



**Call for Inputs: Openreach proposed FTTP offer starting
1 October 2021**

TalkTalk submission

July 2021

NON-CONFIDENTIAL

1 Summary

- 1.1 This is TalkTalk's response to Ofcom's Call for Inputs (CFI) dated 2 July 2021, regarding Openreach's proposed FTTP Offer ("Equinox").
- 1.2 TalkTalk welcomes Ofcom's CFI on this issue, allowing Ofcom to gather stakeholder views before coming to its initial proposal. It is important that Ofcom takes full account of comments received on such an important proposed contract, which will have a significant impact on the evolution of the UK broadband market. Ofcom's openness in consulting on offers made available by a dominant firm such as Openreach is welcome, and should be continued in all future offers by Openreach to Communications Providers ("CPs").
- 1.3 Overall, TalkTalk considers that the offer does not have an exclusionary object or effect in the wholesale local access market, and should be passed by Ofcom. However, we do consider that there are some potential distortions to competition in downstream B2B2C markets and in retail broadband markets resulting from the structure of the deal, which should be dealt with via changes to the structure of the agreement, notably a carve-out for the wholesale divisions of Openreach customers, to prevent there being incentives to refuse to supply some customers in these markets.
- 1.4 Equinox does not have an exclusionary object or effect in the wholesale local access market:
- the offer is structured in such a way that it does not deter CPs from migrating FTTC customers to alternative FTTP networks. Rather, it focusses on disincentivising CPs from putting new customers onto Openreach FTTC in areas where Openreach FTTP is available. This means that altnet FTTP offerings are able to compete on their merits with Openreach.
 - the offer covers the whole area of Openreach FTTP in the UK. It is therefore not geographically targeted at areas where altnets have rolled out their networks. This supports the lack of anticompetitive object of the agreement.
 - the prices contained within Equinox are well in excess of the cost level of an equally efficient operator:
 - the offer does not involve any below Openreach cost pricing; the range of prices under the offer is from £13.93 to £22.00 per month. Frontier Economics have estimated that a price of £9.49 (indexed at CPI) would permit Openreach to fully recover its costs of FTTP roll-out, including a suitable return on capital employed. As such, Openreach's pricing, even under the proposed offer, is well in excess of its actual cost level.
 - [REDACTED]
- 1.5 In contrast to this, the Equinox offer raises potential competition issues in markets downstream of the wholesale local access market which Ofcom should consider when undertaking its assessment of the proposed contract:
- the prices in Equinox remain substantially above cost. This will inflate the price of FTTP products to end consumers, and reduce the number of customers upgrading from FTTC to FTTP, thereby undermining Ofcom's ultimate policy objective of ensuring widespread usage of FTTP products.

- [REDACTED]
- [REDACTED]
- [REDACTED]

- 1.6 Consequently, and subject to any facts which are revealed in Ofcom’s consultation on the offer, TalkTalk provisionally considers that Ofcom should, with minor amendments, pass the deal as being pro-competitive rather than anti-competitive. It will lead to gains in consumer welfare, by lowering prices which consumers will pay to consume FTTP products over the Openreach network, by as much as £58 per month for the 1000Mbps product. It is also likely to have externality benefits, as increased FTTP consumption drives economic growth and in particular increases in e-commerce activities, and in the ability to undertake high quality remote video-conferencing, reducing long-term pressure on transport networks and supporting the UK’s net zero targets.
- 1.7 There is also a need for Ofcom to consider the likely competition outcomes in the FTTP network market in greater detail. The high switching costs in this market mean that customer bases will be substantially locked in when each customer first takes FTTP. This is likely to blunt competition, and create barriers to entry for altnet FTTP builders. While these features are not directly due to the Equinix agreement, they are features of the market in which Equinix will operate, and as such Ofcom should conduct greater analysis on them than it has done to date.
- 1.8 The remainder of this submission sets out TalkTalk’s reasoning in greater detail.

2 The offer is unlikely to exclude altnets from the market for WLA FTTP

- 2.1 One of Ofcom’s primary concerns in its assessment should be whether the offer has the object, or potentially has the effect, of excluding altnets from the WLA FTTP market.
- 2.2 The most likely manner in which this could happen would be if the offer deterred investment in FTTP by altnets. It is unlikely that Openreach could cause exit from the market by an altnet which had already invested in FTTP; the costs of FTTP are sunk at the time of investment, with very low variable operating costs. This has been demonstrated by Virgin Media’s previous bankruptcies, none of which led to exit from the market, or indeed have prevented VM from continuing to extend its network (albeit after a considerable hiatus).
- 2.3 There are several potential ways in which an offer agreement from Openreach for FTTP could lead to an exclusionary effect:
- if it generated a “*suction effect*” through retroactive rebates, of the type seen in European Commission decisions such as *Intel, Tomra and TetraPak*.¹ It is well known

¹ A retroactive rebate is one where, once a threshold volume is reached, a discount is applied across all units. So, for example, such a rebate structure might be where the standard price is £10, but once

in the literature that such rebates being employed by a dominant firm, by creating a gap between the incremental cost and average cost of service, can exclude even an equally efficient operator.

- if it involved prices which are below the cost of an equally efficient operator, meaning that even efficient entrants could not earn returns equal to or greater than their cost of capital.
- if it targets discounts at areas in which altnets have rolled out, potentially deterring entry through Openreach establishing a reputation for fighting entry.

2.4 As shown in the remainder of this section, none of these factors hold. As such, the offer is unlikely to have the object or effect of deterring entry or expansion by altnet FTTP investors.

2.1 The offer does not involve retroactive rebates

2.5 The first potential means by which a discount offer could deter entry or expansion is if it involves the application of retroactive rebates, particularly those which operate on a personalised basis (see, for example, the *Tomra* decision of the European Commission at §§224-226). Such rebates can generate what is known as a “suction effect”, where the price required to be offered by an entrant is below the cost of an equally efficient operator, or indeed below zero. They rely on the downstream party to the agreement having to place a large proportion of their demand with the dominant firm in order to obtain discounts, and the entirety of the discount being lost if the minimum volume condition is not met.

2.6 However, the discount scheme set out in the proposed offer is not of this type, although it is a conditional discount scheme. Rather, discounts are conditional on the proportion of demand *with Openreach* placed on different products from time to time, with CPs having to maintain a consistent 90% of new acquisitions in FTTP areas taking FTTP products in order to obtain the discounts. The split of demand between Openreach and other FTTP providers is therefore of no consequence for CPs’ ability to obtain discounts under the terms of the offer.

2.7 The structure of the discount scheme set out in the proposed agreement therefore has no exclusionary effect on altnets, as it can be met even while a large proportion of a CP’s demand is placed with other networks, as long as the vast majority of demand on the Openreach network is for FTTP products rather than FTTC.

100 units are bought, the price drops to £9. This means that if 99 units are bought, the total expenditure is £990, whereas if 100 units are bought, expenditure is £900. This creates very strong incentives to ensure that at least 100 units are bought.

2.2 The offer does not involve below cost pricing

- 2.8 The second manner in which the offer could have an exclusionary effect on altnets is if it involved below cost pricing, such that an equally efficient altnet could not profitably match Openreach's FTTP prices.
- 2.9 In order to determine if this is the case, the primary form of assessment which has to be undertaken is to compare the average cost to serve an FTTP customer with the average revenue which is earned by Openreach under the offer.
- 2.10 Such a determination is complicated in the current case by the largely fixed cost nature of FTTP networks. This means that the average costs to serve are heavily contingent upon the number of customers connected to the network, as there are increasing returns to scale, with the average cost continuously falling as the number of connected customers increases. It is further complicated by the nature of the investment being undertaken by Openreach, as FTTP is not a stand-alone network, but rather is an upgrade to an existing network.
- 2.11 However, Frontier Economics has recently undertaken, on behalf of TalkTalk, an analysis of the average cost for Openreach to serve FTTP customers. This analysis is based on data published by Ofcom in the context of the WFTMR21, and on data published by BT as part of its Regulatory Financial Statements. The break-even price for FTTP has been modelled on a discounted cashflow basis over a 40 year period, allowing time for long-lived FTTP assets to be depreciated.
- 2.12 Frontier's analysis found that the required ARPU for Openreach to offer FTTP is £9.49 per month (indexed at CPI) on average across the products. This compares to a range of £13.93 to £22.00 per month under the offer— that is, even the lowest price product is 47% above the price required by Openreach. The average price across the full range of FTTP products is likely to be well above this, as a large proportion of customers are likely to take 80/20 or faster products, and this proportion is likely to increase over time. Frontier also undertook sensitivity analysis around this estimate, and produced a high price sensitivity, with lower take-up and lower efficiency gains over time. In this case, the required ARPU increased to £12.60 per month— still well below even the cheapest product available under the terms of the offer.
- 2.13 Consequently, there is no meaningful prospect that the offer could exclude an equally efficient competitor to Openreach. Such a competitor could undercut Openreach's prices by a considerable margin, and win business from Openreach's customers. The level of prices proposed under the offer therefore will not have an anticompetitive effect.

2.2.1 [X]

- 2.14 Another way to look at the exclusionary impact of the pricing in the Equinix offer is its relationship to the prices charged by altnet FTTP operators. Both altnets and Openreach are offering an essentially identical product from a technical perspective, and consumers are expected to be unable to perceive any difference between altnet FTTP networks and the Openreach FTTP network when using them.

- 2.15 Consequently, as Openreach will not have a quality advantage, altnets should be able to compete effectively for customers if they are able to match or beat Openreach’s prices.
- 2.16 At the same time, altnets will not enter into contracts which are loss-making for them, as it would make no commercial sense to do so. As such, it is reasonable to presume that the prices in altnet contracts with downstream CPs are at or above their expected average cost to serve.
- 2.17 Combining these two points, it can be assumed that if Openreach sets a price in excess of the price charged by an altnet FTTP operator, then the Equinox offer will not act to foreclose that altnet FTTP operator.
- 2.18 The prices currently proposed by Openreach under the Equinox agreement are as set out in Table 2.1:

Table 2.1: Openreach pricing under Equinox

Variant	Monthly rental at contract start	Annual indexation
40/10	£13.93	Per list price
55/10	£14.75	Defined by 40/10 Mbit/s price increase
80/20	£14.75	Defined by 40/10 Mbit/s price increase
115/20	£15.50	Defined by 40/10 Mbit/s price increase
160/30	£16.20	CPI-1.25% (with a 0% floor)
220/30	£18.00	CPI-1.25% (with a 0% floor)
330/50	£19.00	CPI-1.25% (with a 0% floor)
550/75	£20.00	CPI-1.25% (with a 0% floor)
1000/115	£22.00	CPI-1.25% (with a 0% floor)

- 2.19 Openreach has therefore set a significant price gradient for its FTTP products under Equinox, with prices rising as higher speed variants are offered, despite there being no cost difference to provide the lower speed and higher speed variants.
- 2.20 [3<]

- 2.21 [REDACTED]:
- [REDACTED];²
 - [REDACTED];³
 - [REDACTED].

2.22 [REDACTED].

2.23 [REDACTED].

2.24 [REDACTED].

2.3 Ofcom should carefully consider the manner in which competition will occur in FTTP markets

2.25 Notwithstanding that the Equinix agreement will not have the effect of distorting competition in the FTTP network market, Ofcom should carefully assess competition in that market, and should determine whether any regulatory actions are likely to be required to ensure that there is vibrant competition and adequate protection of downstream consumers of the products of that market.

2.26 This is because of the high switching costs between FTTP networks, both for CPs and for consumers, relative to potential cost savings. FTTP networks are essentially undifferentiated in terms of their quality and features. The primary reason for switching is therefore in order to obtain lower price.⁴

- 2.27 However, there are high switching costs for CPs looking to move their customer bases between networks:
- the CP will have to persuade its customer base to accept a new FTTP line being installed into their houses. This will in every case require an engineer visit, in order to drill a new hole through the wall in order to get the FTTP line inside, and to install new OLT equipment; the customer will therefore have to be at home, in general on a weekday. The customer will have to accept this without gaining any improvement in their services; this is in stark contrast to the initial installation of FTTP, which will grant the consumer significant direct benefits. In practice, persuading the customer base in this way is likely to require a combination of financial incentives and costly informational campaigns.
 - the CP will have to engage in dual running of two FTTP networks in an area, potentially for an extended period. This is likely to increase that CP's costs, particularly through adding complexity to operations, with separate call centre scripts

² [REDACTED]

³ [REDACTED]

⁴ There may also be a small amount of switching relating to firms' brands and customer service wrappers. However, even this is likely to be much reduced with FTTP in place, as inbound customer calls and webchats generally relate to service problems, which will be much reduced on FTTP circuits.

required; systems that are able to deal with there being two different engineering approaches required for any repairs; and potentially slightly different technical network structures to be taken into account.

- the CP is likely to have to pay connection charges for customers switching to the new network; [X]. These charges are likely to be significant compared to the potential savings in monthly rental charges which can be made; [X].

2.28 Equally, a customer wishing to switch FTTP networks on an individual basis will experience significant switching costs:

- they will only be able to switch when out of contract, or will pay termination charges to their existing provider. This is likely to be the same as switching between CPs operating on the same network;
- they will have to pay any initial charges levied by the network which they are switching to;
- there will need to be an engineer visit to their house to install the new network. This visit is likely to have to be on a weekday, in order to avoid additional engineer charges and to fit with engineers' work patterns; even if weekend appointments are available, they will inevitably be for a minority of customers. Consequently, most customers are likely to have to work from home (potentially without any broadband available) or take a day off work in order to switch.
- the need for an engineer visit, potentially at a time when there are many people attempting to switch between networks, is likely to involve some delay in order to find a suitable appointment. Delay in being able to consume a new product is effectively a hedonic (rather than pecuniary) switching cost, as it reduces customer satisfaction; this is the reason that most industry switching codes specify a maximum time which it should take to switch.
- there will generally either be a period of dual payment of two broadband providers or a period when the premises is without fixed line broadband, as it is difficult to ensure, given current processes for switching between FTTP networks, that the last day of the customer's contract can be aligned with the date when the engineer visits the customer's premises. Even in the event that the customer moves to being out of contract, it will still be difficult to align the provisioning date with the last day of the month-to-month broadband service, while at the same time the customer will have to pay higher charges as an out of contract user.

2.29 These switching costs are likely to significantly blunt competition between FTTP networks once customers have initially upgraded from FTTC/ DOCSIS to FTTP. At that point, customers are likely to be willing to incur costs, in exchange for the much improved broadband service they will subsequently receive. However, in the absence of such improved quality, the switching costs are likely to significantly outweigh any slight difference in rental charges which the customers may be able to obtain. At the same time, there are unlikely to be 'push' factors for switching in the form of customer dissatisfaction with the quality of service provided by an FTTP network. Cross-network switching rates are therefore likely to be very low.

- 2.30 At the same time, these barriers to switching mean that altnets will not overbuild Openreach FTTP networks. Once Openreach has built in an area, and customers have begun to migrate to the Openreach FTTP network, the addressable market in that area will rapidly reduce. Customers will not switch from the Openreach to the altnet FTTP network; BT Retail and its sub-brands (Plusnet, EE) will not switch; and as a result it will be uneconomic to build in an area, as the prospects of achieving viable scale will diminish. This will reduce altnet FTTP construction, and mean that from the mid-2020s there are likely to be few areas which are viable for altnet build.
- 2.31 It is a standard feature of the economic literature that very low switching rates between service providers, in the presence of high switching costs, tend to blunt the intensity of competition; this will be reinforced by the impact on altnet FTTP construction caused by Openreach FTTP construction. While there may be switching between providers on the Openreach network, switching between providers on different networks is likely to be low, and as such competitive tension between the different networks will be low. Ofcom should therefore consider carefully, in the context both of the Equinox agreement, but also the market more generally, how it can ensure that competition is retained in the network market following the transition to FTTP.

3 Ofcom should take account of impacts on downstream markets

- 3.1 Section 2 of this response has set out TalkTalk's views on the impact of Equinox on upstream FTTP markets, and in particular that Equinox will not create an anticompetitive effect in those markets.
- 3.2 However, Ofcom should also consider the competition impact of Equinox in downstream consumer broadband markets. Failing to do so risks Ofcom missing consumer detriment, and enabling BT to vertically leverage its market power from Openreach into its downstream BT Consumer and BT Enterprise divisions.
- 3.3 There are two further layers downstream of FTTP networks – the market for B2B2C products (where purchasers from FTTP networks themselves supply downstream CPs, and have no direct relationship with end users) and the market for B2C products (where purchasers from Openreach then directly supply user households and businesses). These will be considered in turn in this section.

3.1 Impact on B2B2C markets

- 3.4 BT (through BT Enterprise) and TalkTalk are the two largest firms operating in the B2B2C broadband market; TalkTalk has [redacted], situated within that market. The B2B2C market offers significant benefits to consumers by increasing competition in consumer retail markets, and by providing greater choice than could exist with the five main suppliers alone. Many of these providers appeal to particular niches, and therefore help better meet varied consumer tastes.

- 3.5 One of the features of the B2B2C market is that the intermediary does not have any relationship with end customers; it only has relationship with the downstream CP. This means that there is much less control over which products consumers take.
- 3.6 The relationship with the downstream CP is governed by contracts which are only intermittently renegotiated, and which would not generally provide the ability for the B2B2C provider to dictate which products consumers take. Rather, they would be on the basis that the intermediary provides whatever services are requested, on the basis of a predetermined set of prices.
- 3.7 This means that mix thresholds of the type in the Equinox contract are problematic for B2B2C providers, as they have no real means of ensuring that they are met. [REDACTED].
- 3.8 The practical effect of this is likely to be that there is a lessening in competition for the B2B2C contracts of CPs with relatively poorer customer bases, which are likely to have a low proportion of their customers wanting to take FTTP products. Such B2C CPs will make it harder for B2B2C CPs to meet their targets under the Equinox agreement, meaning that the incremental cost of serving them will tend to be higher than the average cost under Equinox. Indeed, in the case of a large B2C CP which took its B2B2C provider from having 90% FTTP sign-ups to 80% FTTP sign ups, the incremental cost to serve that CP would be well in excess of the Openreach list price. They will therefore be less attractive to serve, and will either face higher prices, or potentially potential suppliers refusing to deal with them because of their cost impact.
- 3.9 [REDACTED].
- 3.10 It would therefore be pro-competitive, and less distorting of markets, if there were a permanent carve-out for the reseller businesses of CPs, allowing them to be treated separately for the achievement of Equinox targets for the first five years of the agreement, [REDACTED]. In the absence of such longer-term separate treatment, competition for resellers' contracts is likely to be reduced, and broadband wholesalers' businesses may be harmed through no fault of their own.

3.2 Impact on B2C markets

3.2.0 *Potential loss of competition for vulnerable consumers*

- 3.11 As pointed out in section 3.1 above, competition for B2B2C contracts may be reduced as a result of the structure of the Equinox agreement. Taking on a wholesale contract with a B2C provider which continues to pursue FTTC customers will risk the upstream B2B2C provider failing to meet its Equinox targets, and therefore losing rebates under the agreement.
- 3.12 The same is likely to be true for B2C providers considering taking on an FTTC customer. Each FTTC customer taken on will reduce the prospects for the CP in meeting its Equinox targets; consequently, many providers are likely simply to stop offering products other than FTTP to customers in Openreach FTTP areas.

- 3.13 Such an effective market-wide stop sell may have detrimental impacts for vulnerable customer groups. There remain some customers in the market using legacy personal care alarms which can only be served over copper networks; there also remain older customers in the market with limited usage of broadband over their fixed line network, who will see little benefit from speed increases. For such customers, it is likely to be an unattractive prospect to have the cost and disruption of an FTTP line being installed.
- 3.14 As a practical matter, these types of customers are likely to face diminished competition for their business. While the Equinox contract will not deter providers from retaining those customers wanting or requiring FTTC which they already have, it will have the impact of deterring CPs from acquiring new non-FTTP customers. This is likely to lead to increased prices for these customers, particularly once their incumbent providers realise that there is weak competition for them to switch away.
- 3.15 Ofcom should therefore consider what measures, if any, could be adopted to ensure that competition is retained for such a vulnerable group of customers. An appropriate approach could, for instance, be for customers who need care alarms to be specifically subject to a carve-out, such that they are not taken into account when calculating whether the 90% threshold has been met.

3.2.1 *Urgent provisioning for vulnerable customers*

- 3.16 A second element which is not dealt with as part of the Equinox proposals is around the provisioning process for vulnerable customers. The current Equinox proposals create strong incentives on CPs to push all customers, including vulnerable customers, onto FTTP services.
- 3.17 However, suitable provisioning processes for vulnerable FTTP customers are not yet in place. A vulnerable customer with a healthcare alarm or with internet connected health monitoring equipment requires continuous service with no downtime at all. At present, TalkTalk is unsure how this can be ensured under Equinox, particularly since the equipment may need amendment (or complete replacement) to work over the FTTP network.
- 3.18 To ensure that continuity of service is preserved, Openreach should commit as part of the Equinox contract (or other commitment made contemporaneously) to either:
- a visit which is timed to include a rendezvous between the Openreach engineer and the Telecare engineer, to ensure that the systems are compatible and that the health systems are fully functional before the FTTC service is switched off; or,
 - the reconnection and basic testing of a customer's telecare equipment by the installing Openreach engineer as part of the installation visit.
- 3.19 In the absence of these solutions, there are likely to be reduced incentives on CPs to take vulnerable customers, as they will firstly have to take them as FTTC customers, making it harder to hit Equinox targets; and they will be more difficult to upgrade to FTTP, risking there being dual running costs as there is a need to support FTTC products for a longer period in a particular area. Ofcom should therefore coordinate with Openreach to ensure that the Equinox contract provides suitable protections for vulnerable customers.

3.2.2 Potential reductions in B2C market competition

- 3.20 TalkTalk supports Openreach's goal of encouraging customers to switch to FTTP where available, in order to avail themselves of the improved performance which FTTP offers.
- 3.21 However, the Equinox contract strongly encourages all customers to switch to FTTP, and many CPs are likely to introduce stop sells on FTTC in Openreach FTTP areas in order to ensure that the targets introduced under Equinox are met.
- 3.22 This will impose significant strain on engineering resource within Openreach, as large numbers of customers simultaneously attempt to switch to Openreach FTTP. This strain will be greatest in the early years of the contract, when there are few existing customers on FTTP, and where as a result nearly every customer switch or home move will require engineering resource for the FTTP upgrade.
- 3.23 TalkTalk is concerned that, with a need for such substantial engineering resource, provisioning lead times are likely to balloon, with customers unable to upgrade to FTTP in a timely fashion. This has previously happened in the Ethernet market at times when demand was higher than Openreach had planned for.
- 3.24 Such extended lead times are likely to inhibit customer switching. New providers will not be able to accept customers on FTTC initially without being penalised under the Equinox contract; but customers are unlikely to accept lead times of many weeks for changing provider. Many are likely to lose interest and remain with their existing provider. Such lower switching will reduce competitive tension, and may therefore increase prices to consumers.
- 3.25 In order to ensure that this reduction in competition does not occur, and generate consumer harm, Ofcom should closely monitor provisioning lead times for FTTP. If they start to extend upwards, Ofcom should not hesitate to reverse its incorrect decision in the recent WFTMR, and impose binding quality of service metrics on FTTP provisioning timescales. In the absence of appropriate incentives to maintain rapid provisioning, there is the scope for significant consumer harm.

3.2.3 Equinox weakens the SLA/ SLG regime

- 3.26 One element of the Equinox proposals which is potentially harmful both to downstream CPs, and to customers, is the weakening of the SLG regime which it brings into effect.
- 3.27 [X]
- 3.28 [X].
- 3.29 [X].
- 3.30 This weakening of the compensation payment regime is likely to lead to consumer harm, not least by weakening Openreach's incentives to meet its quality commitments. Ofcom should take action to ensure that these incentives are not weakened, [X].

4 Openreach's unilateral ability to amend terms post-signing

4.1 An issue which could potentially impact on competition at all levels– between networks, B2B2C, and B2C– is that as currently structured Openreach has the unilateral ability to amend various of the terms in the Equinix agreement after that agreement has been reviewed by Ofcom, and after signing.

4.2 [REDACTED]

4.3 [REDACTED]:

- [REDACTED];
- [REDACTED].

4.4 [REDACTED].

4.5 [REDACTED].

4.6 [REDACTED].

4.7 As such, Ofcom should, to as great an extent as possible, compel Openreach to only amend the terms of the contract in response to specific triggers, with the adjustment in response to those triggers being mechanistic. This would reduce the risk that Openreach engages in anticompetitive conduct in practice; make it easier for Ofcom to assess the agreement; and would make it easier for stakeholders to interpret the contract.