

## **Ofcom Consultation on OR Equinox Offer Response from Fern Trading Limited**

### **Summary**

1. The Wholesale Fixed Telecoms Market Review ('WFTMR') required Openreach ('OR') to give Ofcom at least 90 days' notice of the introduction of commercial terms, such as volume discounts, that might give rise to competition concerns by deterring new network build by altnets<sup>1</sup>. On July 1 2021, OR notified Ofcom of its intention to launch a new national wholesale price discount offer, called 'Equinox'.
2. Fern strongly believes that the Equinox offer is not necessary in order for OR to deliver on its fibre rollout plan, and that it raises the following significant competition concerns:
  - Ofcom has failed to consider the different geographic impacts of the offer on the markets it identified as distinct in the WFTMR. Equinox has a disproportionate effect in Area 3, where build costs are higher. Ofcom has poor evidence on both altnet and OR build / operating costs in Area 3, and so cannot credibly claim to have assessed whether or not the offer impedes competition.
  - Ofcom has refused to consider the impact of lower wholesale prices on retail prices in Area 3, and the impact this is likely to have on altnet returns, and therefore their investment decisions. If Equinox is approved, Ofcom should expect rural broadband deployments by both OR and altnets, to slow down.
  - Instead, it has focused on the impact of the offer on ISPs when selecting whether to sell via OR or via an alternative network. While potentially relevant in Area 2, this is much less relevant in Area 3, where altnets at present typically do not offer wholesale access, and the main issue is the lack of any gigabit-capable broadband network.
  - In the WFTMR, Ofcom believed that a favourable price control on the anchor 40/10 product was necessary to stimulate fibre build in Area 3 by OR and by altnets. If OR's proposed discounts end up reducing its fibre revenues, this would demonstrate that it did not need this benefit. By allowing discounts to higher speed products, Ofcom is knowingly reducing competition and gigabit-capable coverage over the control period in Area 3.
  - This argument is bolstered by OR's announcement of an additional 1.8m Area 3 premises, after it had received the higher price control benefit. Even with altnets

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<sup>1</sup> 6 August 2021 Equinox consultation, 1.1

building networks at the rate of tens of thousands of homes a week, Ofcom has not grasped that most of Area 3 is commercially viable for altnets (provided the offer discounts are not applied). OR was already heavily incentivised to build, without additional regulatory support, because otherwise it would have lost out to altnets.

- The Equinox discounts will clearly reduce the number of rural properties that both OR and altnets can profitably build to. Lower revenue from customers results in lower financial returns to network operators for the same build location. By extension, operators will now no longer be able to make a commercial return at some properties. This means that the number of premises requiring public subsidy will increase. It will also increase the funding requirement per property, and reduce competition for Project Gigabit tenders.
  - Ofcom should expect the likely retail consumer price benefits arising from Equinox to disappear at the six-year break point, once the offer has adequately deterred competitors from investing in areas which could otherwise have supported two networks.
  - In fact, pricing beyond this point will naturally increase as competition will have been lower than otherwise in the preceding period – and further regulatory intervention will be required by Ofcom as OR will have maintained its dominant market position across the UK. In any event, Government made clear in the SSP that Ofcom should prioritise network investment over interventions to reduce retail prices, and this offer clearly does the opposite.
  - Lack of OR build plan transparency makes it impossible to assess OR's costs, and therefore whether Equinox pricing is fair. It also makes it impossible to assess the extent to which OR is cross-subsidising its Area 3 build from returns from its more profitable Area 2 locations.
3. It should be clear to Ofcom that the primary objective of Equinox is to undermine alternative network build, particularly in the more rural parts of Ofcom's Area 3. If Ofcom is serious about supporting altnet investment, it should do one of the following:
- a. not approve the Equinox offer;
  - b. if it must accept the offer, then ensure it does not apply in Area 3; or
  - c. put the offer start date back until the end of the current market review period, by which time OR will have had the benefit of the WFTMR charge control, and probably around 75% of the UK will be fully fibred.
4. If Ofcom accepts the offer, then it must also re-assess the revenue assumptions it used in the WFTMR. If the increased volumes arising from the discounts do not

offset the drop in price, then revenue will fall. This would show that OR can build in Area 3 with lower prices from its product mix than Ofcom previously thought possible. In this case, Ofcom should adjust the WFTMR charge control to claw back the additional revenue it has given to OR.

**Ofcom's framework for determining whether Equinox raises competition concerns is too narrow. It overlooks the fact that the discounted prices deter Area 3 investment because they push prices of products above 40/10 closer to cost.**

5. The WFTMR recognised that OR could design commercial terms which undermine altnet rollout, such as loyalty discounts, or pricing contingent on large volume commitments from wholesale customers. These terms would penalise access seekers for moving customers from OR to an altnet. Ofcom stated that its concerns applied to Wholesale Local Access ('WLA') and leased line product markets, where it determined that OR has Significant Market Power ('SMP')<sup>2</sup>.
6. Ofcom also stated that its concerns applied in both the 'Area 2' and 'Area 3' geographic markets it had defined<sup>3</sup>. It said OR could use commercial terms "*which applied in Area 3 alone to deter such build, potentially depriving consumers of greater choice and competition.*"<sup>4</sup> This focus on choice and competition confirms Ofcom's view that OR will always be present anywhere in Area 3 that an altnet builds. It does not recognise that many locations will support only one fibre network, and that if an altnet gets there first, OR is unlikely to build subsequently.
7. On July 1 2021, OR notified Ofcom of its intention to launch a new national wholesale price discount offer, called 'Equinox'. On July 2, Ofcom issued a stakeholder Request For Information ('RFI') on whether Equinox raised competition concerns, or was necessary for OR's FTTP business case or to benefit consumers. On August 6, Ofcom issued a consultation on the same subject.
8. The consultation set out seven categories of concern raised by stakeholders during the RFI process about the Equinox offer. The concerns were:
  - i. whether low OR FTTP prices act as a barrier to altnet entry and expansion
  - ii. whether conditionality acts as a barrier to altnet entry and expansion
  - iii. whether targeted discounts deter altnet build
  - iv. compatibility of Order Mix Targets with prohibition on geographic pricing
  - v. competitive impacts on ISPs
  - vi. whether the Order Mix Targets may leave vulnerable consumers exposed

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<sup>2</sup> 2021 WFTMR, Volume 3, paras 7.18-19

<sup>3</sup> Ibid footnote 445

<sup>4</sup> Ibid 7.31

- vii. various issues not directly related to the Equinox Offer
9. To assess whether the offer raised competition concerns, Ofcom cited the analytical framework that it previously set out in the WFTMR. This said that the creation of any barrier to using altnets would only be 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:
    - 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.<sup>5</sup>
10. Ofcom's considers that its first task, therefore, is to establish whether Equinox "*creates any barriers to using altnets*". Ofcom concludes that it does not, and therefore does not consider it necessary to go on to answer either questions a) or b) from its framework.
11. The fundamental problem with Ofcom's approach, which this response sets out in greater detail, is that it considers issues of anti-competitiveness purely in terms of ISP "*use of altnets*". It simply asks "*whether the terms of the offer could deter ISPs from moving volumes from Openreach to altnets by penalising them in some way*"<sup>6</sup>.
12. This question is certainly relevant in Area 2. But in Area 3, where competitors to OR may not offer wholesale access, it is not. It entirely overlooks the principal issue with the Equinox offer, which is that it deters altnet investment in Area 3 by virtue of pushing prices of products above 40/10 closer to cost.

### **Equinox has a disproportionate impact on investment in Area 3**

13. Ofcom believes that Equinox price levels do not warrant assessment in the absence of a prima facie competition concern. It believes that the charge control on the undiscounted 40/10 FTTP product exceeds the price that a competitor would need to charge in order to recover its efficiently incurred costs. As the higher bandwidth products discounted under Equinox command higher prices for similar build costs, provided Ofcom is right about the anchor product offering sufficient head room for a competitor, it believes it should also be right for these products<sup>7</sup>.
14. The problem with this analysis is that it fails to consider the different build and operating costs, and the different conditions of competition, in different geographic

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<sup>5</sup> WFTMR Statement, Volume 3, paragraph 7.154 and 7.160

<sup>6</sup> 6 August 2021 Equinox consultation, 1.1

<sup>7</sup> Ibid 2.30-32

markets. It therefore does not consider how the impact of discounted prices varies by location.

15. Our concern is that Equinox has a significantly higher impact in Area 3, defined by Ofcom as "*postcode sectors in which there is not, and there is unlikely to be potential for, material and sustainable competition to BT in the commercial deployment of competing networks*". Build costs are much greater in Area 3 than elsewhere. A discount which maintains headroom in Area 2 may not do so in Area 3. Ofcom has simply not assessed this in its consultation.

**Ofcom believed that OR needed the WFTMR price control benefit to incentivise it to build in Area 3. It is unclear whether the Equinox discounts will increase or reduce OR revenues. If they reduce, then OR clearly did not need the benefit of the price control to underpin its Area 3 investment. In this case Ofcom should adjust the charge control.**

16. Ofcom's Area 3 definition confirms its view that OR is the only operator capable of building fibre networks sustainably there at scale. Despite its apparent cost advantage, Ofcom thought that even OR would not invest unless incentivised by a cost-based charge control, which allowed it to recover costs and make a fair return on both its existing copper network and its new fibre investments.
17. Ofcom therefore set the control on the anchor 40/10 FTTP product at a level that it believed would encourage OR to build, while also giving sufficient head room for some limited altnet deployments. Ofcom's evidence for this position in Area 3 is very limited. It removed the OR operating cost model from its WFTMR model and replaced it with a basic percentage figure. It did not gather cost data from well-funded altnets, such as Jurassic and Swish, which are building at scale in Area 3. Ofcom does not have a strong understanding of Area 3 costs.
18. Shortly after receiving the charge control benefit, OR announced its intention to build 25m homes by 2026<sup>8</sup>. This included 5m premises in Area 3, i.e. 1.8m *more* than the 3.2m it had offered in return for the favourable charge control. These additional premises lie deeper in Area 3, and are more expensive to build.
19. It should be clear from OR's expanded plans that it did not need the charge control incentive to build at scale in Area 3. If OR had not invested, it would have lost out to altnets in the vast majority of Area 3. Ofcom fundamentally misunderstood the commercial viability of Area 3, as evidenced by the tens of thousands of premises currently being built there every week by altnets. It did not recognise OR's incentives in the face of this competitive challenge.

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<sup>8</sup> <https://newsroom.bt.com/bt-to-increase-and-accelerate-ftp-build-to-25m-premises-by-the-end-of-2026/>

20. When considering the incentives and capital available to OR to invest in its fibre build plan, Ofcom must have included OR revenues from all of its fibre products, before setting the charge control. If Ofcom accepts the Equinox offer, the revenues required by OR to build out its fibre network may be lower than those approved by Ofcom in the WFTMR, depending on whether increased volumes offset lower prices. If so, Ofcom should adjust the price control downwards, to remove this surplus benefit.
21. The fact that Equinox does not discount the 40/10 product is not relevant in this analysis. The offer drives down pricing of multiple higher-speed products towards or beyond the point at which operators can compete against the incumbent in Area 3. Ofcom does not appear even to have attempted to assess this geographic impact in this consultation, despite the requirement under the Government's *Statement of Strategic Priorities for telecommunications, the management of radio spectrum, and postal services* ('SSP'), for it to "*take account of differences in competitive conditions in geographic areas when designing network regulation.*"<sup>9</sup>

**Ofcom should focus on the impact of Equinox on retail prices in Area 3 and the knock-on impact of this on likely altnet investment, not on the impact of the offer in ISP decisions about which network to use**

22. Similarly, Ofcom does not consider that different conditions of geographic competition are relevant to its assessment of whether Order Mix Targets discourage ISPs from using altnets. Instead, it focuses on areas where altnets that supply FTTP to third-party ISPs are present, as it considers that "*these are the areas where altnets might potentially face increased barriers to entry and expansion as a result of the Equinox Offer. Whether they lie in Area 2 or Area 3 is not crucial to our analysis*"<sup>10</sup>.
23. Ofcom should focus on the wholesale price itself, across the product mix. In a competitive market, these prices are likely to be passed on in full at the retail level. Therefore, whether an altnet is wholesale or retail is irrelevant; the discounted prices will have a drag effect on all competitors to OR, such that it will be less economic for them to build.
24. Unlike altnets, OR, being a large national player with regulatory support, is able to survive such drops in revenue that make building networks in Area 3 much less viable. This is a clear example of anti-competitive behaviour by a dominant entity - i.e. exactly what a regulator should be preventing. The WFTMR was very clear that, at the wholesale level, "*price cuts damage new entrants*"<sup>11</sup>. Yet Ofcom appears to be

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<sup>9</sup> Para 20. Note: approving a discount offer which will determine conditions of competition for up to ten years is clearly a form of network regulation.

<sup>10</sup> Equinox consultation footnote 53, page 12

<sup>11</sup> WFTMR Volume 4, 1.22-1.24

minded to wave these discounts through and harm the free market competition it has helped generate in the sector in the past few years.

**The national Equinox discount allows OR to cross-subsidise from Area 2, where it can build profitably under the offer. This gives OR an unfair advantage over Area 3 operators, even if it does not build more efficiently.**

25. From an economic perspective, OR should (eventually) deploy everywhere that the combined revenues from both its regulated 40/10 product and its discounted faster products exceed its average build and operating cost. As it moves deeper into Area 3, its costs will rise, but its pricing will not. In other words, the national discount offer disproportionately affects less densely populated / more expensive build locations.
26. Unless, that is, OR cross-subsidises its Area 3 activities from Area 2. As the Equinox offer applies at a national level, this is exactly what Ofcom should anticipate. OR can still operate profitably in Area 2 after the discount, and it can use these returns to fund build in Area 3. This is a clear abuse of a dominant position.

**Price benefits will disappear in the long-term, and, in any event, should be subservient to near-term network investment**

27. The Equinox offer sets rental and connection prices according to the proportion of new and transfer OR FTTP orders in available areas, with connection discounts also applying in Area 2. Further discounts are available for new customers on OR's fastest FTTP product. The offer runs for ten years, to 30 September 2031.
28. While Equinox may deliver consumer benefits in terms of cheaper retail prices, we believe these will be limited to the six-year period, until the break clause which allows OR to review the offer prices. After this period, with competitors safely out of the way, OR's natural response will be to raise wholesale price rises significantly.
29. Ofcom has not properly considered this longer-term impact. This issue cannot be discarded because, as Ofcom appears to believe, the conditions of competition for fibre networks will have been fully established by 2026. While this may be the case for the UK's cities, the commercial network build plans of both OR and altnets for market towns and villages continue well into the next market review period.
30. The duration of the offer also cannot be discarded on the grounds that it is not "*a self-standing competition concern*"<sup>12</sup>. Ofcom is required by the Government's SSP to prioritise network investment over interventions to reduce retail prices<sup>13</sup>. It should ensure that national fibre coverage is achieved before seeking to reduce prices.

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<sup>12</sup> Equinox consultation 2.37

<sup>13</sup> DCMS SSP paragraph 18

31. Furthermore, any argument that, at a wholesale level, the impact on ISPs from Equinox is "*likely to be small and time limited*"<sup>14</sup> is completely unfounded. A ten-year discount (even with a mid-period break clause) is a material timeframe for any investor in the sector.

**Equinox is not necessary for OR to achieve its fibre targets**

32. A key question in determining whether the Equinox offer is anti-competitive is whether it is necessary in order to achieve OR's fibre targets and therefore make its investment viable. This is clearly not the case.

33. Firstly, as set out above, BT said publicly that it would achieve 25m fibre premises, and made this announcement without the benefit of knowing whether Ofcom would accept its discount offer. This demonstrates that the offer is simply designed to deter competitors; it is not a pre-requisite to meeting its target.

34. Secondly, the ISPs which currently buy FTTC and ADSL products from OR are likely to continue to do so even without the discount. Even with a regulated One Touch Switching process in place, they face a considerable barrier in moving their customers to another network, including the need for an engineer visit and the installation of new domestic equipment, for what is essentially the same product. Furthermore, ISPs which meet their OR FTTP:FTTC discount ratio are disincentivised from moving their customers to other networks, because doing so automatically lowers this ratio.

35. Given OR's intention to complete its fibre roll-out within the next five years, how can a ten-year discount offer be necessary in order to secure this? How can this be viewed as anything other than an attempt to limit competitor activity? How can Ofcom know now what impact this offer is likely to have on long-term competition when it has not made any assessment of this beyond 2026?

**Lack of OR build plan transparency makes it impossible to assess whether Equinox pricing is above its build and operating costs, throughout Area 3.**

36. We cannot assess whether Equinox pricing is fair without knowing where OR plans to build, and therefore what its likely costs are. If Ofcom has evidence that OR is *not* pricing below cost in Area 3, and is *not* cross-subsidising from Area 2, then it should present its case, showing which locations OR is going to and when, and what its build and operating cost assumptions are for these locations.

37. Listing near-term exchange plans doesn't help with this. It does not allow altnets to assess which premises will be built, when, and at what cost. BT's standard practice is

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<sup>14</sup> Equinox consultation 2.53



to build easy-to-reach towns, but then leave surrounding villages unbuilt while it moves on to more lucrative areas. (The economics of connecting these forgotten villages are such that they then become instantly out of reach to competitors, and can remain stranded for years - very much the opposite of an 'outside-in' approach).

38. However, since the WFTMR, OR has stopped providing even near-term exchange plans. Instead, its 25m premises are now categorised as either 'April 2021 to April 2024', 'April 2022 to April 2025', or 'April 2021 to December 2026' (with this latter category applying to virtually all market towns and villages in Area 3).

39. This uncertainty is a highly effective way to put off prospective competitors. It increases the likelihood of inadvertent overbuild at the expense of building locations that will support only one network, and it makes it almost impossible to prove anti-competitive behaviour by OR. Furthermore, it completely contravenes its 2019 transparency agreement with DCMS.

**Wholesale discounts are designed to induce loyalty, and are geographic in nature, as they only apply in OR fibre locations.**

40. Despite our primary concern being that Equinox deters investment in Area 3, it should also be clear that Equinox has loyalty-inducing effects for ISPs in Area 2, where wholesale access is more prevalent.

41. Furthermore, the new-to-network discounts directly target rival networks, and are clearly geographic in nature in that they apply only in areas where OR has built a fibre network. They therefore fall within the scope of Ofcom's WFTMR ban on geographic price discounting.

**Equinox will increase the number of premises requiring subsidy for fibre build, increase the funding requirement per property, and reduce competition for Project Gigabit tenders.**

42. Equinox will almost certainly affect the requirement for public subsidy in rural areas. For commercial build, the discounts will reduce the number of properties that operators - both OR and altnets - can profitably build to, as they diminish investment returns. This will increase the size of the area requiring subsidy.

43. This leads to a second and related harmful effect. Following Equinox, operators bidding for 'Project Gigabit' vouchers or state aid contracts must seek additional subsidy to offset the fall in revenue they can expect as a result of competing with lower Equinox prices. This will reduce competition in the tender process, and will therefore deliver less value for taxpayer money. It could lead to no one but OR bidding, exactly as happened with the subsidies for superfast broadband.

44. Credible Project Gigabit bidders will have to assume lower long-term revenues in order to compete with OR. Even in locations where OR is not present, ISPs are likely to demand similar pricing from altnets to those they receive on a national basis from OR through Equinox. As a result, more subsidy will be required, and the £5bn funding for Project Gigabit will result in fewer homes being passed and connected.
45. We realise that Ofcom and Government have different views on how best to fibre up Britain. During the WFTMR process, where DCMS consistently recognised the importance and scale of altnets in market towns and villages, Ofcom did not believe the altnet business plans it was presented with. Ofcom has already given OR a huge and unnecessary price control to help it build in the Area 3 locations that altnets were planning to go to. It should use this consultation to level the playing field.

### **Abuse of consultation process - again**

46. Finally, the process for this consultation has been unfair. Giving operators just four weeks during the August holiday period to respond to a huge and complex pricing document is clearly inadequate. If, as we understand, Ofcom has been discussing Equinox with OR for months prior to this consultation, this amounts to both discrimination between operators, and an abuse of process. There is almost total opacity with respect to the data and calculations that Ofcom has used to make its provisional assessment in this consultation, which makes it impossible for stakeholders to comment.
47. This forms part of a consistent pattern over the past few years of shortening consultation durations, inadequate Impact Assessments, and meeting with BT/OR more frequently than with other operators. Ofcom has shown that it is not willing to discuss these concerns<sup>15</sup>. It refuses to acknowledge that there might be aspects of stakeholder engagement and consultation that it could improve. It does not seem to understand that it becomes a better regulator when it goes the extra mile to ensure it takes into account stakeholder views to the fullest possible extent.
48. By working with OR to develop the Equinox offer, and then only offering a consultation to industry participants after protests from other operators, it is clear that Ofcom is encouraging build by the dominant market player in a manner that hinders its competitors. These competitors are the very thing that has finally stimulated OR into building fibre in the UK after years of inactivity. Ofcom is ignoring the role altnets have played, and will continue to play, in helping to fibre up the UK - which still languishes in the lower divisions of global connectivity.
49. In light of Ofcom's refusal to engage on this matter, we - along with other industry players - intend to take this up with Government. We want Ofcom to create clearer

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<sup>15</sup> Letter from Lindsey Fussell to GOS Consulting Limited, dated 12 Feb 2021.

and better rules over how it will conduct its consultations, what constitutes appropriate timing for responses, and to be more transparent over its interactions with stakeholders. Its current guidelines<sup>16</sup> say almost nothing of substance on this.

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<sup>16</sup> <https://www.ofcom.org.uk/consultations-and-statements/how-will-ofcom-consult>