Virgin Media O2 response to Ofcom's call for inputs on ACCN OR728

Virgin Media O2 ("**VMO2**") welcomes this opportunity to respond to a call for inputs by Ofcom[1] on Openreach's first market wide pricing initiative published since the new SMP conditions determined in the Wholesale Fixed Telecoms Market Review 2021-26 ("**WFTMR**") came into force.

In summary, Openreach's new price plan[2] ("**Equinox**") is likely to harm competition and undermine Ofcom's strategic objective.

Applying the logic of Ofcom's Existing Openreach FTTP offers consultation,[3] it is clear that Equinox is geographically specific in its impact, and on that basis, must not be introduced by Openreach without Ofcom's express consent.[4] The effect of the discounts between new to BT network "(**NTN**)" and other customers ("**non-NTN**") is discriminatory – both in the sense of being geographically targeted and because it prices the same processes at different charges, with the clear object of lessening competition. The overall effect is that an already-dominant provider will be able to exert even more pressure to narrow the scope for alt-nets to enter and expand.

Given those effects, it is vital that Ofcom undertakes a thorough review of the Equinox pricing proposal. That review should focus on assessing the effect that Equinox will have on competition in the market.

The stakes are high in this first consultation under the new WFTMR pricing regime. All stakeholders will be looking to Ofcom to clarify its approach, both procedurally and analytically. Openreach's competitors, and their investors, will be seeking confirmation that Ofcom will enforce the safeguards it established in the WFTMR. Openreach will be looking to understand where the boundaries of the regime lie. Many years of experience should lead Ofcom to expect that Openreach will be as aggressive as Ofcom permits it to be.

In the WFTMR, Ofcom made it clear that the regulatory settlement aimed *"to promote competition and investment in gigabit-capable networks – bringing faster, better broadband to people across the UK."*[5] Specifically, *"encouraging competition between different networks where viable, which will provide high quality services, choice and affordable broadband for consumers throughout the UK. We recognise that it will require significant investment from private companies to upgrade the UK's networks, so they are fit for the future. Our decisions incentivise that investment – giving regulatory certainty and allowing companies to make a fair return whilst ensuring consumers continue to have access to affordable broadband as new networks are rolled out."*

Ofcom's strategic shift away from cost-based access regulation, the inclusion of a fibre premium, and a presumptive decade of regulatory certainty and clarity on BT's fair bet, were meant to stimulate BT and others to invest.

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[1] Call for inputs: Openreach proposed FTTP offer starting 1 October 2021 - Ofcom
[2] https://www.openreach.com/news/openreach-announces-special-offer-for-communications-providers-to-drive-adoption-of-full-fibre-broadband/
[3] https://www.ofcom.org.uk/__data/assets/pdf_file/0013/221332/statement-existing-openreach-fttp-offers.pdf
[4] SMP condition 4.5.
[5] https://www.ofcom.org.uk/__data/assets/pdf_file/0022/216085/wftmr-statement-volume-1-overview.pdf p.1

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Consequently, Openreach's pricing need to be viewed through the lens of both encouraging the migration from copper networks to fibre, but also ensuring that the incentives for investment for the roll-out of fibre remain for all network infrastructure providers and not just BT. To do otherwise risks not meeting the Government's objectives.[6]

Applying this principle specifically to Equinox, Ofcom should ask itself: will this new scheme make it more or less likely that there be a vibrant mix of competing fibre deployments in Area 2? If the answer is that it will make it less likely that competitors will invest, that scheme is harming, and not advancing, Ofcom's strategy. If Ofcom were to allow Openreach to implement wholesale pricing arrangements which provide the keenest pricing only to those access seekers in areas where Openreach faces competition from another infrastructure investor, it would dampen the upside of Ofcom's strategic shift to further investment in the UK by those other than BT for the next decade. The winner would be BT; the losers would be consumers, facing fewer choices and delayed or displaced fibre investments and hence, poorer outcomes.

Having reviewed the Equinox proposal, VMO2 has some significant concerns regarding particular aspects of the pricing proposals, specifically the differential pricing applied to both connection and rental charges as between:

- CPs connecting residential customers already on the Openreach network (non-NTN); and

- CPs connecting new residential customers to the Openreach network, so-called "New to BT Network (NTN) Residential customers".

Under the proposed scheme, NTN connections attract both:

- A 50% discount in connection charges within Area 2; and

- A rental discount which entitles the CP to procure "550/75M at the price of 160/30M for 12 months".[7]

These preferential terms for NTN connections would be available throughout the full term of the agreement, until October 2031.

The effects of this feature of Equinox, i.e. the NTN vs non-NTN discrimination, need to be considered carefully by Ofcom.

In setting a different price for NTN and non-NTN installations, the Equinox proposal:

1. Is discriminatory and therefore is in breach of SMP Condition 4 because:
    a. It is geographically targeted (falling within the scope of SMP condition 4.5). We explain why this is so in the next section; and
    b. It treats as different two situations that are, in truth, the same. NTN and non-NTN installations of new fibre connections are technically and operationally the same. An economically efficient price would be one that reflected this similarity (and the true economic cost of the resources needed to install a new connection). Discriminatory conduct which unfairly favours Openreach to a material extent so as to place the alt-nets at a competitive disadvantage is prohibited pursuant to SMP Condition 4.2;

[6] Statement of Strategic Priorities for telecommunications, the management of spectrum, and postal services, Section 1.3
[7] https://www.openreach.co.uk/cpportal/updates/briefings/ultrafast/nga201721

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2. Is loyalty inducing (when viewed in conjunction with other aspects of the Equinox offer) or similarly, a pre-committed punishment mechanism for disloyalty and therefore raises concerns pursuant to SMP Condition 8.6.

There is a dynamic as well as a static policy concern here. If Ofcom permits Openreach to implement the Equinox offer as it stands, Openreach will consider that it has the green light to go further. This would be a dangerous precedent to be setting. Openreach would subsequently have a clear incentive to surgically target further discounts towards NTN scenarios so as to exacerbate the competitive disadvantage of the alt-nets. The effect will be to reduce the incentives to continue to invest further in new gigabit-capable network infrastructure.

VMO2 submits that given that SMP conditions 4.2, 4.5 and 8.6 are engaged, Ofcom needs to signal clearly to Openreach that (i) the Equinox offer raises competition concerns that require ex ante intervention; and (ii) sets out in its provisional findings consultation the specific measures it seeks to impose on Openreach or the changes it will require Openreach to make to remove such damaging effects on competition.

The key change that Ofcom should require Openreach to make is **to remove all NTN and non-NTN differentiation from the terms of Equinox.**

Below we briefly set out our concerns on each of the points raised above in turn.

Targeted geographic pricing

In the WFTMR, Ofcom observed that Openreach has an incentive to use geographically targeted discounts to harm competition, especially in areas of alt-net build. This threat was sufficiently clear that it was necessary for Ofcom to prevent such strategies rather than merely being ready to react to them. Ofcom therefore set an SMP condition on Openreach which prohibited geographic discounting of rental charges:

> *"7.11 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.*
>
> *7.12 Rolling out FTTP is resource intensive and it is not possible to roll out in all areas simultaneously. If Openreach targeted discounts in areas where alternative new network is being built, this could reduce its competitors returns in the area and ultimately curtail its wider investment plans. This means Openreach may be able to deter large scale alternative network rollout (and therefore face reduced competition over a wider area) by reducing prices in relatively few local areas….."*[8]

[8] cp cit p.170

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It is also clear from the WFTMR, that Ofcom is alive to the fact that Openreach may seek to implement geographic price reductions in a creative, and non-transparent manner i.e. by implementing pricing provisions that on their face do not target specific geographies, but which when looked at in the round, the underlying effect is such as to amount to a geographic pricing restriction.

In para 7.72 of the WFTMR, Ofcom states that the "*geographic discrimination prohibition we are imposing prevents differentiated prices and other pricing measures which might have the same effect.*" "*We consider that Openreach applying a migration credit of any form in effect reduces rental charges. As such, applying a credit on a geographic basis amounts to charging different prices in different geographic areas for rental services and is therefore prohibited under the geographic discrimination prohibition*".

The difference in installation charges between NTN and non-NTN is a "migration credit". It is geographic in effect as the discounted connection and rental prices are only available at premises within the relevant areas that have access to alternative access networks. In Ofcom's recent statement regarding *"Existing Openreach FTTP offers with geographic pricing"*, Ofcom found Openreach's pricing to be geographic in nature for exactly the same reason i.e. that only certain categories of premises within an area qualified for a discount.[9]

In relation to the Local Marketing Offer, Ofcom noted

> *"Even if Openreach's intention was to use the offer to deter alternative network build, **it would likely be a very imprecise mechanism**, given the access seeker is selecting the locations. **We do not think it would be an effective way for Openreach to target geographic discounts at specific areas where rivals are building or planning to build**."*

Under Equinox, unlike the Local Marketing Offer, the geographic discount is surgically precise in targeting rival build and therefore would be expected to be an effective geographic pricing mechanism.

Although it is not defined across an area defined by postcode, Equinox is targeted to a category of connections that are equally geographically distinct – only those connections that are, or could be, served by a rival network could ever face the discounted charge, and only premises already taking a rival's service will receive the subsidy. As a result, Openreach benefits from avoiding the inefficiency (a deadweight loss to Openreach) of offering this incremental discount in any circumstance other than when reacquiring a customer back from an alt-net. As a result, it minimises the cost of this strategy to Openreach.

On this basis, Ofcom must consider whether there can be any objective justification for the differential pricing; and whether that pricing is consistent with Ofcom's strategic objective.

In weighing up that question, Ofcom should place little weight on any justification by Openreach that such a strategy is beneficial to its FTTP business case. If this was the case, connection charges would apply in both Areas 2 and 3 and the reduction in price would be available to <u>all</u> new connections and not just those that could be targeted by alt-nets.

[9] Statement: Existing Openreach FTTP offers with geographic pricing (ofcom.org.uk), para 3.4

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The more plausible explanation is that the commercial case for these discriminatory discounts is premised on the impact that they have on competition – that the object of the differential is the elimination of alt-net competition both existing and potential, and to lessen the intensity of competition between ISPs on the Openreach platform. Both of these effects harm the interests of consumers.

Discriminatory pricing

In addition, the NTN discounts within the Equinox scheme are discriminatory as they seek to impose different conditions on equivalent transactions.

All the connections are new installations. The only difference is that the CP has an ability to seek alternative supply from an alt-net. This unfairly favours Openreach to a material extent so as to place the alt-nets at a competitive disadvantage.

To test whether this is compatible with Ofcom's objectives, Ofcom should consider whether there can be any objective justification for the differential pricing; and whether it is consistent with our overarching policy objectives.

VMO2 finds no clear economic justification for this discrimination. If the aim was to reflect the underlying cost of connection, the price for NTN connections could be higher than non-NTN on the basis that a new connection to the network must be established. Instead the price is halved. VMO2 does not see how that commercial logic can be reconciled with Openreach's obligation to ensure its terms are 'fair and reasonable', More importantly, it is expressly a distortion of competition, designed to favour Openreach's own network business over third party networks. Because rivalry between fibre networks (which is Ofcom's strategic objective) can only occur where long-term investments in competing fibre are made, even the perception that Openreach could target its rivals is likely to undermine investment incentives of the alt-nets going forward and/or creates disincentives to competition in the downstream retail market between retailers on the Openreach network.

Balanced against this risk is the question of whether there is any corresponding benefit. There appears not to be – no case for the consumer or pro-competitive effects of such a difference are apparent. This is the point that Ofcom needs to test with Openreach: is there any objective justification that warrants allowing a price change that is otherwise likely to make consumers worse off?

Other commercial terms that act as a loyalty inducement

In the WFTMR, Ofcom stated:

> *"**In the January 2020 Consultation we set out our concern that Openreach could design commercial terms which undermine alternative network operator rollout.**[444] For example, commercial arrangements such as loyalty discounts or pricing contingent on large volume commitments from wholesale customers, **which penalise access***

> ***seekers for moving volumes from Openreach to an alternative network operator**." [10]*

Ofcom went on to conclude:

> *"**If Openreach uses commercial terms that undermine new network build, our starting point is that they are likely 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."* [11]

Finally, in para 7.159 WFTMR, Ofcom highlights:

> "*Our objective is to promote investment in gigabit-capable networks by Openreach and other operators in order to promote network-based competition, and this will be our guiding principle in assessing commercial terms proposed by Openreach.* ***Our key concern is commercial terms that could undermine investor confidence in new network build and impact rollout plans e.g. by discouraging access seekers from switching demand to alternative networks*.**"

The proposed terms of Equinox do not have volume-contingent discounts, or an explicit loyalty discount. But the structure of the scheme, especially with regard to the NTN vs non-NTN differential pricing, has the effect of encouraging loyalty/discouraging disloyalty.

Were a CP to opt to provision customers via an alt-net, they would be doing so in the knowledge that other Openreach CPs could seek to win the customer using NTN discounts made available by Openreach. This therefore acts as a disincentive for a CP to ever consider switching provision to an alt-net for the full 10-year period.

These tools would not be available to other CPs if the CP were instead to remain loyal and provision the customer via Openreach. In that context, the loyal CP would face dampened competitive pressure amongst other retailers that also remained loyal, as these lower NTN Equinox prices would not be available when competing amongst each other. This is not just a credible threat of punishment for those that are disloyal; it is pre-committed, automatic and confirmed to endure until 2031. This is clearly discriminatory against those that are 'disloyal' as they are placed at a competitive disadvantage when compared against the alternative of provisioning the connection with Openreach.

Because the competition between ISPs is so intense (itself a reflection of Ofcom's efforts over many years to make retail broadband competition a success), no ISP can afford not to take even a marginal source of competitive advantage. As a result, the effect of Equinox is to increase the risk to ISPs of committing to a provider other than Openreach.

As with other efforts by Openreach to lock-in ISPs (such as percentage limits on 'Volume Target Relief', now seen off by Ofcom's earlier intervention), all that is needed to affect ISP switching

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[10] WFTMR, vol.3 para 7.18
[11] WFTMR, vol.3 para 7.29

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behaviour is the fear that other ISPs might gain an advantage – even a small advantage – to distort their incentives and narrow their competitive choices.

In our view, this construct is not conducive to encouraging investor confidence. Any prospective new investors will have received a clear signal from Openreach that any new network operator, or any wholesale customers it seeks to attract, will face the sharpest price competition that prevails in the market and this will have been pre-committed to apply until 2031.

In addition, early customer bases established by nascent alt-nets may also now be viewed in jeopardy from October 2021, with consequential impacts on current business cases; as new tools will be deployed to win back earlier adopters of gigabit-capable connections.

It would also signal that the changes Ofcom deployed to encourage network competition in the WFTMR will not be fully felt by alt-nets. It is only Openreach that stands to fully benefit from these changes.

Aggregate impact of offers

In its statement on existing offers, Ofcom acknowledged that it may be theoretically necessary to consider the aggregate effect of offers.[12] Whilst Ofcom has previously considered that, in the round, the existing offers did not have material impact, VMO2 believes that Ofcom should review all existing offers in light of the Equinox offer which has the practical effect of being discriminatory and loyalty inducing (as set out above). The cumulative effect of these pricing schemes each of which have their own intrinsically complex geographic and loyalty inducing elements, bring about the effect that access seekers will seek the majority (if not all) of their supply from Openreach and reduce any incentive for network investment by existing or potential alt-nets. This is contrary to Ofcom's policy objections which run throughout the WFTMR.

Conclusion

VMO2 is still considering details of the Equinox offer in the context of the Openreach pricing structures and the impact that it will have on infrastructure competition. VMO2 therefore reserves its position on whether to raise additional policy or competition concerns with Ofcom.

Ofcom's own assessment is that Ofcom has "*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. Competition law cases can take years to reach resolution and new network builders may be unable to secure access seekers while a competition case is ongoing (e.g. because it is unclear whether commercial terms introduced by Openreach will be ultimately be deemed unlawful)"* [13]

The WFTMR price review framework exists to secure the dual objectives of fibre migration <u>and</u> a competitive supply market by intervening before damage to investment incentives is achieved by problematic prices or terms. Current and prospective investors into UK fibre infrastructure expect this price review tool to be used in preference to reliance on competition law.

[12] https://www.ofcom.org.uk/__data/assets/pdf_file/0013/221332/statement-existing-openreach-fttp-offers.pdf, 3.17
[13] WFTMR, Para 7.56

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VMO2 therefore urges Ofcom to take fast and effective action to ensure that the narrow window to secure Ofcom's objectives is not lost. The available evidence shows that the Equinox offer raises competition concerns that requires ex ante intervention. Ofcom should set out in its provisional findings consultation the specific measures it seeks to impose on Openreach or the changes it will require Openreach to make to remove such damaging effects on competition. Failure by Ofcom to act now would be inconsistent with Ofcom's policy to promote competition and encourage investment in gigabit-capable networks across the UK.

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