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[X]

Gigaclear response: Openreach Proposed FTTP Offer ('Equinox')

Question 1: Do you agree with our assessment of the Equinox Offer as set out above?

Introduction and Summary

Gigaclear disagrees with Ofcom's proposed assessment of Openreach's Equinox offer.

Ofcom states that "all prices under the Equinox Offer are ... set at a level above ... the price that an altnet would need to charge in order to recover its efficiently incurred costs".¹ We consider this statement to be demonstrably false.

Rather, we propose that the Equinox discounts function to drive down the pricing of multiple product bands to be below the point at which network operators exclusively building network infrastructure in Area 3 could meaningfully recover their efficiently incurred costs. This will in turn undermine the business case for sub-national competitive entry in rural areas.

To evidence this point, in [X] we set out the scale of Openreach's planned FTTP overbuild of Gigaclear's network. This shows that Gigaclear will inevitably compete against the Equinox discount rates (should they be approved) during the period of the market review.

In [X], we test Ofcom's statement regarding all prices in the Equinox offer being at a level where an altnet can recover its efficiency incurred costs, by modelling the impact of Gigaclear adopting the 40/10 FTTP anchor price. [X].

This analysis indicates that exclusively rural operators competing against Openreach FTTP and who cannot blend their cost base with lower cost, urban areas, will struggle to recover efficiently incurred costs not just in their future build plans, but across their already live assets. As this is identified by their current investors, this will inhibit such operator's ability to raise further capital and consequently limit their future build ambitions and deter new entrants. This will inevitably have a chilling effect for Area 3 altnet investment; an outcome that Ofcom consciously sought to avoid in its WFTMR decision.²

Consequently, the competitive tender process of the planned 'Project Gigabit' contracts will be artificially weighted to Openreach's benefit, as altnets exclusively operating in Area 3 will require significantly more subsidy than Openreach in order to provide services that can compete against

¹ https://www.ofcom.org.uk/_data/assets/pdf_file/0032/222989/Equinox-condoc.pdf 2.33

² https://www.ofcom.org.uk/_data/assets/pdf_file/0025/216088/wftmr-statement-volume-4-pricing-remedies.pdf
2.58 – 2.59

Openreach's established pricing. This will likely result in the competitive tender process being significantly less effective in driving value for the taxpayer.

Given the scale of this identified harm, we urge Ofcom to act. Given the point of concern is largely the capacity for exclusively rural operators to recover their efficiently incurred costs, we propose that Ofcom do not permit the Equinox discounts to apply in Area 3 as defined within the WFTMR.

Procedural Consideration

Whilst Gigaclear welcomes the opportunity to comment on this consultation, we are concerned by the manner in which Ofcom has conducted its initial assessment of the Equinox offer.

Within this consultation, Ofcom arrives at its preliminary conclusion largely on the basis of responses it has received during a 10-day request for information (RFI) window.

Ofcom often grants 6 weeks for network operators to respond to statutory information requests, which are usually of significantly smaller scope to the issues relevant to the Equinox offer.

Given the scale and complexity of the detail of the offer and its potential impact, a 10-day timeframe to respond to the RFI is then inadequate; particularly so as Ofcom appears to have used the analysis it has received during this window as the evidence on which it has based its preliminary view.

If Ofcom is to then use an RFI to consider whether it should consult on relevant Openreach price changes (as established in Ofcom's WFTMR decision), it must consider the signaling effects of any preliminary decision it then arrives at.

We then advise that either Ofcom review the length of response time for any future such RFIs or avoid arriving at any preliminary conclusions prior to fully consulting on the proposed pricing change.

If this process is not amended, we are concerned that the timing of the RFI could be purposefully gamed to coincide with seasonal holidays, in order to limit the scale of objections and concerns brought forward by industry. It should be noted that a 10-day response period to inform an NRA's preliminary conclusion on such a commercially significant question is out of step with industry practice and may open Ofcom's eventual decision-making to legal challenge.

Principal Concern

Gigaclear's principal concern is that the lowest end of the Equinox discount is below the level at which an operator exclusively rolling out network in high-cost rural areas could recover their efficiently incurred costs.

The Equinox discounts then function to drive down the pricing of multiple product bands to be below the point at which such operators could meaningfully compete against the incumbent.

We are conscious that within the consultation Ofcom considers the danger of competitors to Openreach being unable to recover efficiently incurred costs when competing against the Equinox discounts.

Ofcom states that “Under the Equinox Offer, the price for the FTTP 40/10 anchor product is set at the regulated price ceiling” and that when establishing said price ceiling Ofcom “compared it with our estimate of the price that an entrant operator would need to charge in order to recover its efficiently incurred costs.”³

Ofcom’s position can then be summarised as concluding that, as the bottom rung of the Equinox discount model is not below the 40/10 FTTP anchor product price point, it believes that a competitor to Openreach could recover its efficiently incurred costs at the bottom price tier in the Equinox offer. From this point, Ofcom then concludes that “all prices under the Equinox Offer are ... set at a level above our estimate of the price that an altnet would need to charge in order to recover its efficiently incurred costs”.⁴

We consider this conclusion to be demonstrably false. The above Ofcom statement does not consider sub national market entry targeting build in exclusively high cost build areas (such as within Area 3).

This is because the 40/10 FTTP regulated anchor price ceiling is derived from Openreach’s average build costs across its nationwide footprint. The anchor price then reflects an above cost recovery point of a cost base that blends the rural, higher build costs of Area 3 with the urban, lower build costs of Area 2.

In effect then, Openreach is enabled to price at the FTTP anchor price level in Area 3 because of the comparatively lower build costs it faces in Area 2.

The 40/10 FTTP anchor may well then be at a point where an altnet incurring a similar average cost of build per premise past (CPPP) to Openreach could hypothetically recover their efficiently incurred costs.

However, any operator competing against Openreach FTTP purely in Area 3 will then be forced to compete against an FTTP anchor price point that does not fully reflect the higher costs of build in this geography.

The result is that if an altnet faces a significantly higher average CPPP than that of Openreach, it is unlikely to recover its efficiently incurred costs if it were to charge at the 40/10 FTTP anchor price point, nor at many of the discounted price points above this level in the Equinox discounts.

[<].

The WFTMR established that almost the entirety of Gigaclear’s network footprint falls within Area 3, an area that is, by definition, unlikely to sustain countervailing buyer power against Openreach in the period of the market review.⁵

³ https://www.ofcom.org.uk/_data/assets/pdf_file/0032/222989/Equinox-condoc.pdf 2.31-2.32

⁴ https://www.ofcom.org.uk/_data/assets/pdf_file/0032/222989/Equinox-condoc.pdf 2.33

⁵ https://www.ofcom.org.uk/_data/assets/pdf_file/0023/216086/wftmr-statement-volume-2-market-analysis.pdf 8.115

Further, [redacted] establishes the scale of Openreach's planned FTTP overbuild of the Gigaclear network, which establishes that Gigaclear's BDUK enabled footprint will see [redacted] Openreach FTTP overbuild by the end of 2026.

The scale of the overbuild and the absence of countervailing buyer power means that Gigaclear will inevitably be forced to compete against the Equinix pricing discounts.

[redacted].

[redacted].

[redacted].

[redacted].⁶

[redacted].

[redacted]. However, these Annexes consider the impact of competing against the 40/10 FTTP anchor to a) test Ofcom's statement, and [redacted].

[redacted].

Further, as identified by Ofcom in the WFTMR and in this consultation "alternative operators building new networks face considerable challenges in becoming established and overcoming Openreach's incumbency advantages. For example, Openreach benefits from economies of scale (meaning it has lower unit costs than an entrant); in relation to FTTP, a key advantage comes from Openreach having high existing customer volumes; and it has established relationships with ISPs and some level of system/process integration".⁷

Openreach's ability to then leverage its incumbency advantages and blend its Area 3 build costs with lower cost, urban locations in Area 2, results in the incumbent then being able to sustain a price point that [redacted].

[redacted].

[redacted].

Another Ofcom consideration may be that Gigaclear need not compete against Equinix discounts, as its BDUK enabled footprint will not be overbuilt by Openreach FTTP at scale. Ofcom signalled this expectation in the WFTMR.⁸

Despite Ofcom's assessment that such overbuild of pre-existing intervention areas would be unlikely given the assumed lack of commercial incentive for Openreach to invest in such areas, [redacted] establishes that Ofcom intend to overbuild [redacted].

⁶ [redacted].

⁷ https://www.ofcom.org.uk/_data/assets/pdf_file/0032/222989/Equinix-condoc.pdf 2.20

⁸ https://www.ofcom.org.uk/_data/assets/pdf_file/0024/216087/wftmr-statement-volume-3-non-pricing-remedies.pdf 2.70 (3rd bullet point).

In light of the evidence we have presented, we then propose that it is false for Ofcom to claim that all prices under the Equinox Offer “are ... set at a level above ... the price that an altnet would need to charge in order to recover its efficiently incurred costs”.⁹

The ramifications of the above are that the Equinox discounts then drive the wholesale price point of multiple Openreach FTTP bandwidth products down below the point at which a competitor could recover their efficiently incurred costs when rolling out infrastructure exclusively within Area 3.

Commercial Impact

The impact of this outcome will be that FTTP network operators exclusively rolling out their infrastructure in Area 3 will increasingly struggle to recover their efficiently incurred costs, as the Openreach FTTP rollout expands to overbuild their pre-existing assets. This will in turn undermine any future build plans they have.

This impact will be seen first in areas already overbuilt, where the Equinox offer will likely drive a monthly line rental price reduction in Openreach enabled FTTP services at a retail level.

Again, given the absence of countervailing buyer power, competitor networks will come under pressure to price match in these areas.

To give an indication of the potential scale of this change, we refer Ofcom to Figure 2.9 of Volume 2 of their WFTMR decision.¹⁰ In Ofcom’s consideration of competitor network pricing, Ofcom only captured a single competitor that exclusively builds in rural, difficult to reach areas, that being Gigaclear. Ofcom will see that Gigaclear’s pricing is considerably higher than industry average, reflecting the far higher cost of network build in the areas Gigaclear serves.

To then assess the impact of how the Equinox discounts would compete against altnet operators in Area 3, we would advise Ofcom to re-run this analysis with only Area 3 wholesale operators’ pricing and to overlay this with the proposed Equinox price points. We expect that this will reveal a significant gap between the Area 3 altnet average price points and the Equinox discount ladder. For Area 3 altnets then competing against the Equinox discounts, they are likely to experience falling ARPU’s when compared to their current wholesale ARPU rate.

Lower penetration caused by overbuild of FTTP, combined with lower ARPUs due to competing against the Equinox discount, will then drive down returns for altnet build in Area 3. Our modeling suggests that this will likely result in leaving these operators unable to recover their cost of build in these areas.

As this impact expands as Openreach’s overbuild in Area 3 grows, it will be identified by the respective altnet’s investors who will hold covenants that govern the release of capital to fund future build. These covenants will likely be triggered by falling ARPU and penetration.

⁹ https://www.ofcom.org.uk/_data/assets/pdf_file/0032/222989/Equinox-condoc.pdf 2.33

¹⁰ https://www.ofcom.org.uk/_data/assets/pdf_file/0023/216086/wftmr-statement-volume-2-market-analysis.pdf

Figure 2.9

These will consequently restrain the allocation of further capital for competitor build. This process will also prompt a signaling effect to other sources of potential investment in non-incumbent Area 3 network operators, resulting in deterring any potential new entrants.

In time, it logically follows that these factors will function to foreclose sub-national entry and wider competition in Area 3. Once this has occurred, Openreach's commercial incentives to continue investment in Area 3 will be reduced, as it will no longer be required to deploy capital to the same extent in order to protect its pre-existing market share.

Impact on 'Project Gigabit' and current aid programmes

[REDACTED].

This will likely result in a net reduction of premises receiving gigabit capable connectivity. [REDACTED].¹¹

As for future aid programmes such as 'Project Gigabit', the disparity between Openreach and Area 3 focused altnets to recover their efficiently incurred costs when offering/competing against the Equinix price points will result in significantly more subsidy being required for altnets contesting state aid tenders.

[REDACTED].

Altnet operators competing against Openreach must already overcome the significant incumbent advantages that Openreach benefits from.¹² These benefits are then leveraged further if Openreach is permitted to drive down the pricing of multiple bandwidth products below a point where such competitors can recover efficiently incurred costs.

This means that operators that face higher average costs of build than Openreach will likely be unable to effectively compete against Openreach in bidding for such tenders. Rather, only operators with a similar business model to Openreach, where the cost base of build in Area 3 can be mixed with that of Area 2 to produce an average cost base that can be efficiently recovered at Equinix pricing, will be able to compete.

Sub national operators focused on Area 3 build will then be unlikely to secure bids, and so deterred from bidding. This reduction in viable competition to Openreach then risks the BDUK tender processes becoming effectively uncontested.

Considering the combined impact on both current and future subsidy programmes, we consider that the outcome will inevitably jeopardise the UK Government's target of at least 85% of UK premises having access to gigabit-capable broadband by 2025.

Proposed Remedy

¹¹ [REDACTED].

¹² https://www.ofcom.org.uk/data/assets/pdf_file/0024/216087/wftmr-statement-volume-3-non-pricing-remedies.pdf 7.45-7.46

As established in the above, our principal concern with the proposed Equinox discount is that it functions to drive down the pricing of multiple product bands to be below the point at which altnets exclusively building FTTP networks in Area 3 could recover their efficiently incurred costs.

This is because, as we evidence [§<] FTTP 40/10 anchor price is likely below the point at which such operators exclusively building in Area 3 can recover their efficiently incurred costs.

We then propose that Ofcom prohibit the proposed Equinox discounts from applying within Area 3.

As proposed, the Equinox discounts disproportionately inhibit competition in higher cost build areas. Amending the Equinox discounts so that they cannot then apply to such areas targets this change to the Equinox terms to where the harm to competition is caused.

This solution also builds on the precedent already established in the WFTMR. Ofcom has already acknowledged that the competitive characteristics vary across the country's geography, largely driven by factors of density, geography and ultimately cost to build. This informs whether an area is likely to sustain competition and on this basis Ofcom designated areas and varied its remedies accordingly.

Considering Equinox's impact on competition in each area as defined within the WFTMR is then aligned to the regionalised approach that Ofcom has already established.

The outcomes of amending the Equinox discounts in this way would also align to Ofcom's own stated priorities. In the WFTMR statement, Ofcom acknowledged the scale of non-incumbent investment in Area 3 and that the designation between areas is likely to be imprecise; so accepted that competition may materialise in Area 3 and amended the WFTMR outcome to acknowledge this.¹³

Further, the Statement of Strategic Priorities obliges Ofcom to "prioritise investment over reduced retail prices in the near term [and] to promote investment and competition... to as many people and places as possible" and Ofcom is required to have regard to this in its regulatory decision-making.¹⁴

In addition, we have provided evidence that [§<]. Ofcom must then address this evidence, or risk opening itself to legal challenge should it ultimately fail to act, permit Equinox to discount pricing to a level that only Openreach can readily replicate and so effectively foreclose competition in an area that could otherwise sustain it.

To clarify, this proposal does not seek to re-run the WFTMR and the logic behind the 40/10 FTTP price anchor.

At the time of the market review, Openreach's build plan in Area 3 was deemed to be the 3.2 million it offered to enable the RAB forecast approach. The risk of Openreach FTTP scale

¹³ https://www.ofcom.org.uk/_data/assets/pdf_file/0025/216088/wftmr-statement-volume-4-pricing-remedies.pdf 2.57 – 2.59

¹⁴ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/952627/SSP_-_as_designated_by_S_of_S_V2.pdf paragraph 18

overbuild of Area 3 altnets was then significantly less than the context of this consultation, where Openreach has since expanded its Area 3 build plan by an additional 3 million premises.¹⁵

Neither could the WFTMR have preempted that Openreach would subsequently seek to reduce its FTTP pricing to push multiple product bandwidths closer to the 40/10 FTTP anchor price.

It is then largely events that have occurred since the close of the WFTMR that have created the issue at hand.

Whilst the 40/10 FTTP anchor point then remains appropriate when considering Openreach's nationwide cost base, events since the WFTMR decision should prompt Ofcom to consider the impact of the Equinix discounts being a price model that Area 3 focused altnets must compete against, and whether it is appropriate for them to do so.

Consideration of Ofcom's RFI statement

We note that in Ofcom's RFI statement, it associates concerns regarding high cost of build and the ability to recover efficiently incurred costs, with concerns regarding lower wholesale prices. We advise that Ofcom consider these issues separately. Whilst we are sympathetic to arguments extended by others regarding the competitive impact of falling wholesale pricing from the incumbent, we appreciate that Openreach should be enabled to react to competition (within the limits of competition law) and that such a response to competition has positive outcomes for consumers.

Our concerns here are separate to these arguments. We do not dispute Openreach's right to respond to competition. Rather, our concern is wholly regarding the ability of networks exclusively building network infrastructure in Area 3 and their recovering of their efficiently incurred costs when competing against the proposed Equinix discounts.

Explanatory Note: Annexes

[X].

[X].

[X].

[X].

[X].

[X].

¹⁵ <https://www.ispreview.co.uk/index.php/2021/05/openreach-boost-rural-ftp-broadband-build-to-6m-uk-premises.html>