching objective of infrastructure competition.

- Large ISPs will have the volumes to trigger the discounts in the offer footprint, and there is a strong likelihood that the discounted Openreach prices would fall below the cost base of an infrastructure competitor (limit pricing).

- Even if the discounted prices remain above the competitor cost base, the reduced revenues will result in lower returns, harming investment incentives.
- Vertically integrated CPs, if they have the volumes to trigger the rental discounts, will have increased incentive to purchase Openreach services rather than build their own FTTP infrastructure.
- This offer was introduced in the very early stages of Openreach's FTTP deployment and it focuses primarily on FTTC products and offers ISPs significant discounts on FTTC products, providing that the ISP achieves a ratio of higher speed FTTP product mix. The significant FTTC discounts could tie the ISP to the Openreach platform, even if an altnet were to deploy FTTP before Openreach, creating a significant barrier to the ISP's use of the altnet FTTP infrastructure. It is therefore very possible that the GEA Volume Offer could result (and potentially already has resulted) in effective foreclosure of the use of alternative networks and an overall delay in the migration to FTTP services (in that it prevents migration to FTTP consumption on competitive networks).

110. Given the above analysis, it is our view that the GEA Volume Offer is unlikely to comply with Ofcom's geographic pricing rules in either Area 2 or 3.

5.2 FTTP only offer v2

111. Key features of the offer are:

Geographic scope	FTTP Fibre First footprint ready for service by August 2021
Offer expiry	August 2021
Rental discount expiry	Discounts defined until September 2022, <u>but then endure until 31st March 2025, subject to annual CPI increases</u>
Rental discount levels	7% – 23% depending on speed.

Volume criteria	None
Service mix criteria	Target for FTTP new provides as % of total new provides
Revenue criteria	None
Forecasting accuracy criteria	None
Marketing criteria	None

112. We now consider this offer in the light of the decision tree for geographic pricing.

113. Firstly, as Area 2 and Area 3 are separate markets, Ofcom must perform a separate analysis for each market. We note that Ofcom has not done so, and we consider this to be a significant error that must be remedied through a follow-up consultation.

114. In this response we highlight where we consider that the analysis may differ between the two markets, but as we do not have access to detailed market information, this can only be indicative.

115. Is location of local price "contestable"?

- Some parts of the offer footprint are in Area 2, which by definition should be classified as contestable. So, the discount should be analysed to determine whether it results in prices that are below cost. The relevant measure of cost should be determined by a consideration of the costs of an efficient entrant;
- Other parts of the footprint may be in non-contestable areas. We do not have the necessary data to make that assessment but refer to data submitted by individual operators building competitive fibre networks to identify locations of existing and planned competitive deployment.

116. For the non-contestable areas, the first test is whether the proposed discount is objectively justifiable by Openreach?

- According to Ofcom, Openreach internal papers indicate the rationale for the offer is to:
  - increase FTTP take-up;
  - test ADSL/VDSL stop-sell; and
  - underpin the FTTP business case.

117. We are not able to provide detailed insight into whether these justifications are acceptable. For example, it is not clear whether the offer increases FTTP uptake for Openreach but has a corresponding (or larger) reduction in FTTP uptake from competitive fibre networks.

118. Whilst we understand that the offer may underpin Openreach's business case, this must not be at the cost of the viability of other competing fibre networks.

119. Ofcom should conduct its own analysis of the validity of Openreach's rationale and provide a transparent assessment to stakeholders.

120. If Ofcom determines that the offer is objectively justifiable, then an assessment should be made of whether the offer price is consistent with Ofcom's overarching objective of infrastructure competition.

- There is potential for a material impact on investment incentives:
  - Rental discounts will be available to any ISP able to sell a high proportion of FTTP lines within an Openreach FTTP footprint area, and these discounts may reduce the price to below the cost base of an infrastructure competitor (limit pricing).
  - Even if the discounted prices remained above the competitor cost base, the reduced revenues would result in lower returns, harming investment incentives.
  - Impact on investment incentives is magnified by the fact that <u>discounts run until September 2022 and, according to Openreach, then endure until 31 March 2025</u>. That is 4 years of the duration of this 5-year review period

121. The points set out above indicate significant potential detrimental effects on the market and investment incentives for Openreach's competitors. it is our view that Ofcom needs to provide a full and transparent analysis of this offer before recommending whether to grant its consent.

122. We note that Ofcom considers that the offer may be justified as it is not specifically targeted at where a competitor network is being built, but across all Openreach FTTP deployment since 2018. Rather than justifying the offer, this action by Openreach instead sends a very strong signal that it intends to set these discounted prices across all its FTTP deployment and this action will, without a doubt, have a significant chilling effect on investor confidence for competitive fibre. The geographic extent of the discount should be considered as a reason for Ofcom not to approve the price, rather than as a justification.

123. We also challenge Ofcom's presumption that this offer is to assist in early migration to FTTP. If that were the case, the offer would not need to run till 2025.

5.3 Local marketing offer

124. Key features of the offer are:

Geographic scope	CP selects up to 4 conurbations, max 500k premises in total, within Fibre First footprint.
Offer expiry	March 2021
Rental discount expiry	Discounts defined until September 2022, <u>but then endure until 30 September 2026, subject to annual CPI increases</u>
Rental discount levels	7% – 23% depending on speed.
Volume criteria	None
Service mix criteria	None

Revenue criteria	Minimum ARPU over offer term
Forecasting accuracy criteria	None
Marketing criteria	CP must demonstrate local marketing activities in the selected areas.

125. We now consider this offer in the light of the decision tree for geographic pricing.

126. Firstly, as Area 2 and Area 3 are separate markets, Ofcom must perform a separate analysis for each market. We note that Ofcom has not done so, and we consider this to be a significant error that must be remedied through a follow-up consultation.

127. In this response we highlight where we consider that the analysis may differ between the two markets, but as we do not have access to detailed market information, this can only be indicative.

128. Is location of local price "contestable"?

- Some parts of the offer footprint are in Area 2, which by definition should be classified as contestable. So, the discount should be analysed to determine whether it results in prices that are below cost. The relevant measure of cost should be determined by a consideration of the costs of an efficient entrant;
- Other parts of the footprint may be in non-contestable areas. We do not have the necessary data to make that assessment but refer to data submitted by individual operators building competitive fibre networks to identify locations of existing and planned competitive deployment.

129. For the non-contestable areas, the first relevant test is whether the proposed discount is objectively justifiable by Openreach?

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- Potentially yes as, according to Ofcom, Openreach internal papers indicate the rationale for the offer is to:
    - increase FTTP take-up;
    - test the impact of local marketing; and
    - underpin the FTTP business case.

130. We are not able to provide detailed insight into whether these justifications are acceptable. For example, it is not clear whether the offer increases FTTP update for Openreach but has a corresponding (or larger) reduction in FTTP uptake from competitive fibre networks.

131. Whilst we understand that the offer may underpin Openreach's business case, this must not be at the cost of the viability of other competing fibre networks.

132. Ofcom should conduct its own analysis of the validity of Openreach's rationale and publish this in a transparent manner.

133. If Ofcom determines that the discount is objectively justifiable, then an assessment should be made of whether the price is consistent with Ofcom's overarching objective of infrastructure competition.

- Rental discounts will be available for any ISP able to actively market and sell FTTP lines within an Openreach FTTP footprint area, subject to achieving the ARPU target, which effectively implies selling a sufficient proportion of higher speed services. These discounts may reduce the price to below the cost base of an infrastructure competitor (limit pricing).
- Even if the discounted prices remained above the competitor cost base, the reduced revenues would result in lower returns, harming investment incentives.
- Impact on investment incentives is magnified by the fact that discounts run until September 2022 and, according to Openreach, then endure until 30 September 2026. That is for the entirety of this review period and 6 months beyond.

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134. The points set out above indicate significant potential detrimental effects on the market and investment incentives for Openreach's competitors. It is our view that Ofcom needs to provide a full and transparent analysis of this offer before recommending whether to grant its consent.

135. We note that Ofcom considers that this offer is not targeted at competitive fibre deployment, as the locations covered are selected by the ISP. Whilst this may or may not overlap with specific individual competitive fibre deployments, it is clear that, to the extent there is overlap with competitive fibre deployment, it will increase barriers for ISPs to switch in those areas.

136. In particular, the duration of the offer until September 2026 suggests that this offer would effectively sterilise such locations to competitive deployment.

6 Proposed assessment framework for OCTs

6.1 Introduction

137. The above discussion has concentrated on geographic prices as a means of foreclosing the market to competition. In this section we consider how other commercial terms (OCTs) may do the same. As with geographic prices, we introduce a decision tree, consistent with Ofcom's objectives set out in para. 7.154, which states that OCTs that create any barrier to using alternative network operators are only justified where:

a) *"The impact on nascent network competitors is unlikely to be material;* ***and***

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

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

   b. *The arrangements are necessary to offer more efficient prices that would deliver benefits for consumers."* (Emphasis added)

138. We note that both criteria need to be met for the OCT to be permitted.

139. Ofcom provides two examples of OCTs that could undermine competitive roll-out loyalty or volume discounts that penalise access seekers for moving volumes to an alternative network operator (para. 7.18). Ofcom is also clearly aware of the potential problems of such discounts:

"If Openreach uses commercial terms that undermine new network build, our starting point is that they are likely to be contrary to the interests of consumers in the long term. In this context, terms which could induce loyalty e.g. Openreach offering lower prices in return for large volume commitments, are a particular concern because this could deter access seekers from switching demand to new alternative networks." (para 7.29)

140. In 2005, the European Commission set out its concerns with loyalty inducing terms, that encourage customers to purchase a single brand of a product, stating:

"The main possible negative effect of single branding obligations and rebate systems is foreclosure of the market to competing suppliers and potential suppliers, which maintains or strengthens the dominant position by hindering the maintenance or growth of residual or potential competition (horizontal foreclosure)."[28]

141. Ofcom's focus on the effects of OCTs on operators of nascent competitive networks means that whether an OCT is consumer welfare enhancing in the short term should play a secondary roll to its entry deterring effects in the longer term. In other words, it is the potential effect on competition that matters and not whether the outcome of any action is welfare enhancing. This is upheld by two famous cases concerning loyalty discounts.

142. In a case concerning rebates offered by British Airways to travel agents in 2003[29] the EU's Court of First Instance (CFI) held that:

"for the purposes of establishing an infringement of Art.82 EC, it is not necessary to demonstrate that the abuse in question had a concrete effect on the markets concerned. It is sufficient in that respect to demonstrate that the abusive conduct … tends to restrict competition, or in other words, that the conduct is capable of having, or likely to have, such an effect."[30]

143. Similarly in a case concerning rebates offered by the French tyre manufacturer, Michelin, the CFI stated that there was no need to demonstrate anti-competitive effect only that the behaviour is capable of having such an effect[31].

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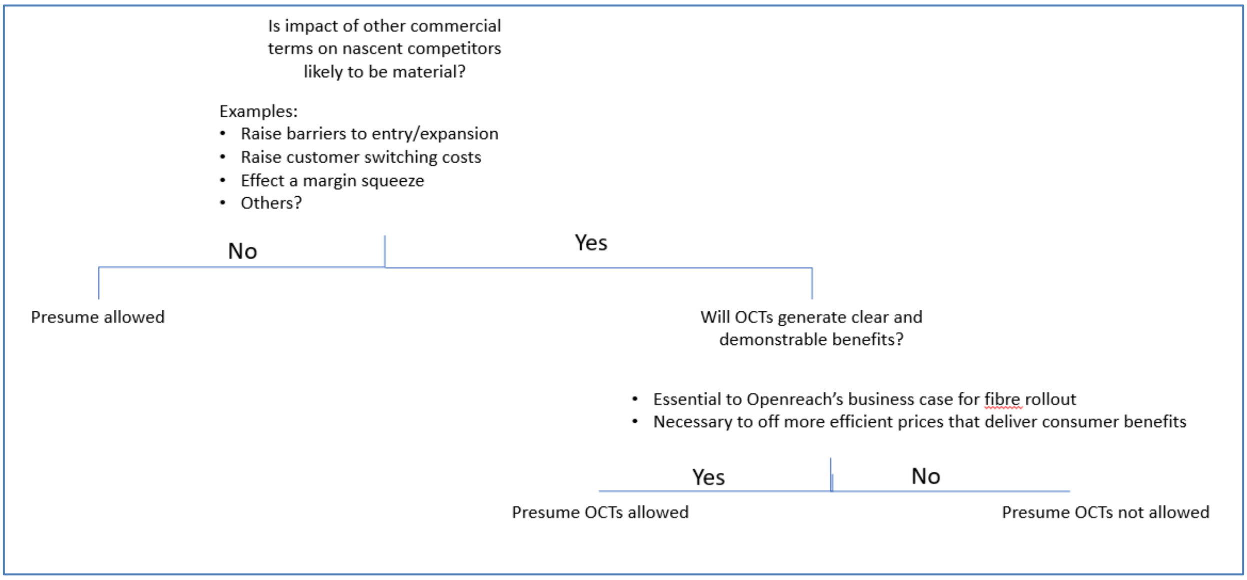
[28] European Commission (2005) *DG Competition discussion paper on the application of Article 82 of the Treaty to exclusionary abuses* Para. 139

[29] Case T–219/99 British Airways v Commission, December 17, 2003
[30] Ibid para. 293
[31] Case T–203/01 Michelin v Commission, September 30, 2003, para. 239.

144. Some economists and lawyers have argued that the CFI was incorrect in focussing on the likelihood, rather than the actuality, of an anti-competitive effect[32]. However, given Ofcom's objective of promoting competition in FTTP, the potential harm to investment through the deterrent effect of OCTs is more relevant than outcomes once the networks are built[33].

145. The decision tree presented below (with a larger version in Annex 1), therefore, is designed to identify whether any OCTs proposed by Openreach are likely to restrict competition, rather than whether they actually have an anticompetitive effect.

Figure 2: OCT Decision Tree



146. The decision tree is based on Ofcom's principal concerns with OCTs. Therefore, the first question is whether the impact of OCTs is likely to have a material effect on

[32] See for example Kallaugher, J., & Sher, B. (2004). Rebates revisited: Anti-competitive effects and exclusionary abuse under Article 82. *European Competition Law Review*, 25(5), 263-285 and Lyons, B. (Ed.). (2009). *Cases in European competition policy: the economic analysis*. Cambridge University Press, part A Chapter 1
[33] See Section 3 above

nascent competitors. Three potential ways in which an OCT may have a material effect are shown.

1) Is the OCT likely to raise customer switching costs or other barriers to switching? Any entrant in a market, that is not growing rapidly, will be dependent on customers switching from the incumbent supplier to the entrant. If the incumbent is able to raise switching costs that will obviously make it harder for the entrant to win customers and create a sustainable business. Many discount schemes are designed to increase loyalty, through rebates once a threshold volume is reached or a simpler increasing discount with higher volumes. Loyalty schemes are barriers to switching.

2) Is the OCT likely to raise barriers to entry and expansion? Somewhat similar to the above, an OCT that raises switching costs also creates a barrier to entry and expansion if the competing operator is too unsure of winning sufficient business to justify network investment. Where there is little competitive build in a contestable market, OCTs may be acting as a significant deterrent to any further competitive investment and thus to competition.

3) Is the OCT likely to effect a margin squeeze? A margin squeeze is a well-known anticompetitive practice that forces existing firms to exit the market and prevents new firms from entering. An OCT that is likely to effect a margin squeeze is, therefore, likely to have a material effect on nascent competitors.

147. If the impact of the OCT is likely to be material, then the OCT should be prohibited regardless of whether it would generate any clear and demonstrable benefits as it is likely to harm competitive entry.

148. However, if the effects are not likely to be material then, according to Ofcom's own words in paragraph 7.154, it will also be necessary to examine whether the OCT will "generate clear and demonstrable benefits". Ofcom provides two examples in paragraph. 7.160:

a) *"The arrangement is essential to achieving fibre roll-out. Ofcom is clear that it will consider the impact on both Openreach's and other operators' fibre roll-out.*

b) *The arrangements offer more efficient prices that would deliver benefits to consumers."*

149. Before further discussion on this point, it is necessary to consider what is meant by "material". Ofcom's discussion on the definition on Area 2 seems to imply that only CityFibre and Virgin Media provide material competition to Openreach and, by implication, other developers of fibre networks do not. If Ofcom persists in this belief, then it could allow Openreach to take actions that foreclose the market to smaller competitors as long as those actions do not affect CityFibre of Virgin Media. This would clearly be wrong as fibre networks developed in specific areas can have a competitive effect and should not be foreclosed by Openreach to allow it to enjoy the easy life of a monopolist.

150. With regard to point (a), Ofcom makes it clear that Openreach would have to explain why any "restrictive elements", by which we presume Ofcom to mean "offer terms", were necessary over and above copper switch off arrangements. However, any price set by Openreach will have a spillover effect on other operators, and given Openreach's market position, the presumption must be that any spillover effect is likely to be negative for entrants. Therefore, Ofcom will need to very carefully weigh the effects on Openreach and on other networks.

With regard to point (b), Ofcom should recognise that discounts resulting from large volume commitments almost inevitably create a barrier to switching from Openreach to other suppliers and, therefore, foreclose at least some of the market to competition. It is our view, therefore, that the default position should be that volume discounts or rebates are presumed to be harmful to Ofcom's overarching objective and, therefore, forbidden. Only if there is compelling evidence that discounts will not create barriers to switching should they be considered.

7 Assessing discount offers under OCT pricing framework

151. In this section we review each of the Openreach discount offers under consideration, summarising the most relevant aspects of each, and analysing how our proposed OCT pricing assessment framework might be applied. It should be noted that a full assessment of the offers is a significant task which is not possible without access to confidential information from the operators; only Ofcom can perform such an analysis, and our intention in this consultation response is only to outline the analysis that would be needed and to indicate, where appropriate, where we consider it likely that the three offers may not satisfy Ofcom's ex-ante competition framework.

152. For ease of assessment, we have chosen to make the assessment of each offer stand-alone and, as the same or very similar concerns are identified for the three offers, there is inevitably a level of repetition in across the three offers.

7.1 GEA volume offer

153. Key features of the offer are:

Geographic scope	For FTTP/G.fast the geographic scope of the offer is limited to the legacy footprint prior to July 2018 plus BDUK locations and new sites, but FTTC discounts are available in all locations.
Offer expiry	September 2023
Rental discount expiry	November 2023
Rental discount levels	0-25% depending on volume tier

Volume criteria	Targets defined in 5 tiers; all of CP's fibre volumes are taken into account (not just those in the offer footprint) Volumes a CP acquires from an alternative network provider in the Openreach footprint are also taken into account.
Service mix criteria	A percentage of fibre base is required to be 80Mbps+, and a percentage FTTP/G.fast
Revenue criteria	None
Forecasting accuracy criteria	Discounts are reduced if forecasts not achieved.
Marketing criteria	None

154. We now attempt to apply the decision tree for OCT to this offer.

155. Firstly, as Area 2 and Area 3 are separate markets, Ofcom would need to perform a separate analysis for each market.

156. In this response we highlight where we consider that the analysis may differ between the two markets, but as we do not have access to detailed market information, this can only be indicative.

157. Is the impact of OCT on nascent competitors likely to be material?

- The impact of price discounts on altnets is likely to differ between Areas 2 and 3, and so separate analysis would be needed.
- For both Area 2 and Area 3, it seems highly likely that the price discounts under this offer would have a material impact on infrastructure competitors:
    - Large retail CPs will have the volumes to trigger the discounts in the offer footprint, and there is a strong likelihood that the discounted Openreach prices would fall below the cost base of an infrastructure competitor (limit pricing).

- Even if the discounted prices remained above the competitor cost base, the reduced revenues would result in lower returns, harming investment incentives.
- Vertically integrated CPs, if they have the volumes to trigger the rental discounts, will have increased incentive to purchase Openreach services rather than build their own FTTP infrastructure.
- This offer was introduced in the very early stages of Openreach's FTTP deployment and it focuses primarily on FTTC products and offers ISPs significant discounts on FTTC products, providing that the ISP achieves a ratio of higher speed FTTP product mix. The significant FTTC discounts could tie the ISP to the Openreach platform, even if an altnet were to deploy FTTP before Openreach, creating a significant barrier to the ISP's use of the altnet FTTP infrastructure. It is therefore very possible that the GEA Volume Offer could result (and potentially already has resulted) in effective foreclosure of the use of alternative networks and an overall delay in the migration to FTTP services (in that it prevents migration to FTTP consumption on competitive networks).

158. Will OCTs generate clear and demonstrable benefits?

- Ofcom do not present any evidence, either from Openreach or elsewhere, that justifies the discount. Openreach do note that the offer will:
    - benefit CPs which are Openreach customers, and their customers;
    - drive an increase in take-up of superfast and ultrafast services across the UK;
    - raise average speeds received by end customers.
- There may be a risk that the widespread discounts on FTTC products impede migration to FTTP services, given that the discounts do not apply in Fibre First areas

159. Given this potential for the discounts to impede take-up of FTTP, a thorough analysis is needed by Ofcom to determine whether the discount can be justified.

7.2 FTTP only offer v2

160. Key features of the offer are:

Geographic scope	FTTP Fibre First footprint ready for service by August 2021
Offer expiry	August 2021
Rental discount expiry	Discounts defined until September 2022, but then endure until March 2025, subject to annual CPI increases
Rental discount levels	7% – 23% depending on speed.
Volume criteria	None
Service mix criteria	Target for FTTP new provides as % of total new provides
Revenue criteria	None
Forecasting accuracy criteria	None
Marketing criteria	None

161. We now consider this offer in the light of the decision tree for OCT.

162. Firstly, as Area 2 and Area 3 are separate markets, Ofcom would need to perform a separate analysis for each market.

163. In this response we highlight where we consider that the analysis may differ between the two markets, but as we do not have access to detailed market information, this can only be indicative.

164. Is impact of OCT on nascent competitors likely to be material?

- The impact of price discounts on altnets is likely to differ between Areas 2 and 3, and so separate analysis would be needed.

- For both Area 2 and Area 3 it seems highly likely that the price discounts under this offer would have a material impact on infrastructure competitors:
  - Rental discounts will be available for any CPs able to sell a high proportion of FTTP lines within an Openreach FTTP footprint area, and these discounts may reduce the price to below the cost base of an infrastructure competitor (limit pricing).
  - Even if the discounted prices remained above the competitor cost base, the reduced revenues would result in lower returns, harming investment incentives.
  - Impact on investment incentives is magnified by the fact that <u>discounts run until September 2022 and, according to Openreach, then endure indefinitely; this means that the price reductions will have a long-term impact on rental revenues.</u>

165. Will OCTs generate clear and demonstrable benefits?

- According to Ofcom, Openreach internal papers indicate the rationale for the offer is to:
  - increase FTTP take-up;
  - test ADSL/VDSL stop-sell; and
  - underpin the FTTP business case.

166. We are not able to provide detailed insight into whether these justifications are acceptable. For example, it is not clear whether the offer increases FTTP uptake for Openreach but has a corresponding (or larger) reduction in FTTP uptake from competitive fibre networks.

167. Whilst we understand that the offer may underpin Openreach's business case, this must not be at the cost of the viability of other competing fibre networks.

168. Ofcom should conduct its own analysis of the validity of Openreach's rationale and provide a transparent assessment to stakeholders.

169. The points set out above indicate significant potential detrimental effects on the market and investment incentives for Openreach's competitors. It is our view that Ofcom needs to conduct a full and transparent analysis of this offer before recommending whether to grant its consent.

170. The fact that the offer will run for 4.5 years of this 5 year review period means that this offers cannot be considered essential to the Openreach FTTP business plan nor is it targeted at early migration. The offer appears to be designed to prevent overbuild in the Openreach Fibre First locations included in this offer. In our view that is clear abuse of Openreach's existing ISP relationships and overall market power and could result in a significant reduction of competition in many locations where Ofcom is expecting two or three competing networks.

7.3 Local marketing offer

171. Key features of the offer are:

Geographic scope	CP selects up to 4 conurbations, max 500k premises in total, within Fibre First footprint.
Offer expiry	March 2021
Rental discount expiry	Discounts defined until September 2022, <u>but then endure until end of September 2026, subject to annual CPI increases</u>
Rental discount levels	7% – 23% depending on speed.
Volume criteria	None
Service mix criteria	None
Revenue criteria	Minimum ARPU over offer term

Forecasting accuracy criteria	None
Marketing criteria	CP must demonstrate local marketing activities in the selected areas.

172. We now consider this offer in the light of the decision tree for OCT.

173. Firstly, as Area 2 and Area 3 are separate markets, Ofcom would need to perform a separate analysis for each market.

174. In this response we highlight where we consider that the analysis may differ between the two markets, but as we do not have access to detailed market information, this can only be indicative.

175. Is impact of OCT on nascent competitors likely to be material?

- The impact of price discounts on altnets is likely to differ between Areas 2 and 3, and so separate analysis would be needed.
- For both Area 2 and Area 3 it seems highly likely that the price discounts under this offer would have a material impact on infrastructure competitors:
  - Rental discounts will be available for any CPs able to actively market and sell a FTTP lines within an Openreach FTTP footprint area, subject to achieving the ARPU target (which effectively implies selling a sufficient proportion of higher speed services. These discounts may reduce the price to below the cost base of an infrastructure competitor (limit pricing).
  - Even if the discounted prices remained above the competitor cost base, the reduced revenues would result in lower returns, harming investment incentives.
  - Impact on investment incentives is magnified by the fact that <u>discounts run until September 2022 and, according to Openreach, then endure indefinitely;</u>

<u>this means that the price reductions will have a long-term impact on rental revenues.</u>

176. Will OCTs generate clear and demonstrable benefits?

- According to Ofcom, Openreach internal papers indicate the rationale for the offer is to:
  - increase FTTP take-up;
  - test the impact of local marketing; and
  - underpin the FTTP business case.

177. We are not able to provide detailed insight into whether these justifications are acceptable. For example, it is not clear whether the offer increases FTTP uptake for Openreach but has a corresponding (or larger) reduction in FTTP uptake from competitive fibre networks.

178. Whilst we understand that the offer may underpin Openreach's business case, this must not be at the cost of the viability of other competing fibre networks.

179. Ofcom should conduct its own analysis of the validity of Openreach's rationale and provide a transparent assessment to stakeholders.

180. The points set out above indicate significant potential detrimental effects on the market and investment incentives for Openreach's competitors. It is our view that Ofcom needs to conduct a full and transparent analysis of this offer before recommending whether to grant its consent.

181. Although less extensive in reach than the Fibre Only Offer 2, the long duration of this offer would likely result in locking competitive network operators out of locations where one or more ISP has chosen to use this offer.

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8 Conclusions

182. As clearly and objectively demonstrated in this response, there are significant potential competition concerns and harm to investment in and deployment of competitive fibre networks resulting from the three offers, both in respect of geographic pricing and the use of OCTs by Openreach in its contractual arrangements with ISPs.

183. Ofcom appears to have not performed a meaningful analysis of the offers,[34] and we consider Ofcom’s conclusions to be ill-founded and unsound.

184. Ofcom has not performed separate analyses for individual relevant markets.

185. Ofcom's analysis assumed that two offers expired in 2022, when in fact they run until 2025 and 2026.

186. Ofcom should withdraw its recommendation to grant consent for the three offers and perform a full and transparent analysis, on which it should then base its recommendations for the three offers.

[34] Or has neglected to share that analysis with stakeholders in the consultation.

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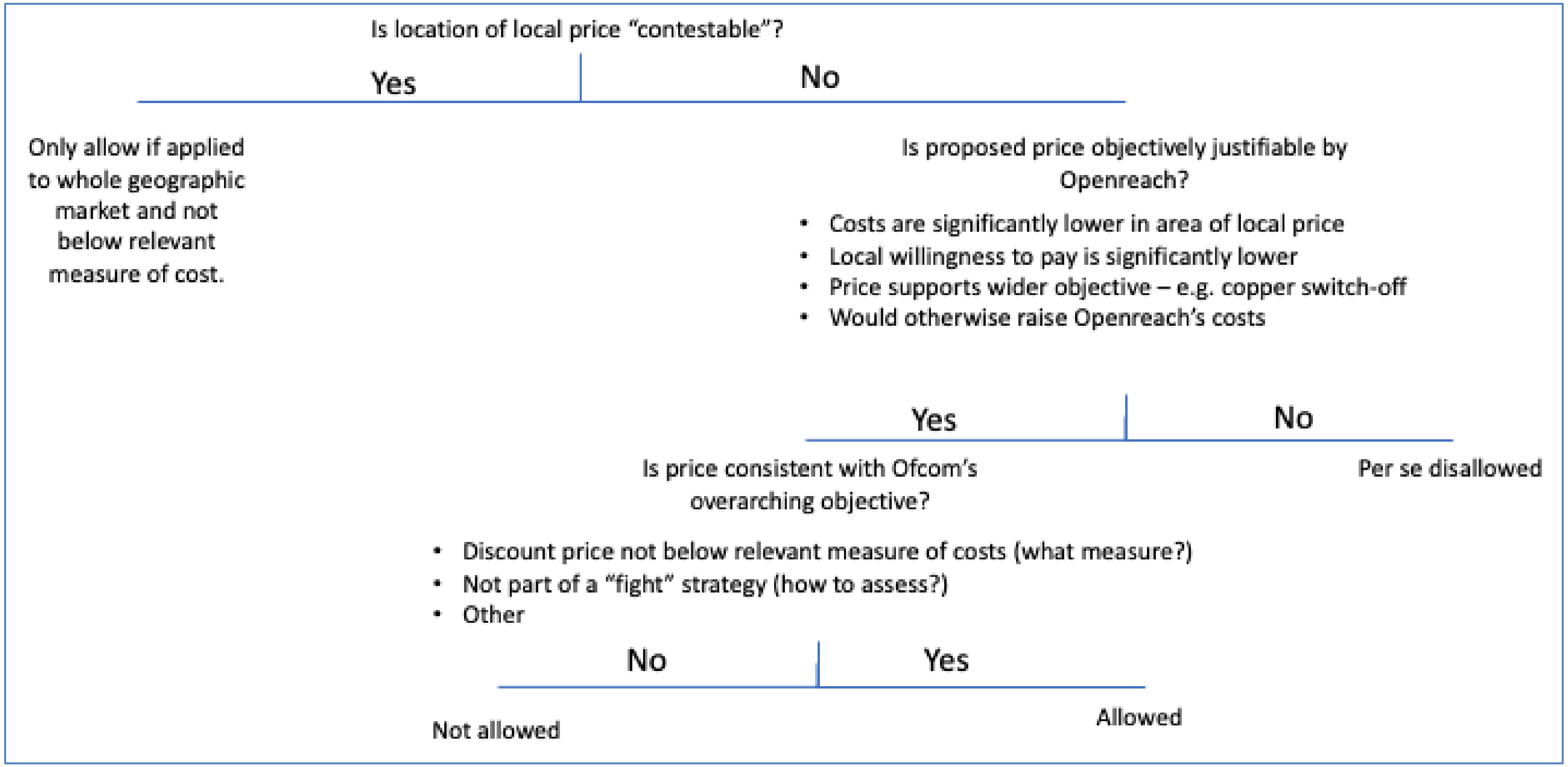
9 Annex 1 Decision trees

Geographic Price Decision Tree



OCT Decision Tree

Is impact of other commercial terms on nascent competitors likely to be material?

Examples:
- Raise barriers to entry/expansion
- Raise customer switching costs
- Effect a margin squeeze
- Others?

No

Yes

Presume allowed

Will OCTs generate clear and demonstrable benefits?

- Essential to Openreach's business case for fibre rollout
- Necessary to off more efficient prices that deliver consumer benefits

Yes

No

Presume OCTs allowed

Presume OCTs not allowed