CityFibre response to Ofcom's consultation on BT Openreach's Equinox 2 offer

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Non-confidential version

INDEX

Annexes

1. Overview

1.1 This is CityFibre's response to Ofcom's consultation on BT Openreach's Equinox 2 offer (**Equinox 2**).

1.2 Ofcom's provisional conclusions in relation to Equinox 2 are not well-founded and should be revised. The available evidence indicates that the offer is liable to serve as a potential barrier to the use of altnets by ISPs. The adverse consequences for BT Openreach's network competitors are likely to be material and have not been justified. The appropriate course is for Ofcom to prohibit the offer from being introduced into the market; or alternatively to delay its introduction pending further and more detailed investigation.

1.3 The stakes for the industry and for Ofcom could not be higher. Ofcom's and the Government's defining policy objective in this sector is to encourage competition between different FTTP networks wherever viable. CityFibre and other alternative network operators have invested billions of pounds in the UK's FTTP infrastructure in the expectation that Ofcom will use its powers without fear or favour to maintain a level playing field.

1.4 As Ofcom has previously recognised, and the Competition Appeal Tribunal (**CAT**) has emphasised[1], effective regulation requires careful ongoing scrutiny of BT Openreach's commercial conduct. That is the reason underlying the notification regime which Ofcom must now apply to Equinox 2. BT Openreach is the incumbent operator with significant market power. It has obvious incentives to deter the rollout of rival networks. It has the means to do so through its contractual terms with the retail ISPs which are its competitors' essential route to market.

1.5 Any doubts as to the continuing need for vigilance can be laid to rest following the recent press comments of Philip Jansen, BT's CEO. Mr Jansen confidently predicted that "*there is only going to be one national network*"; he queried "*why […] you need to have multiple providers*" in the market; and he looked forward to a future in which the longstanding partial duopoly of a "*couple of big players*" is restored and – save for a smattering of niche services – the plans of other operators "*end in tears*".[2] This direction of travel runs directly counter to the model of network-based competition pursued by the WFTMR.

1.6 The views of BT Openreach's competitors, recorded in Ofcom's consultation document (**ConDoc**), provide an equally clear indication of the need to apply active and careful regulatory oversight. Alternative network operators are unanimous in identifying Equinox 2 as a potential barrier to network competition in the UK. Having attended to BT Openreach's account of its actions in discussions prior to consultation, it is essential that Ofcom now considers the wider

[1] *CityFibre Limited v Ofcom* [2022] CAT 33, para 152.

[2] Financial Times, "BT chief warns Openreach fibre push will 'end in tears' for rivals", 2 February 2023 (**Exhibit 1**).

picture in an even-handed way, giving equal attention to the views of the operators who are committing substantial resources in response to Ofcom's and the Government's invitation to invest.

1.7 As explained further below, the following factors weigh decisively against approving Equinox 2:

(i) First, Ofcom should take no comfort from the form or justification of the offer. As a sophisticated operator with long experience of regulation, BT Openreach can of course be expected to avoid any naked restrictions on ISPs' abilities to source network inputs from its rivals; and to frame its actions neutrally in terms of accelerating the migration of retail customers to full fibre. Ofcom should look beyond these features and should focus on the likely effects of the offer on network competition. The Equinox structure has conditionality at its core; and has been skilfully crafted to produce powerful incentive effects for the ISPs to purchase BT Openreach's FTTP products. Equinox 2 skews the incentives further by offering additional deep discounts across all units supplied, provided that the ISPs buy sufficient volumes of BT Openreach FTTP as a proportion of their total BT Openreach purchases.

(ii) Second, the potential impact of Equinox 2 must be considered in the real world, bearing in mind the current state of competition. In this connection, CityFibre is the largest altnet by far and the most credible FTTP competitor to BT Openreach. CityFibre's routes to market are massively curtailed by structural features of the market: two of the five large retail ISPs – BT Consumer and Virgin Media – are captive to other wholesale providers. **[✂]**.

(iii) Third, the history of Equinox 1 is a salutary one, which should put Ofcom on its guard. CityFibre understands that Ofcom now accepts that some ISPs could be deterred from purchasing from altnets in overlap areas by the need to meet the order mix targets (**OMTs**) imposed under the Equinox scheme. Ofcom no longer maintains that limited network overlap or ISPs' mitigation strategies provide comfort that the OMTs will not create a potential barrier to altnets. Indeed, it appears that – contrary to Ofcom's assessment when approving Equinox 1 – ISPs have in fact struggled to meet the OMTs; and at least one major ISP (**[✂]**) is expected to continue to do so. The resulting incentives upon ISPs to sell BT Openreach FTTP have the potential to block altnets who have already rolled out from achieving take-up in overlap areas; and to block altnets who are planning to roll out to new areas as they will be deprived of potential take-up in those areas given the barriers to switching between FTTP networks.[3]

[3] Ofcom has recognised that "*[s]witching costs mean that migration of end-customers is likely to be more difficult once they are connected to an FTTP network. This is because migration will lead to financial costs, and disruption to the end-customer*". See WFTMR, Volume 2, para 8.56(c).

(iv) Fourth, Ofcom now relies centrally on a new contractual feature, labelled by BT Openreach as the "Failsafe Mechanism" (**FM**), as the basis for concluding – notwithstanding the potential for the OMTs to deter ISPs from sourcing from altnets – that Equinox 2 has no potential to foreclose altnets. Ofcom's reliance on this mechanism is wholly misplaced. The mechanism depends on ISPs being willing and able to identify "overbuild areas" so that they can be excluded, through a process of *ex post* reconciliation, from the calculation of compliance with the OMTs.

(a) As regards ISPs' willingness to use the mechanism, ISPs (whether sourcing exclusively from BT Openreach or dual-sourcing from BT Openreach and altnets) may well achieve higher levels of BT Openreach FTTP sales, and higher BT Openreach "Fibre Only" measures, in overbuild areas than outside them. Such areas are selected for early build by more than one network operator precisely because of the likelihood of high FTTP take-up. Following launch of service, the presence of multiple networks is likely to generate targeted local advertising of FTTP products by ISPs, resulting in pockets of increased consumer demand. An ISP who is struggling to meet the OMTs nationally will have no interest at all in invoking the FM to exclude overbuild areas which improve its performance as against the OMTs. Moreover, even the prospect that FTTP orders in overbuild areas may improve the scope to meet OMTs provides a reason for ISPs to favour BT Openreach *ex ante* (when ISPs decide the extent to which they will commit to taking lines from altnets).

(b) As regards ISPs' ability to use the mechanism, this depends on ISPs committing the resources needed to engage in detailed monitoring to identify overbuild areas; to keep track of the sales in those areas made across two or more networks; to determine whether it is advantageous to use the FM given their BT Openreach order mix; and to administer the application process to the Independent Verifier. It is unreal to suppose that ISPs who are facing significant commercial pressures, **[✂]**, will take such steps in practice. **[✂]**. Ofcom appears to have gathered no hard evidence at all on these matters.

(c) Moreover, the FM is incapable of guarding against the harm to dynamic competition arising from the OMTs' potential impact on ISPs' purchasing incentives in areas which are not currently overbuilt, but where altnets are expected to build in the near future.

(v) Fifth, the terms of Equinox 2 should be considered in the round to understand the overall effects of the offer on ISPs' willingness to procure from altnets. The level of

pricing applied by BT Openreach is an essential component of the offer and Ofcom is right to assess it. However, Ofcom's consideration of that price level is significantly flawed. It rests on (i) a comparison of BT Openreach's prices with a fibre cost model which is not fit for this purpose and does not reflect current market conditions; and (ii) a comparison with altnets' current prices, **[✂]**. Ofcom should give proper and serious consideration to the levels of Equinox 2 prices, which have an obvious potential to block access by reasonably efficient competitors to the market; and are unlikely to deliver short-term consumer benefits given the substantial increases applied by BT Openreach to its wholesale FTTC prices and their contribution to the retail price blend.

(vi) Sixth, Ofcom should further investigate as a matter of urgency whether BT Openreach's practice of repeatedly amending its prices (signalling) is capable of acting as a barrier to altnet entry and expansion. The *prima facie* concerns about BT Openreach's signalling are yet another reason for Ofcom to direct that Equinox 2 should not be implemented pending further investigation. Indeed, for the reasons further spelled out in CityFibre's Competition Act Complaint of 5 December 2022 (**Competition Complaint**), Equinox 2 should be viewed as part of a general strategy designed to throttle ISP demand for altnets, **[✂]**.

(vii) Seventh, in assessing the consequences of Equinox 2, Ofcom should focus on the key metric of take-up when assessing network operators' performance. This is the main metric that shows whether network competition is actually emerging.[4] The evidence shows that BT Openreach enjoys a very significant advantage by this measure. **[✂]**.

2. Market and policy context

2.1 The UK Government's strategy is to promote competition and investment in gigabit-capable networks. Government has emphasised that "*[t]he most effective way to deliver nationwide full fibre connectivity at pace is to promote competition and commercial investment where possible*"[5] and that "*[i]nvestment in new networks by BT and alternative providers is key to improving consumer outcomes, in terms of choice, service quality, and innovation*". Accordingly, it has stated that "*promoting investment should be prioritised over interventions to further reduce retail prices in the near term*".[6]

[4] Whilst rollout (or "premises passed") is also significant, take-up becomes an increasingly important measure as networks are built out, **[✂]**.

[5] DCMS, Future Telecoms Infrastructure Review, 23 July 2018.

[6] DCMS, Statement of Strategic Priorities for telecommunications, the management of radio spectrum, and postal services, 29 October 2019 (**SSP**). Under the Communications Act 2003, Ofcom must have regard to the SSP when carrying out its functions.

2.2 Consistently with this, Ofcom has made clear that its policy objective in relation to broadband is to promote competition and investment in gigabit-capable networks, and that such competition should benefit consumers in the long term.[7] In Volume 1 of the WFTMR, it stated:

> "*Our approach to supporting investment in gigabit-capable networks is focused on* ***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*."[8] (Emphases added)

2.3 Ofcom has recognised that there is a "*relatively small window of opportunity to encourage new network build*".[9] **[✂]**.[10] **[✂]**.

2.4 There are, however, three salient, and formidable, impediments to achieving the objective of network competition, each of which Ofcom has acknowledged.

2.5 The first is BT Openreach's enormous incumbency and scale advantages as a wholesale operator[11], including its ubiquitous network coverage; large captive retail base through its vertical integration with the largest ISP, BT Consumer; long-standing relationships with all of the large, independent ISPs[12]; and large installed customer base across those ISPs.[13]

2.6 The second is the very significant barriers to entry and expansion faced by altnets such as CityFibre[14], **[✂]**.[15] The crucial importance of ISP take-up has been acknowledged both by

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[7] ConDoc, para 3.17. See also Competition Complaint, paras 2.17-2.18.

[8] WFTMR, Volume 1, page 1. More recently, Ofcom stated that "*the alternative networks to Openreach provide a vital part of our strategy for better broadband. They help form the engine room of the UK's digital infrastructure. […] If we see evidence of any company acting in a way that distorts or prevents competition, we won't hesitate to step in. Competition is the force that is driving better broadband for everyone. By promoting it, and keeping it fair and effective, we can help secure the UK's digital future*". See Ofcom, 'Full fibre to reach half of homes, as competition drives better broadband', 17 February 2023, available at https://www.ofcom.org.uk/news-centre/2023/full-fibre-to-reach-half-of-homes,-as-competition-drives-better-broadband.

[9] WFTMR, Volume 3, para 7.56.

[10] CityFibre submission on Equinox 2 dated 27 June 2022, section 4.

[11] Acknowledged inter alia at WFTMR, Volume 3, para 7.45. See also ConDoc, para 3.20.

[12] BT Openreach's addressable customer base represents c. 80% of the downstream market. **[✂]**.

[13] ConDoc, para 3.20. See also Competition Complaint, paras 2.4 and 4.7-4.8.

[14] See Competition Complaint, para 4.9.

[15] This is not the same as 'premises passed'. Rather, it means having large ISPs integrate with and promote CityFibre's network even where BT Openreach is also available (or soon will be).

Ofcom ("*[i]f Openreach is able to deprive new networks of demand, they will fail*"[16]), and by BT's own Chief Executive, Philip Jansen ("*[b]uilding is irrelevant – it's how many people you've got on the network [that matters]*").[17] **[✂]**.[18]

2.7 Moreover, CityFibre's routes to market are significantly limited by structural features of the market: two of the five large retail ISPs – BT Consumer and Virgin Media – are captive to other wholesale providers.[19] **[✂]**.[20] **[✂]**.[21] **[✂]**.

2.8 The third impediment to achieving Ofcom's objective of network competition is the potential for (and CityFibre would say the reality of) exclusionary conduct by BT Openreach. Ofcom has acknowledged that BT Openreach has the ability and incentive to foreclose altnet competition, to the detriment of consumers.[22] CityFibre considers that Equinox 2 is merely the latest example of conduct designed to achieve that end, by deterring non-captive ISPs from switching their orders to altnets. CityFibre has explained in detail in its Competition Complaint how BT Openreach is exploiting the loopholes in the *ex ante* notification regime to pursue a highly effective strategy, the overlapping elements of which include: (i) engaging in continual dialogue with ISPs about future FTTP offers, in order to signal the potential for further discounts in future; (ii) failing to notify Equinox 2 to Ofcom in a timely manner; (iii) introducing a series of FTTP offers with loyalty-inducing features; and (iv) reducing prices to a level that will have a significant impact on the scale of network coverage that reasonably efficient rival operators can achieve. And recent comments by senior BT executives suggest, strikingly, that foreclosure of BT Openreach's rivals is indeed what they foresee:

(i) BT's Chief Executive, Philip Jansen, has stated that "*[n]o one else has got a machine anywhere near ours. It's […] unstoppable*". In his view, "*the market would probably shake out to be just a 'couple of big players' as well as a smattering of specialist providers for things like rural areas and multi-occupancy buildings – a process that*

[16] WFTMR, Volume 3, para 7.50. See also para 3.18 of the ConDoc.

[17] Financial Times, "BT chief warns Openreach fibre push will 'end in tears' for rivals", 2 February 2023 (**Exhibit 1**).

[18] See Competition Complaint, para 5.36(i) and Confidential Annexes C and D.

[19] See Competition Complaint, section 2.

[20] See Competition Complaint, Confidential Annex B. **[✂]**.

[21] See Competition Complaint, Confidential Annex A.

[22] See WFTMR, Volume 3, para 1.6: "*BT Openreach has the ability and incentive to engage in various forms of exclusionary and/or exploitative conduct that could distort competition and/or harm consumers, including […] target[ing] price reductions or adopt[ing] other commercial terms in order to deter the rollout of new networks by competitors*." See also CityFibre Competition Complaint, paras 1.3, 1.7 and 5.1.

would 'end in tears' for many of the other operators". He added: "*There is only going to be one national network. Why do you need to have multiple providers?*"[23]

(ii) During the recent BT Results Call for period ended 31 December 2022, BT's CFO, Simon Lowth, stated: "*Openreach is investing at massive pace scale [sic] and building FTTP. And […] the rate of connection and take-up is probably somewhat ahead of our expectation, and clearly, that gives Openreach a huge competitive advantage. […] We're not seeing any change in sort of competitor loss. [It is] very much in line with what we expected.*"[24]

2.9 The scale of the challenge posed by these three impediments to Government's, and Ofcom's, policy objectives is evident **[✂]**. BT Openreach recently reported that its FTTP network coverage has now reached 9.6 million premises.[25] It has also installed equipment in several exchanges before building out to customer premises, such that it has already partially built its network to around half of UK homes.[26] As regards take-up on the BT Openreach FTTP network, Philip Jansen recently stated: "*Customer demand is extremely strong from both CPs and end customers, with orders up a staggering 51% versus last year. And the take-up rate has now reached 29% […], bringing our total FTTP customer base to 2.7 million. So we are building like fury, and we are connecting like fury.*"[27] **[✂]**[28] **[✂]**:

(i) **[✂]**; and

(ii) **[✂]**. BT Openreach has also recently stated that "*if we […] look at FTTP built just 24 months ago, **nearly 50%** of end customers using Openreach's broadband network have made the switch to FTTP*" (emphasis added).[29] **[✂]** (see **Confidential Annex 1**).

[✂]

Source: **[✂]**

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[23] Financial Times, "BT chief warns Openreach fibre push will 'end in tears' for rivals", 2 February 2023 (**Exhibit 1**).

[24] Transcript of BT Results Call for the period ended 31 December 2022, 2 February 2023 (**BT Transcript**) (**Exhibit 2**, page 6).

[25] BT Transcript (**Exhibit 2**, page 3).

[26] See https://www.openreach.com/news/dont-expect-us-to-slow-down/. **[✂]**.

[27] BT Transcript (**Exhibit 2**, page 3).

[28] ConDoc, para 3.122. VMO2 has announced plans to upgrade the whole of its cable network to FTTP by 2028; and Nexfibre (the joint venture established between VMO2's parent companies and Infravia) is seeking to deploy FTTP to 5 million premises by 2026. **[✂]**.

[29] BT Transcript (**Exhibit 2,** page 4).

2.10 **[✂]**.[30] **[✂]**.

2.11 Equinox 2 stands to be assessed in this context and against this background. CityFibre submits that, for reasons further spelled out in its Competition Complaint, Equinox 2 should be viewed as part of a general strategy designed to throttle ISP demand for altnets, which is already undermining the prospect of scale competition at the network level. In any event, Equinox 2 clearly needs to be assessed (i) in the round, (ii) by reference to Ofcom's objectives as set out in the WFTMR, on which investors have relied in choosing to invest significant sums in competitors to BT Openreach, and (iii) in light of the extremely fragile prospects for competition in this market as they stand.

3. Ofcom's assessment of whether the Order Mix Targets act as a barrier to using altnets

The limitations of Ofcom's analysis

3.1 Ofcom has approached its analysis of Equinox 2 by reference to the same 3-stage analytical framework deployed in relation to Equinox 1. Ofcom explains that, under Question 1, "*Ofcom must first determine the extent to which a notified offer might create a barrier for ISPs' use of altnets*" (3.39). However, despite this wording, Ofcom has not in fact applied this "gating" question to the offer as a whole. Instead, it has applied it to three aspects of the offer taken individually: (i) the OMTs, (ii) the forecasting requirements, and (iii) the level of the prices on offer. CityFibre submits that this approach is artificial and wrong in principle. The relevant question is whether these features of the offer may in aggregate (and in the market context explained above) materially affect ISPs' incentives to purchase from altnets generally and CityFibre in particular as the most significant potential scale competitor. Ofcom has simply not addressed that question.

3.2 Ofcom's analysis in relation to the OMTs is moreover flawed because Ofcom approaches the issue statically, ignoring the **dynamic effects** of the OMTs on ISP purchasing incentives and therefore altnet rollout. Ofcom acknowledges that the underlying question is whether the OMTs may have "indirect" loyalty-inducing effects.[31] But in addressing this question, Ofcom focuses on a localised (non-national) theory of harm relating to the potential loyalty-inducing effects in overlap areas. In other words, Ofcom limits itself to the question of whether, once BT Openreach and one or more altnets have rolled out in a particular area (i.e. an area of current overlap), the OMTs might incentivise ISPs to deal mainly with BT Openreach in that area.[32] CityFibre agrees that this is a relevant consideration and addresses it below. However, an

[30] See CityFibre's response of 28 February 2023 to Ofcom's section 135 request of 22 February 2023 and Attachments 2 and 3 to that response.

[31] ConDoc, para 3.50.

[32] ConDoc, paras 3.58-3.66 and 3.84.

assessment of whether Equinox 2 is loyalty-inducing in areas where both BT Openreach and altnets are currently available will not capture the potential harm to competition arising from the possibility that Equinox 2 will **itself** inhibit scale altnet entry and expansion in the first place.[33] It is therefore important also to consider how Equinox 2 may affect dynamic competition in FTTP rollout. That is to say: in addition to the question of how ISPs' purchasing incentives may be affected in overlap areas, Ofcom needs to consider how they will be affected in areas in which BT Openreach has already built and altnet build is in prospect.

The dynamic effects on competition in 'BT Openreach-first' areas

3.3 Ofcom records that VMO2 has made submissions to it on the latter question: namely, the impact on ISP incentives where BT Openreach has deployed to an area before an altnet (referred to by Ofcom as the **Future Overlap Scenario**).[34] Ofcom dismisses VMO2's concern (that, in that scenario, the OMTs will induce ISPs to purchase from BT Openreach where they would otherwise have waited for an altnet), on the basis that the OMTs do not prevent altnets having a "*fair opportunity*" to compete with BT Openreach in the Future Overlap Scenario.[35] However, Ofcom's reasoning is flawed for the following reasons:

(i) Ofcom states that VMO2's concern "*is not within [the] scope of the competition concerns we set out in the WFTMR Statement*", because (a) "*[u]nder this scenario, we are not considering whether ISPs are deterred from switching to using altnets where they are available*"; (b) Equinox 2 does not "lock in" ISPs to prevent them switching when the altnet arrives; and (c) "*[a]bsent the Equinox 2 Offer, the first network to deploy FTTP in an area is likely to enjoy a commercial advantage*".[36] However, this narrow approach is misconceived. The question Ofcom is required to address is whether Equinox 2 constitutes a potential barrier to ISP take-up of altnets. It is incorrect, and inconsistent with the WFTMR, to proceed on the basis that the only commercial term that could constitute such a barrier is one that impedes switching from BT Openreach to an altnet in areas where both are already available. A term which has the effect of incentivising ISPs not to wait for altnets when they otherwise would have waited will be just as damaging.

(ii) Ofcom says that it is "unclear" whether it is credible that, absent the OMTs, some ISPs in BT Openreach-first areas would prefer to wait for altnet deployment.[37] However, if

[33] **[✂]**.

[34] ConDoc, paras 3.29-3.31 and 3.42-3.46.

[35] ConDoc, para 3.44.

[36] ConDoc, para 3.44(a)-(c).

[37] ConDoc, para 3.46.

that is unclear, then it is a question on which Ofcom must urgently seek information. In principle, if an altnet offers lower prices or better-quality products, then an ISP would be expected to weigh up the commercial benefits of Equinox 2 against the benefits of waiting for an altnet to roll out, particularly where altnet build plans have been announced and are at an advanced stage. In such circumstances, the relevant question is whether Equinox 2 makes waiting for the altnet to roll out less attractive than before. Rather than dismiss this matter as irrelevant, Ofcom must urgently seek evidence on this question from the ISPs.[38]

(iii) Nor is it an answer to this concern that Equinox 2 "*does not contain terms which lock in ISPs, to prevent them switching to using an altnet if one later becomes available*".[39] Ofcom has itself recognised that once an ISP's customers have been migrated to a particular FTTP network, it is much more difficult to persuade them to switch from one network to another.[40] Ofcom noted in the WFTMR that "*[s]witching costs mean that migration of end-customers is likely to be more difficult once they are connected to an FTTP network. This is because migration will lead to financial costs, and disruption to the end-customer*".[41] As a consequence, "*the potential for wholesale deals to support entry will be greater where most customers have not yet migrated onto an FTTP network. The opportunities provided by this migration process will eventually close, creating a time window where entry is more likely to occur*".[42]

(iv) Given these difficulties, it is likely that accelerated migration of ISP customers to BT Openreach FTTP will significantly reduce rates of ISP take-up on alternative networks. Indeed, in the WFTMR, Ofcom itself recognised the scope for BT Openreach to use migration as an anti-competitive tool, noting that "*Openreach has a relationship with all the main access seekers and it is in a strong position to migrate customers to its FTTP network as this is built*".[43]

3.4 If they are at any risk of missing the Equinox 2 OMTs, ISPs are likely to seek to migrate existing legacy customers to BT Openreach FTTP as quickly as possible, especially in areas where BT

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[38] In its assessment of Equinox 1, Ofcom relied heavily on the fact that there was "*a range of things ISPs can do to mitigate the risk of missing the OMTs in the short term*" (Equinox 1 Statement, para A3.35). Whilst Annex 8 of the ConDoc is heavily redacted, it appears that these ISP mitigation strategies have not materialised. Ofcom should not rely on unevidenced assumptions in its assessment of Equinox 2.

[39] ConDoc, para 3.44(b).

[40] If Ofcom is now abandoning that position, it must seek evidence from those ISPs who buy from both CityFibre and BT Openreach on whether they would switch customers from one network to another and in what circumstances.

[41] WFTMR, Volume 2, para 8.56(c).

[42] WFTMR, Volume 2, paras 8.72-8.73.

[43] WFTMR, Volume 3, para 7.49.

Openreach FTTP is available but altnets such as CityFibre have not yet rolled out. **[✂]**.[44] **[✂]**.[45]

3.5 If Equinox 2 achieves its purported objective of accelerating migration to BT Openreach FTTP[46], this will therefore affect ISP incentives not just in areas where altnets are currently present but also in areas where altnets have plans to build in the near future. It will raise barriers to altnet growth by reducing the addressable market available to altnets and thereby lowering the expected return on investment in rolling out FTTP. In view of its policy objective of promoting network competition, Ofcom should consider in detail whether Equinox 2 is likely to affect altnet build in the longer term, since altnet build is what will deliver the benefits of network competition.

3.6 In other words, there is an obvious tension between (i) faster migration to BT Openreach FTTP (incentivised by deep Equinox 2 discounts) and (ii) greater network competition in the long term between BT Openreach and a scale FTTP challenger, with the former harming the scope for the latter by making altnet expansion considerably less attractive. The rollout of FTTP is a 'race to invest' in which BT Openreach already has a very large head start and does not need a helping hand from Ofcom. In such circumstances, Equinox 2 is unnecessary and harmful: it tilts the slope further in favour of BT Openreach, thereby undermining dynamic longer-term competition rather than promoting it. Any benefits from BT Openreach's lower prices to ISPs are likely to be short-term and outweighed by the harmful effects of lost network competition.

Ofcom's assessment of the impact of the OMTs on ISP incentives in overlap areas (ConDoc 3.47-3.86)

3.7 Since the OMTs in Equinox 2 are the same as those in Equinox 1[47], information gathered by Ofcom through its market-monitoring (including the monitoring that the CAT has urged it to undertake in its judgment in relation to Equinox 1[48]) should play a key role in informing Ofcom's assessment of whether the Equinox 2 OMTs potentially create a barrier to altnet entry and

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[44] **[✂]**.

[45] Particularly given the short-term financial and commercial pressures ISPs are under.

[46] BT Openreach has made clear that the objective of Equinox 2 is to incentivise ISPs to migrate their legacy customer base to BT Openreach FTTP as quickly as possible. BT Openreach's Briefing for Communications Providers of 14 December 2022 stated that "*Equinox 2 provides additional commercial incentives for CPs to accelerate their adoption of GEA-FTTP by migrating their existing copper end customers to GEA-FTTP*". See https://www.openreach.co.uk/cpportal/updates/briefings/ultrafast/nga2010822.

[47] To qualify for rental discounts, ISPs must achieve an order mix of at least 80%. To qualify for the full connection discounts, ISPs must achieve an order mix of at least 90%.

[48] *CityFibre Limited v Ofcom* [2022] CAT 33, para 152: "*Ofcom has reserved to itself the power to review its decision [on Equinox 1] and to intervene if it considers that the Equinox offer is affecting competition in a way which Ofcom had not previously appreciated. We would encourage Ofcom to maintain careful scrutiny of the market at this important time, to ensure that the judgements it has made in the [Equinox 1] Statement continue to be validated by the emerging evidence of actual competitive conditions*."

expansion.[49] Ofcom now has the benefit of real-world evidence of the impact of the OMTs contained in Equinox 1 and it cannot rely solely on theoretical analysis and speculation of the likely effects of Equinox 2 on ISP incentives.

3.8 In its assessment of Equinox 1, Ofcom accepted in its Statement of 30 September 2021 (**Equinox 1 Statement**) that: (a) the Equinox 1 discounts could be substantial, such that ISPs could be strongly incentivised to meet the OMTs[50]; and (b) in principle, moving volumes to altnets could jeopardise an ISP's ability to meet the OMTs if the ISP used BT Openreach for legacy products but an altnet for FTTP, since this would skew the mix of orders placed with BT Openreach from FTTP to legacy products.[51] However, Ofcom concluded that the OMTs did not create a potential barrier to using altnets because:

(i) The limited overlap of the BT Openreach FTTP footprint by altnets in the next 12-24 months meant that placing orders with an altnet would likely have little effect on an ISP's mix of new BT Openreach orders across the whole BT Openreach FTTP footprint.[52]

(ii) Whilst some ISPs may struggle to meet the OMTs in the first 12-24 months, these challenges would be "*temporary*" and there were also various steps that ISPs could take to mitigate the risk of missing the OMTs in the short term.[53]

3.9 Ofcom appears from the ConDoc to accept that neither of these propositions still holds good. As to (i), Ofcom now appears to accept that the extent to which BT Openreach's FTTP network will be overlapped by altnets is significantly higher than anticipated in the Equinox 1 Statement, concluding that it is "*reasonable to assume*" that:

(i) "*approximately 15% of Openreach's FTTP network is likely to be overlapped by altnets […] during the first year or so of the Equinox 2 Offer*";[54]

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[49] Based on the evidence cited in the ConDoc, it is not clear what monitoring Ofcom has undertaken prior to January 2023 (apart from the usual market data-gathering and reports). There are over 80 references in the ConDoc to information requests issued by Ofcom to stakeholders in January 2023 (after notification of Equinox 2). There is only one reference (in footnote 202) to an information request which pre-dates January 2023.

[50] Equinox 1 Statement, paras 3.78(a) and 3.79.

[51] Equinox 1 Statement, para 3.80.

[52] Equinox 1 Statement, para 3.78(e). Ofcom's underlying modelling assumed network overlaps of 2% and 5% in the next 12-24 months (i.e. in the period September 2021 to September 2023) – see Equinox 1 Statement, Annex 3.

[53] Equinox 1 Statement, paras A3.33 – A3.35. Ofcom identified two main mitigation strategies: (i) ISPs could channel sales into FTTP through marketing and price changes; and (ii) ISPs' contracts with resellers could "*evolve*" to match the Offer and ISPs could offer "*inducements beyond their current contracts*" to promote FTTP.

[54] ConDoc, para 3.61(a).

(ii) "*approximately 25% of Openreach's FTTP network is overlapped by altnets […] two to three years after the Equinox 2 Offer comes into effect*".[55]

3.10 On the issue of whether ISPs will struggle to meet the OMTs:

(i) CityFibre understands that at least some ISPs have struggled to meet the OMTs under Equinox 1. The redactions in Annex 8 of the ConDoc are so extensive that it is impossible to discern whether (and if so to what extent) this is the case (despite a request from CityFibre, Ofcom has also declined to provide a non-confidential gist summary of the relevant evidence[56]). However:

(a) CityFibre understands that BT Openreach has not required ISPs to meet the OMTs to obtain the Equinox 1 connection discounts since October 2022. Footnote 13 of the ConDoc acknowledges that BT Openreach granted such a waiver, but Ofcom has not explained why this decision was taken, and in particular how it relates to ISPs' performance against the OMTs. Ofcom should seek evidence from both BT Openreach and ISPs on the reasons for the suspension of the Equinox 1 connection-discount OMTs and address such evidence in its Equinox 2 decision.

(b) Equinox 2 includes a provision which enables BT Openreach to "*suspend and/or reduce the Fibre Only Target and/or Fibre Only Threshold for a limited period of time*" (the **Suspension Mechanism**).[57] Surprisingly, Ofcom does not address this at all in the ConDoc. Ofcom should seek evidence from BT Openreach and ISPs on the reasons for the inclusion of – and ISPs' expected use of – the Suspension Mechanism; and it should address such evidence in its Equinox 2 decision. The perceived need to introduce such a mechanism itself suggests an expectation that ISPs will struggle to meet OMTs on a consistent basis such that *ad hoc* waivers or suspensions are required.

(ii) In any case, contrary to its findings in relation to Equinox 1, Ofcom now appears to accept that at least some ISPs may struggle to meet the Equinox 2 OMTs, even in the "*very long term*".[58]

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[55] ConDoc, para 3.61(b).

[56] See Bristows' letters to Ofcom of 6 and 13 February 2023 and Ofcom's letters in response of 9 and 14 February 2023.

[57] Draft Equinox 2 contract, para 3.3.

[58] Consequently, the hypothetical scenarios referred to in para A8.5 of the ConDoc – which assume that if an ISP only uses BT Openreach then either 92% or 95% of its orders are for FTTP (i.e. significantly in excess of the 80% threshold for rental discounts) – are of little relevance.

(a) Ofcom states that for a particular ISP (whose identity is redacted), "*placing orders with [altnets other than VMO2 and Nexfibre] is unlikely to jeopardise meeting the OMTs. However, this is not the case for all ISPs*" (emphasis added).[59]

(b) Ofcom notes that "*there may be points in the future where using an altnet potentially affects the discounts received by [redacted] (absent the Failsafe Mechanism)*".[60]

(c) Ofcom acknowledges that a particular ISP (whose identity is redacted) "*may take longer to surpass the OMTs than originally expected*".[61] **[✂]**.

(d) Ofcom states that "*[w]here an ISP pursues a strategy of almost entirely ending sales of Openreach legacy products in areas where Openreach FTTP is available then, notwithstanding the expected growth in overlap, using an altnet should not jeopardise its ability to meet the OMTs. However, where an ISP chooses not to pursue such a strategy, there is uncertainty about whether using an altnet might affect its ability to meet the OMTs even in the very long term*" (emphasis added).[62]

(e) In its provisional conclusion on Question 1, Ofcom states that "*[w]e cannot rule out the possibility that in the future placing orders with an altnet could jeopardise some ISPs' ability to hit the OMTs, absent the Failsafe Mechanism*".[63]

3.11 In summary, therefore, it appears to be accepted that neither of the planks of Ofcom's conclusion that the Equinox 1 OMTs did not create a potential barrier to using altnets can sustain the same conclusion in relation to Equinox 2. To the extent that CityFibre can understand Ofcom's position (in view of the extensive redactions), Ofcom appears to accept that: (i) the discounts if the OMTs are met are substantial and ISPs will be strongly motivated to meet them (3.58-3.59); (ii) ISPs could be deterred from switching volumes from BT Openreach to altnets if this jeopardised meeting the OMTs (3.60); (iii) whether it might do so will depend on the extent of overlap and ISPs' performance against the OMTs (3.60); (iv)

[59] ConDoc, para 3.64.

[60] ConDoc, para 3.64.

[61] ConDoc, footnote 53.

[62] ConDoc, para 3.66.

[63] ConDoc, para 3.84(b).

overlap is material and expected to grow (3.61); and (v) not all ISPs will comfortably exceed the OMTs (3.63-3.66).

3.12 In consequence, Ofcom's position is understood to be that, absent the Failsafe Mechanism, some ISPs could be deterred from purchasing from altnets in overlap areas by the need to meet the OMTs. Ofcom is right so to conclude. Given the scale of the Equinox 2 discounts[64], ISPs who are concerned that they may miss the OMTs in any quarter will have strong incentives to focus on selling BT Openreach FTTP rather than altnet FTTP.[65] ISPs will err on the side of caution and prioritise the sale of BT Openreach FTTP products in all areas.[66] This cliff-edge effect of the OMTs is particularly pronounced as the discounted rental prices apply to all the FTTP lines that the ISP purchases from BT Openreach, not just the orders placed in the relevant quarter.[67]

3.13 **[✂]**. Ofcom states that "*the relative importance of the rental discounts (and thus meeting the 80% OMT) will rise over time, as ISPs' base of Openreach FTTP subscribers grows*".[68] However, this ignores the fact that ISP economics are typically assessed on a per unit basis, taking into account the time value of money. Particularly for ISPs who are seeking to improve profitability, the current cash position is very important and removing or reducing upfront charges (for example through discounts to connection fees) is very attractive as it goes straight to the bottom line. In other words, Ofcom's approach to connection charges does not reflect the commercial reality of how ISPs view discounts in the round.

3.14 Moreover, even if spread over the lifetime of a customer, the connection discounts involved can be material.[69] This is important because connection discounts extend the range over which

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[64] Ofcom acknowledges in paras 3.58 and 3.84(a) of the ConDoc that the discounts are "*substantial*". See also ConDoc, para A6.2: "*[Equinox 2] provides discounts of up to 42% for rental charges and up to 75% for connection charges compared with Openreach's standard list prices*."

[65] Ofcom states that it "*intend[s] to consider whether there is evidence that TalkTalk is being deterred from placing orders with CityFibre*" and suggests that "*[o]ne possibility is testing whether orders per premise passed differs significantly for CityFibre as compared to Openreach FTTP*" (ConDoc, para A8.35 and footnote 202). **[✂]**.

[66] ISPs are unlikely to have systems in place which track performance against the OMTs in 'real time'. If there is a realistic prospect of missing the OMTs, prioritising BT Openreach FTTP is the most likely course of action for an ISP.

[67] See ConDoc, para 3.6. An ISP who is not certain of meeting the OMTs in every quarter will face uncertainty over the wholesale cost of all of its BT Openreach FTTP lines. Given the size of the difference between list prices and discounted prices under Equinox 2, it is possible that ISPs have entered into fixed-term contracts with some consumers at prices that would become loss-making in every quarter where the OMTs are not met. Alternatively, ISPs may choose not to pass through the lower Equinox 2 wholesale prices to consumers to guard against the risk of losing the discounts.

[68] ConDoc, para 3.59.

[69] For example, where an ISP migrates an existing customer to an 80/20 FTTP BT Openreach product, the ISP receives a c. £30 discount (i.e. £57.88 under Equinox 1 down to £28 under Equinox 2). Even if the time value of money is ignored (that is, the ISP values revenues in five years as equivalent to receiving them today), the discount is equivalent to a reduction in the rental charge of £0.50 per month for a customer likely to remain with the ISP for five years. The connection charge discount is considerably larger (£1.45 per month over a five-year period) when compared to the standard list price of £114.78, which applies if the ISP fails to meet the OMTs.

incentives to favour BT Openreach FTTP applies (since additional discounts can be obtained above the 80% threshold for Fibre Only shares of 81%, 82%, 83% and so on, all the way up to 90%). In other words, the connection discounts can distort incentives even for ISPs that are comfortably meeting the 80% target.

3.15 CityFibre therefore considers that the OMTs will potentially create a barrier to using altnets (Question 1 of Ofcom's framework). That will in turn significantly impair altnets' ability and incentive to roll out at scale, such that the OMTs will thereby also have a material impact on nascent network competitors (Question 2 of Ofcom's framework). **[✂]**.

3.16 Ofcom's provisional conclusion to the contrary is dependent, as CityFibre understands it, on Ofcom's assessment that the Failsafe Mechanism provides a reliable means of ensuring that ISPs will not be incentivised to meet the OMTs by switching volumes from altnets to BT Openreach in overlap areas. However, the Failsafe Mechanism is not an effective remedy for the reasons explained below.

Inadequacy of the Failsafe Mechanism

3.17 The Failsafe Mechanism (**FM**) purports to eliminate "*even a theoretical possibility*" that the OMTs will distort ISP incentives to use altnets in areas where they have a choice between BT Openreach FTTP and altnet FTTP.[70] In simple terms:

(i) The FM allows an ISP to define an "**Overbuild Area**" in which it is able to place orders with an altnet. Any orders placed with BT Openreach in this area – whether legacy or FTTP – would be excluded from the calculation of the ISP's "Fibre Only" performance.

(ii) An Independent Verifier will be appointed by BT Openreach to confirm the specific addresses that fall within the Overbuild Area and recalculate the ISP's Fibre Only performance in the remaining part of the BT Openreach FTTP footprint.

(iii) BT Openreach reserves the right to review and amend the FM if its use results in ISPs placing a "disproportionate" level of orders on BT Openreach's legacy network in the Overbuild Area.[71]

[70] BT Openreach, 'Equinox Failsafe Mechanism - Overview', 14 December 2022, slide 2.

[71] BT Openreach will ask the Independent Verifier to compare the BT Openreach legacy order rate per premises within the Overbuild Area with the same order rate outside the Overbuild Area. See BT Openreach, 'Equinox Failsafe Mechanism - Overview', 14 December 2022, slide 5.

3.18 BT Openreach claims that as a result of the FM, "*any decisions to use an [altnet] in the Overbuild Area for any level of order volumes could not in any way affect the Fibre Only measure and, therefore, the level of discounts the [ISP] would receive*".[72]

3.19 CityFibre strongly disagrees and believes that the FM suffers from significant shortcomings. The effectiveness of the FM depends on ISPs being both willing and able to identify "Overbuild Areas" so that they can be excluded, through a process of *ex post* reconciliation, from the calculation of compliance with the OMTs.[73] The commercial reality is that ISPs are highly likely to prefer the certainty offered by placing FTTP orders with BT Openreach, over the uncertainties and costs associated with relying on the FM.[74] The FM will not therefore 'break the link' between the OMTs and ISPs' incentives to prioritise BT Openreach FTTP over altnet FTTP.

3.20 As regards ISPs' willingness to use the FM, ISPs (whether sourcing exclusively from BT Openreach or dual-sourcing from BT Openreach and altnets) may well achieve higher levels of BT Openreach FTTP sales, and higher "Fibre Only" measures, in Overbuild Areas than in non-overbuild areas. As explained in the accompanying RBB Economics paper on the FM (**Confidential Annex 2**):

(i) Overbuild Areas are typically selected for early build by more than one network provider precisely because of the likelihood of high FTTP take-up. Following launch of service, the presence of multiple networks is likely to generate targeted local advertising of FTTP products by ISPs, resulting in pockets of increased consumer demand.

(ii) Subsequent marketing campaigns may also mean that (in some quarters) an ISP would fail to meet the OMTs unless it obtained orders in Overbuild Areas from BT Openreach at the expense of an altnet. The mere prospect of this provides a reason for the ISP to promote BT Openreach *ex ante*, such as when it makes decisions on the extent to which it will commit to taking lines from BT Openreach or an altnet.

(iii) An ISP's Fibre Only performance may also be higher in Overbuild Areas than in non-overbuild areas (a) if retail-level competition in non-overbuild areas reduces an ISP's total FTTP orders from BT Openreach in those areas, such that the ISP has to rely more heavily on Overbuild Areas to meet the OMTs; or (b) as a result of quarterly fluctuations in take-up, whether resulting from marketing campaigns or other factors. Since it is straightforward to envisage scenarios in which the FM would not prevent ISPs from favouring BT Openreach to the detriment of altnets, Ofcom must provide

[72] BT Openreach, 'Equinox Failsafe Mechanism - Overview', 14 December 2022, slide 2.

[73] If an ISP receives larger discounts as a result of the FM, it only does so once the process is complete. See Equinox 2 draft contract, Appendix 1, para 9.5.

[74] Under the FM process, an ISP effectively has to gamble on foregoing significant discounts upfront and recovering them at the end of the process. The risk of any claim not being approved under the FM is very high, since it will prevent the ISP from obtaining significant discounts.

compelling evidence that these scenarios would never arise before it can confidently deem the FM fit for purpose.

(iv) An ISP who is struggling to meet the OMTs nationally will have no interest at all in invoking the FM to exclude Overbuild Areas which improve its performance as against the OMTs. In other words, ISPs may be disincentivised to use the FM in the very areas in which the FM could in principle operate.

3.21 As regards ISPs' ability to use the FM, this depends on ISPs committing the resources needed to engage in detailed monitoring to identify Overbuild Areas; to keep track of the sales in those areas made across two or more networks; to determine whether it is advantageous to use the FM given their BT Openreach order mix; and to provide any other information required by the Independent Verifier. More specifically, for the FM to be effective, an ISP would need to ensure that it could identify:

(i) All addresses (UPRNs) which are ready for service in the BT Openreach FTTP footprint;

(ii) For each alternative FTTP network the ISP uses, all addresses within the alternative network footprint to which it has access;

(iii) Addresses which lie within both the BT Openreach FTTP footprint and the alternative network footprint to which the ISP has access (i.e. the Overbuild Area);

(iv) In each quarter:

- How many FTTP orders the ISP has placed with BT Openreach in the BT Openreach FTTP footprint;
- How many legacy orders the ISP has placed within the BT Openreach FTTP footprint;
- How many FTTP orders the ISP has placed with BT Openreach in the Overbuild Area;
- How many legacy orders the ISP has placed in the Overbuild Area;
- The number of legacy orders per premises the ISP has placed in the Overbuild Area;
- The number of legacy orders per premises the ISP has placed outside the Overbuild Area (but within the BT Openreach FTTP footprint); and

(v) BT Openreach's likely approach to its review of the FM in the event that the proportion of legacy orders in the Overbuild Area is significantly higher than that outside the Overbuild Area.

3.22 ISPs are unlikely to have systems in place which track their performance against the OMTs in 'real time'. To build an effective model which can assess whether the FM is likely to deliver results, an ISP would need to establish new systems to facilitate the calculation of its effect on an ongoing basis. UPRN footprint data for both BT Openreach and relevant altnets would need to be updated on a rolling basis (as and when supplied by the networks)[75] and a means of attributing FTTP and legacy orders to the different geographic areas would need to be established.[76]

3.23 Ofcom should give serious consideration to whether the FM is likely to give ISPs comfort in practice, given the onerous investment that will be required to put it into operation. In CityFibre's view, it is unrealistic to suppose that ISPs who are facing significant commercial pressures – **[✂]** – will take the practical steps referred to above and place reliance on the FM. **[✂]**.

3.24 Moreover, the FM is incapable of guarding against the potential impact of the OMTs on dynamic competition explained in paragraphs 3.3 - 3.6 above. It does not permit ISPs to exclude from the calculation areas where BT Openreach currently offers FTTP, and altnets are expected to build in the near future. It does not therefore address the possibility that the OMTs may cause ISPs in those areas to purchase from BT Openreach when they would otherwise have waited for the altnet to arrive.

Ofcom's provisional conclusion on the Failsafe Mechanism is not supported by evidence

3.25 Ofcom recognises that in principle, the FM will "*provide little comfort*" to an ISP who is considering using an altnet if (i) the ISP believes that applying the FM is "*unworkable in practice*" or (ii) the FM is "*too onerous or otherwise unacceptable"* to the ISP.[77]

3.26 In para 3.84(d) of the ConDoc, Ofcom concludes that the FM "*is in our view practically workable and we expect it to be acceptable to ISPs*" (emphases added). However, Ofcom's provisional view is not supported by any evidence whatsoever:

(i) Ofcom recognises that the steps involved in the FM process "*may be relatively complex*", but anticipates that "*sophisticated entities such as the main ISPs and*

[75] Ofcom's own difficulties in calculating overlap due to issues such as different definitions of premises (see e.g. footnote 142 of the ConDoc) illustrate how challenging this is likely to be.

[76] These are points on which Ofcom should seek evidence from ISPs.

[77] ConDoc, paras 3.70 and 3.73.

Openreach should be capable of complying with these steps".[78] Rather than relying on evidence provided by the ISPs, Ofcom simply asserts that the FM "*contains similar requirements to those already contained in other Openreach discount contracts (e.g. GEA volume agreement)*" and that it is "*not aware of any complaints made by ISPs in relation to these verification processes or that any significant concerns have been raised*".[79]

(ii) CityFibre disagrees that the requirements in the FM process are similar to those in the BT Openreach GEA Volume Agreement. Under the GEA Volume Agreement, ISPs simply have to calculate their total FTTP orders[80], which is a much simpler exercise than the one required under the FM. Indeed, given that ISPs have in practice generally been able to understand and implement the GEA Volume Agreement, it is not clear why BT Openreach is proposing to replace the relatively simple GEA mechanism with the much more complex combination of the OMTs and the FM.

(iii) INCA and Zzoomm submitted that since ISPs' eligibility for discounts is determined at the end of the FM process, this diminishes ISPs' working capital.[81] Ofcom dismisses this concern without any evidence or structured analysis, merely stating that "*we doubt that any delays are likely to be long enough for these impacts to be material*".[82]

3.27 As noted above, the FM is central to Ofcom's conclusion that the OMTs do not create a potential barrier to using altnets. In view of its importance to the analysis, it is essential that Ofcom properly assesses ISPs' views on the workability of the FM before reaching its final decision on Equinox 2. **[✂]**.

3.28 **[✂]**. In particular, in addition to seeking their views, Ofcom should ask ISPs for any internal documents in relation to: (i) the steps required to use the FM; (ii) plans to use the FM; (iii) the time, cost and resource required to use the FM and the extent to which these resource requirements mean reduced scope (in terms of time and staff) to integrate with and promote altnet FTTP; (iv) the implications of BT Openreach's ability to review and amend the FM; and (v) whether the requirements in the FM process are similar to (or different from) those in the BT Openreach GEA Volume Agreement.

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[78] ConDoc, para 3.71.

[79] ConDoc, para 3.71 and footnote 59.

[80] Under the 'Volume Target Relief' provisions of the GEA Volume Agreement, if an ISP acquires Superfast broadband connections with a 'Qualifying Alternative Network Provider' and the connections are in BT Openreach's FTTP network footprint, then the ISP's volume commitment will reduce by the same number of connections. In this sense, the targets in the GEA Volume Agreement are network-agnostic.

[81] ConDoc, para 3.33(c).

[82] ConDoc, footnote 62.

4. Ofcom's assessment of whether the forecasting requirements act as a barrier to using altnets

4.1 Under Equinox 1, ISPs are required to forecast their BT Openreach FTTP orders covering the subsequent six months on a rolling monthly basis for 27 geographic areas. ISPs lose 25% of the available Equinox 1 connection discounts if the difference between forecast and actual BT Openreach FTTP orders is more than 10% in three consecutive quarters.[83]

4.2 Under Equinox 2, the forecasting requirements have been amended through the introduction of a new method of calculating the variance between forecast and actual BT Openreach FTTP orders.[84] An average variance of no more than 10% per quarter is permitted, but if ISPs are above this for three consecutive quarters then this will result in a proportional loss of discount: for every percentage point outside the permitted variance, ISPs will have £1 deducted per line connected in the relevant quarter.[85] ISPs are also required to notify BT Openreach at least six weeks in advance if their forecasts are expected to be inaccurate by more than 20% in any given month.

4.3 Ofcom states that the purpose of the forecasting requirements in Equinox 1 and Equinox 2 is to "*help Openreach plan capacity and resources*".[86] **[✂]**. This casts significant doubt on the extent to which the forecasting requirements help BT Openreach to plan capacity and resources in practice.[87]

4.4 **[✂]**.[88]

4.5 The forecasting provisions put in place a further layer of commitment by ISPs to purchase FTTP products from BT Openreach instead of altnets. Those provisions need to be considered alongside the OMTs. The combined effect of the forecasting requirements and the OMTs is to solidify demand for BT Openreach FTTP products over rivals' fibre products. On the one hand, ISPs would suffer severe financial consequences if they were to miss the OMTs and lose discounts across their entire FTTP order base. This renders them risk-averse and inclines them to prioritise sales of BT Openreach FTTP to make sure that they are comfortably above

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[83] See Equinox Statement, para 3.94.

[84] BT Openreach will compare an ISP's forecast and actual volumes for each month and calculate the variance, and the variances for the three months within each quarter are then averaged.

[85] The maximum deduction is capped at £12.50 per line.

[86] ConDoc, para 3.88.

[87] In para 3.40 of the ConDoc, Ofcom itself recognises that under Question 1 of its analytical framework, it must consider "*the likelihood of events happening (or not happening)*". See also para 3.39 of the ConDoC, in which Ofcom acknowledges that conclusions need to be "*plausible given the evidence available and based on reasonable underlying assumptions*".

[88] See Competition Complaint, paras 5.13-5.15 and Confidential Annex A. Many ISPs are low-margin businesses and so the financial impact of missing forecasts may be significant for their bottom line.

the OMT thresholds. On the other hand, the forecasting requirements oblige ISPs to cement this prioritisation by pre-committing to particular volume levels that they will then deliver to BT Openreach, reducing their freedom to reallocate demand to altnets; and adding the risk of further financial penalties if they were to do so and thereby depart from their forecasts.

4.6 Ofcom appears to dismiss CityFibre's concerns regarding the forecasting requirements on the basis that ISPs "*have a strong incentive to prioritise Openreach regardless*".[89] This misses the point. Particularly in view of BT Openreach's formidable incumbency advantages, the key question that Ofcom must address is whether the forecasting requirements in Equinox 2 sharpen ISPs' incentives to prioritise BT Openreach FTTP over altnet FTTP.

4.7 Ofcom also states that the Equinox 2 forecasting requirements apply "*regardless of whether or not an ISP uses an altnet*".[90] However, the relevance of this is hard to understand. If the forecasting requirements divert ISPs from using altnets to a greater extent than would be the case in their absence, then they create a barrier to using altnets.

4.8 In addition, whilst its substance is entirely redacted, CityFibre understands that the final sentence of paragraph 3.89 of the ConDoc summarises ISPs' views on the forecasting requirements. **[✂]**. As CityFibre explained in its submission of 20 January 2023, Ofcom should ask ISPs to provide internal documents relating to their assessment of: (i) actual performance against the forecasting requirements in Equinox 1; (ii) the impact of missing the forecasting requirements in Equinox 1; (iii) the impact of the changes to the forecasting requirements in Equinox 2 (including the time, effort and resource required to develop forecasts and ensure that they are met); and (iv) their ability to meet the forecasting requirements in Equinox 2. Ofcom should also request BT Openreach to provide internal documents discussing the rationale for the changes to the forecasting requirements in Equinox 2.

5. The level of prices under Equinox 2

5.1 As part of its assessment of Equinox 2, Ofcom has, rightly, "*considered whether the lower prices under the Equinox 2 Offer are likely to act as a barrier to altnet entry and expansion*".[91] The Equinox 2 prices would be likely to act as a barrier if, for instance, altnets would be unable to compete with those prices while covering their efficiently incurred costs, or if they prevent new entrants from undercutting BT Openreach to the extent necessary to drive the ISP take-up that is essential to their ability to compete at scale.

[89] ConDoc, para 3.90.

[90] ConDoc, para 3.89.

[91] ConDoc, Overview, page 1.

5.2 Ofcom has provisionally reached the very strong conclusion that the level of prices under Equinox 2 does not even raise any *prima facie* concerns in this regard that would lead Ofcom to investigate this matter further. However, the analysis and evidence on the basis of which Ofcom has reached this provisional conclusion is extremely limited, and suffers from a number of serious flaws.

5.3 Ofcom has asked itself the question whether an altnet in Area 2 could profitably compete against BT Openreach's average FTTP price under Equinox 2.[92] It has addressed this question by comparing those prices with (i) the estimate of an altnet's costs that Ofcom used in its 2021 cost model (the "**fibre cost model**", which was designed to cross-check the price cap imposed on BT Openreach's 40/10 product), and (ii) prevailing altnet prices and offers. Ofcom then bases its provisional conclusion that the Equinox 2 prices do not even raise any *prima facie* concerns on its observations that:

(i) BT Openreach's average FTTP price under Equinox 2 is above the top end of the estimated range in the fibre cost model for the unit cost of an efficient entrant operator;[93]

(ii) BT Openreach's average FTTP price under Equinox 2 is above the prices currently being offered by CityFibre;[94] and

(iii) altnets may be able to further reduce their prices in response to Equinox 2.[95]

5.4 However, these observations do not rationally sustain the conclusion that the Equinox 2 pricing raises no *prima facie* concerns in relation to altnet entry and expansion, for the reasons explored in detail in the RBB Economics and AlixPartners papers that accompany this response (**Confidential Annexes 3 and 4)**. In summary:

(i) Ofcom's 2021 fibre cost model does not provide a sound indication of the efficiently incurred costs of a scale competitor that would provide material and sustainable competition to BT Openreach. This model was built for a different purpose, is out of date, and misses out significant costs that must be incurred by a new entrant capable of becoming a scale competitor.

[92] ConDoc, para 3.103.

[93] ConDoc, paras 3.109 and 3.125.

[94] ConDoc, para 3.125.

[95] ConDoc, paras 3.120 and 3.125.

(ii) Even a minor, reasonable adjustment to update Ofcom's fibre cost model is sufficient to indicate that BT Openreach's average Equinox 2 price is substantially below the level predicted by Ofcom's fibre cost model for an efficient scale entrant.[96]

(iii) Moreover, the gap between an efficient scale entrant's costs and BT Openreach's average price becomes even greater when further (reasonable and conservative) adjustments are made to account for the fact that an efficient scale entrant faces substantial barriers to entry and expansion when competing with BT Openreach, due to the latter's substantial incumbency advantages.

5.5 More specifically, RBB have reached the following conclusions:

(i) First, while RBB strongly disagree with Ofcom's use of the incumbent's WACC for the purpose of a fibre cost model that seeks to understand the cost of an efficient scale entrant, they note that updating BT Openreach's WACC to 2023/24 figures is sufficient to cause BT Openreach's average price (**[✂]**[97]) to fall below an efficient entrant's cost (**[✂]**). Such updates could easily be made within the 90-day process.

(ii) Second, there are different ways to adjust the fibre cost model further to account for the fact that BT Openreach's huge incumbency advantages mean that an efficient entrant would face substantially higher costs of becoming a scale player than would BT Openreach. For example, the fibre cost model can be adjusted as follows (**[✂]**):[98]

(a) **Reasonably efficient entrant operator (REO) WACC**. Use the WACC of an efficient entrant instead of BT Openreach (**[✂]**)[99] and make no other changes to the fibre cost model. In this case the efficient entrant's cost would be **£[✂]**.

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[96] In footnote 91 of the ConDoc, Ofcom itself acknowledges that "*the precise choice of inflation metric could affect the cost range when it is expressed in 2023/24 prices. Indeed, it is possible that average FTTP prices could lie at the top end of the cost range generated by some inflation metrics*".

[97] CityFibre notes that ISPs' bandwidth mixes are likely to evolve in response to the Equinox 2 pricing. Significantly, while the 40/10 'anchor' product is set at the list price, the 55/10, 80/20 and 115/20 products are now priced below the 40/10 product. This effectively makes the 80/20 product the new anchor, since the 40/10 is unlikely to be promoted by ISPs once Equinox 2 comes into effect. In the WFTMR Ofcom stated that it expected higher wholesale prices for higher FTTP speeds, and that the FTTP price premium for higher speeds was important in promoting investment. That premise is now undermined by BT Openreach's plan to price its 55/10, 80/20 and 115/20 products below the 40/10 FTTP product and at comparable levels to the 40/10 FTTC price, so eliminating the price premium which was at the heart of Ofcom's strategy.

[98] Adjustments (a), (b) and (c) are three reasonable alternative ways of showing that Ofcom's position on the fibre cost model is not well founded. (Since the basis for using an REO WACC overlaps to some degree with the other adjustments, presenting the adjustments as alternatives avoids any issues of double-counting.)

[99] CityFibre asked AlixPartners to assess the WACC for an REO – see **Confidential Annex 4**. In summary, AlixPartners found that: (i) an REO's WACC is significantly higher than that of BT Openreach and that estimated by Ofcom in the WFTMR; (ii) Ofcom's existing WACC estimate should be updated to account for changed market conditions since the publication of the WFTMR; (iii) there are significant differences between the systematic risks of a new entrant FTTP network and those of BT Openreach; and (iv) Ofcom's approach takes insufficient account of non-systematic asymmetric risks of a new entrant, such as BT Openreach's legacy customer base, anchor ISP tenants, and availability of low-cost debt financing.

Adjusting the model to account for an REO's WACC should not be controversial: if the aim is to understand the costs of an REO then it is obvious that the REO's WACC is more relevant than the regulated incumbent's WACC.

(b) **REO take-up**. Use the WACC of BT Openreach (**[✂]**%) but assume a more realistic take-up rate for the entrant (**[✂]**).[100] In this case the efficient entrant's cost would be c. **£[✂]**.

(c) **Compensating multi-sourcing ISPs.** Use the WACC of BT Openreach (**[✂]**%) and the take-up assumptions in the fibre cost model (30% by year 3 for a scale entrant) but increase the cost base by **[✂]**% to allow the entrant to compensate ISPs for switching some lines away from BT Openreach, thereby providing the entrant with the means to achieve the take-up rates predicted by the model. In this case the efficient entrant's cost would be **£[✂]**.[101]

[✂]

Source: **[✂]**

(iii) Third, it is meaningless to benchmark BT Openreach prices against CityFibre prices. **[✂]**[102] **[✂]**[103]. **[✂]**.

5.6 Moreover, a number of the points made by Ofcom in relation to the level of Equinox 2 pricing are poorly reasoned and/or unsupported by evidence. For example:

(i) Ofcom's main objection to updating its fibre cost model appears to be that it would "*require a significant amount of time and work*" and that such an exercise would be "*disproportionate*".[104] This is a particularly weak justification in circumstances where the future viability of network competition is at stake. If material changes have occurred, it is proportionate for Ofcom to update the model appropriately. In any case,

[100] Ofcom assumes that the entrant achieves take-up of 30% by year 3 of deployment (WFTMR, Annex 15, para A15.84). This assumption does not reflect reality: **[✂]**. Ofcom should base the take-up profile in its model on up-to-date evidence from stakeholders rather than speculative, outdated assumptions. Doing so would provide a reality check for the amount that an REO might spend to overcome barriers to entry and expansion and thereby avoid the costs of low or slow take-up.

[101] **[✂]**.

[102] See Competition Complaint, Confidential Annex B.

[103] See Competition Complaint, Confidential Annex A.

[104] ConDoc, Annex 10, para A10.6(c).

the analysis of RBB and AlixPartners indicates that Ofcom could make relatively straightforward adjustments to its model within the 90-day process which would show that Ofcom's provisional conclusion is unsafe and that the level of prices under Equinox 2 does give rise to *prima facie* concerns.

(ii) Ofcom suggests that "*[o]nly selecting a sub-group of input assumptions to update (such as those raised in the altnet submissions […] or a selection of cost and volume assumptions based on what specific entrants have currently achieved) could result in a biased estimate of costs and/or risks introducing inconsistency into the model*".[105] This is unpersuasive: it is incumbent on Ofcom to ensure that its fibre cost model reflects reality. If it does not reflect reality, it cannot rationally be relied on in support of the conclusion that the Equinox 2 prices do not even raise any *prima facie* concerns.[106]

(iii) Ofcom states that it calibrated the fibre cost model during the WFTMR "*using information from operators in connection with their business plans, cost modelling and forecasts*".[107] However, market conditions have evolved rapidly since the publication of the WFTMR and if information previously obtained by Ofcom is no longer accurate, Ofcom should gather new, up-to-date information. **[✂]**.

(iv) In relation to the WACC, Ofcom states that "*the increase [of corporation tax] to 25% is expected to be a short-term measure*", but provides no evidence in support of this assumption.[108] Ofcom appears to ignore the fact that tax levels are generally set indefinitely and remain in place unless and until they are altered.[109]

(v) Ofcom also states: "*As stated in the 2021 WFTMR Statement, we agree that FTTP is higher risk than copper and FTTC. However, we also recognised that there are potentially greater revenue opportunities with FTTP, e.g. the ability to set higher prices for premium very high bandwidth services, that would limit how much higher an FTTP WACC would be.*"[110] This statement is difficult to understand: WACC is a cost concept, with firm-specific variations in WACC being driven by variations in the systematic risk

[105] ConDoc, Annex 10, para A10.6(b).

[106] Ofcom acknowledged in the WFTMR that "*it is important to verify that the outputs of our cost modelling are reflective of reality*" (WFTMR, Annex 15, para A15.69).

[107] ConDoc, Annex 10, para A10.6(a).

[108] ConDoc, Annex 10, para A10.22.

[109] The issue of corporation tax is considered in more detail in section section 4.4 of AlixPartners' paper on the WACC (**Confidential Annex 4**). CityFibre also notes that in other instances where Government measures have been characterised as short-term, this has been clearly stated; and even a "short-term" measure might extend beyond the current market review period.

[110] ConDoc, Annex 10, para A10.24.

that firms face and takes no account of revenues. Ofcom's statement thus seems irrelevant to a consideration of WACC.

(vi) In the context of comparing BT Openreach's prices with CityFibre's prices, Ofcom notes that "*[s]ince [CityFibre] already supplies TalkTalk and Vodafone, we would expect some of the costs that these ISPs face in integrating their sales systems and processes with CityFibre to already have been sunk*".[111] **[✂]**.[112]

5.7 For the above reasons, Ofcom's provisional conclusion that there is no *prima facie* concern that Equinox 2 prices may act as a barrier to altnet expansion has no sound basis. Ofcom needs to address this question by reference to an updated and adjusted cost model, and an economic analysis that takes account of the huge incumbency advantages enjoyed by BT Openreach on the one hand, and huge barriers to altnet entry and expansion on the other.

5.8 In addition to commenting on the extent to which Ofcom's fibre cost model acts as a suitable benchmark for BT Openreach's pricing, CityFibre has asked RBB to consider more generally how the price levels under Equinox 2 may impact on Ofcom's objective of promoting network competition. RBB's conclusions (which are set out in detail in **Confidential Annex 3**) include the following:

(i) There are sharp incentives for ISPs to meet the Equinox 2 OMTs and thereby secure substantial discounts on prices.

(ii) Faster migration to BT Openreach FTTP (which is the aim of the Equinox 2 discount scheme) reduces the customer base available to altnets, while lower BT Openreach prices reduce the expected returns available from any customers won by altnets. Both of these factors make entry and expansion by altnets less profitable and therefore less likely to happen.

(iii) Ofcom faces a difficult challenge of balancing the conflicting objectives of (a) promoting competition between wholesale FTTP providers in the longer term (and the lower prices and greater innovation that this would likely bring) and (b) allowing BT Openreach to compete on price in the short term. An error-cost framework sheds light on how Ofcom can balance these objectives and points strongly to Ofcom erring on the side of promoting competition in the longer term and therefore being wary of the level of prices under Equinox 2.

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[111] ConDoc, para 3.122.

[112] **[✂]**.

5.9 RBB has concluded that the level of prices under Equinox 2 is unlikely to be consistent with Ofcom's objective of promoting competition. [113]

5.10 It is CityFibre's view that the Equinox 2 pricing certainly raises – at the very least – *prima facie* concerns that these lower prices will impede altnet entry and expansion; that Ofcom's provisional conclusion to the contrary is unsound and based on flawed and inadequate analysis and evidence; and that Ofcom should further investigate these concerns. These *prima facie* concerns about the level of prices are an additional reason for Ofcom to direct that Equinox 2 should not be implemented pending further investigation. In view of the narrow window of opportunity for network competition to emerge, Ofcom's further investigation should be carried out without delay.

6. BT Openreach's practice of repeatedly amending its FTTP prices

6.1 Under the heading "*Is the Equinox 2 Offer part of an Openreach practice of repeatedly amending its FTTP prices that could act as a barrier to altnet entry and expansion?*", Ofcom states that it has considered whether "*the submissions by stakeholders raise prima facie concerns that would lead us to decide to further investigate the issues raised*" and that it is "*seeking further evidence to enable us to reach a view on whether to investigate this matter further*". [114]

6.2 CityFibre believes that BT Openreach's practice of repeatedly amending its FTTP prices does indeed give rise to *prima facie* concerns. CityFibre has explained in detail in its Competition Complaint and its letter to Ofcom of 13 January 2023[115] how BT Openreach's strategic engagement in continual dialogue with ISPs about future FTTP offers is disincentivising ISPs from engaging with altnets and creating broader uncertainty in the market, which is in turn deterring investment in altnets and undermining their build plans. [116] Those submissions are not repeated here, but CityFibre asks Ofcom to treat them as incorporated into this consultation response, and to take them into account in addressing the question it has raised.

6.3 In summary, relevant to Ofcom's consideration of Equinox 2, those concerns are as follows:

- BT Openreach has engaged in a strategy of continuous negotiation of price discounts with ISPs providing expectations of further price reductions. That strategy has the

[113] CityFibre notes that, if Ofcom approves the level of pricing in Equinox 2, it will effectively allow BT Openreach to get rid of the fibre premium that Ofcom previously deemed necessary for promoting network competition (see also footnote 98).

[114] ConDoc, paras 3.132 - 3.133.

[115] CityFibre's letter of 13 January 2023 developed points raised in CityFibre's letter to Ofcom of 11 July 2022.

[116] As noted in section 2 above, Ofcom has itself recognised that regulatory certainty is important for investment in alternative networks.

effect of ensuring that ISPs' willingness to develop and invest in relationships with altnets is significantly diminished;

- BT Openreach's practice of moving seamlessly from one conditional discount scheme to the next is creating an expectation on the part of ISPs of significance that BT Openreach's terms will be subject to regular improvement – Equinox 1 now followed by Equinox 2 – tying in those ISPs to BT Openreach on an ongoing basis.

- CityFibre has no doubt that if Ofcom fails to take action in respect of Equinox 2, BT Openreach will begin the process of discussing a further set of Equinox discounts with those ISPs, with the intention of preventing nascent network competitors from obtaining take up necessary to justify further roll out.

6.4 CityFibre remains of the view, previously expressed in correspondence, that Ofcom should further investigate – as a matter of urgency – whether BT Openreach's signalling conduct is capable of acting as a barrier to altnet entry and expansion. Philip Jansen's recent comments to the market[117] can be seen as part of the same pattern of signalling. The suggestion in the Financial Times that other operators' entry efforts were "*likely to end in tears*" following a return to the established partial duopoly was clearly intended to send an aggressive message which will close equity and debt markets for future investment and leave rivals in little doubt as to the outcomes which BT Openreach is targeting through its "*unstoppable*" commercial conduct.

6.5 The *prima facie* concerns identified by CityFibre in relation to BT Openreach's signalling provide a powerful additional reason why Ofcom should proceed on a precautionary basis; and should prevent the implementation of Equinox 2 pending its further investigations of the state of the market.

7. Questions 2 and 3 of Ofcom's analytical framework

7.1 If Ofcom concludes that, contrary to its provisional view, Equinox 2 creates a potential barrier to using altnets, it must go on to consider (and to consult on) Questions 2 and 3 of its analytical framework, namely: whether Equinox 2 is likely or unlikely to have a material impact on nascent network competitors, and whether it is likely to generate clear and demonstrable benefits.

7.2 In CityFibre's view, Equinox 2 is likely to have a material impact on nascent network competitors for all the reasons explained above. Each of (i) the OMTs, (ii) the forecasting requirements and (iii) the lower prices – separately, and certainly in combination – are likely materially to affect ISP incentives to purchase FTTP from altnets.

[117] See paragraphs 1.5 and 2.8 above.

7.3 Further and in any event, CityFibre notes that it is entirely unclear what the "demonstrable benefits" are of Equinox 2 that could outweigh the harm to competition. The offer is not essential to BT Openreach's business case for FTTP rollout; and is unlikely to generate clear and demonstrable benefits for consumers.

7.4 BT Openreach has stated that Equinox 2 provides additional commercial incentives for ISPs to accelerate their adoption of BT Openreach FTTP.[118] However, this is not a legitimate justification:

(i) As explained in sections 2 - 3 above and in CityFibre's Competition Complaint, BT Openreach's aim of accelerating migration of customers from BT Openreach FTTC to BT Openreach FTTP itself forms part of BT Openreach's wider exclusionary strategy. BT Openreach cannot therefore credibly argue that its migration objective is objectively justified.

(ii) Various elements of Equinox 2, including the OMTs, are disproportionate, going beyond what is reasonably necessary to achieve any legitimate aim. In this connection, Ofcom indicated in the WFMR that it "*would need to see evidence that the restrictive elements were necessary over and above [Ofcom's] copper switchover arrangements which already give Openreach very powerful levers to achieve migration quickly*".[119]

(iii) It is unclear why BT Openreach considers it necessary to further reduce its FTTP prices in circumstances where it has such strong incumbency advantages and is apparently already struggling to keep up with demand for its FTTP products. As noted in section 2 above, Philip Jansen recently stated that "*[c]ustomer demand is extremely strong from both CPs and end customers, with orders up a staggering 51% versus last year. […] [W]e are […] connecting like fury*".[120]

7.5 As for consumer benefits, Ofcom's provisional view is that Equinox 2 "*is consistent with promoting investment in gigabit-capable networks by Openreach and other operators and promoting network-based competition, ultimately delivering better consumer outcomes*".[121] In CityFibre's view, however, Equinox 2 will be seriously harmful to consumer interests. In this context, migration of customers to BT Openreach FTTP at the expense of altnet competition cannot be seen as a benefit. Whilst ISPs may benefit for the period that the discounts are maintained, they (and end-consumers) will suffer in the longer term if the scale of network competition is curtailed. The effects of reduced network competition, including higher prices

[118] ConDoc, para 3.23.

[119] WFTMR, Volume 3, para 7.160(a).

[120] BT Transcript (**Exhibit 2**, page 3).

[121] ConDoc, para 3.136(a).

and reduced quality/innovation, are likely to be felt for decades to come and will outweigh any short-term benefits. It is for this reason that Ofcom's and the Government's consistent policy has been to promote competition at the network level wherever possible. CityFibre and others have made enormous investments on the basis of the policy commitment to network competition. Ofcom now needs to deliver on that commitment with firm and decisive regulatory action.

7.6 It is also highly doubtful whether the lower wholesale prices in Equinox 2 will benefit end-consumers even in the short term:

(i) At the same time as BT Openreach plans to reduce its FTTP rental and connection charges, it plans to increase its wholesale FTTC prices significantly, so removing the FTTP premium whilst maintaining ARPU.[122] BT Openreach's higher FTTC wholesale prices are expected to be passed on by ISPs to end-consumers (and particularly in-contract customers) in the form of higher retail prices.[123] And since all the major ISPs apart from TalkTalk[124] offer a single retail price for each speed category regardless of the underlying technology (FTTC or FTTP), the higher FTTC wholesale prices will at the least dampen (and possibly overturn) ISPs' incentives to reduce FTTP retail prices as a result of the Equinox 2 discounts.

(ii) The cliff-edge effect of the Equinox 2 OMTs may also make it less likely that lower wholesale prices are passed on to new customers. An ISP will typically sign up customers to an 18-month contract for a fixed retail price. At that point, the ISP will not know what wholesale price it will pay over those 18 months: it depends on whether it achieves the OMTs in each quarter. If the ISP has any doubts over its ability to meet the OMTs, it is likely to be cautious about passing on the discount that it may or may not earn.

(iii) ISPs' incentives to pass on wholesale FTTP price reductions will be further reduced by their desire to retain some of the benefit for themselves, to bolster profitability.

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[122] See e.g. https://www.endersanalysis.com/reports/openreach-cuts-full-fibre-prices-while-increasing-copper.

[123] It has been widely reported that telecoms providers are preparing to launch "inflation-busting" price increases for broadband and mobile contracts in spring 2023. See e.g. The Guardian, "UK mobile and broadband firms plan huge price rise for existing customers", 13 February 2023, available at https://www.theguardian.com/business/2023/feb/13/uk-mobile-broadband-firms-bt-ee-vodafone-huge-price-rise-existing-customers. See also ISPreview, "Broadband Consumers Brace for Massive 2023 UK Price Hikes", available at https://www.ispreview.co.uk/index.php/2022/12/broadband-consumers-brace-for-massive-2023-uk-price-hikes.html.

[124] TalkTalk cannot yet provide Voice over IP (VOIP) services. Consequently, where FTTP is available, customers who want a landline would be offered an FTTC-based service at £24, whereas other customers would be offered an FTTP line at £26 (based on 65 speed prices).

8. Conclusion – the action that Ofcom should take

8.1 For the reasons set out above, CityFibre disagrees with Ofcom's assessment of Equinox 2 as set out in the ConDoc. Taking the three questions of Ofcom's analytical framework in turn, there is evidence that:

(i) Equinox 2 does potentially create a barrier to using altnets. In a change of approach since its review of Equinox 1, it appears that Ofcom now accepts that the OMTs and associated substantial discounts may be liable to have incentive effects for at least one of the major ISPs, to the commercial advantage of BT Openreach and the detriment of altnets. Instead, Ofcom now places its faith in BT Openreach's "Failsafe Mechanism". Ofcom's reliance on that mechanism is fundamentally misplaced: it shows a lack of understanding of the likely dynamics in overbuild areas and rests on an uncritical acceptance of BT Openreach's representations rather than any concrete evidence or enquiry. Ofcom's commitment to promoting network competition should lead it to adopt a precautionary approach and not simply to hope for the best.

(ii) Equinox 2 is likely to have a material impact on nascent network competitors. Evidence-based regulation requires Ofcom to consider the market realities. Altnets have limited access to market given the importance of the captive ISPs. Any incentive effect on any of the other major ISPs will harm the take-up rates which are key to investor confidence and continued commitment to network rollout. Ofcom was called by the CAT in the Equinox 1 appeal to monitor market conditions carefully. It should properly apprise itself of information about take-up rates in the market in order to assess the current state of network competition in the UK and the likely adverse effects of Equinox 2 on ISPs' incentives to purchase freely from competing network providers.

(iii) Equinox 2 is not essential to BT Openreach's business case for FTTP rollout and the offer is unlikely to generate clear and demonstrable benefits for consumers. Again, this necessitates real-world evidence. BT Openreach's statements to the market suggest that it is already generating high levels of FTTP take-up without the need to stack the Equinox conditionality mechanism further against the altnets by increasing the discounts to ISPs that are dependent on their purchasing sufficient FTTP volumes from BT Openreach.

8.2 Ofcom should therefore use its direction-making powers to prevent Equinox 2 from coming into effect in its current form. Ofcom should also further investigate as a matter of urgency:

(i) The level of prices under Equinox 2 (given the *prima facie* concerns set out in section 5 and **Confidential Annexes 3 and 4**).

(ii) Whether BT Openreach's practice of repeatedly amending its FTTP prices is capable of acting as a barrier to altnet entry and expansion.

8.3 The *prima facie* concerns about the level of pricing and BT Openreach's practice of repeatedly amending its FTTP prices (see sections 5 and 6 above) are additional compelling reasons for Ofcom to direct that Equinox 2 should not be implemented pending further investigation.

8.4 Resolute action is needed to confirm Ofcom's continued commitment to the even-handed promotion of network competition. Contrary to BT Openreach's vision of the future, there is no reason why efforts to establish network competition at scale in the UK need to "end in tears". Ofcom has the evidence it needs as to the likely impact of the Equinox conditionality mechanism on ISPs' willingness to purchase from altnets. There are good reasons why the Failsafe Mechanism does not provide a satisfactory solution to avoid exclusionary effects. The scale of the discounts increases the risk for ISPs of shifting their purchasing away from BT Openreach. This is classic exclusionary conduct which requires a clear and robust response from Ofcom.

CityFibre response to Ofcom's consultation on Openreach's Equinox 2 offer

Confidential Annex 1

[✂]

CityFibre response to Ofcom's consultation on Openreach's Equinox 2 offer

Non-confidential version Annex 2

RBB Economics

Note on the Failsafe Mechanism

RBB Economics, 4 March 2023

1 Overview

The Equinox 2 Offer introduced a Failsafe Mechanism, which did not exist under Equinox 1. Openreach proposed this mechanism to allow ISPs (where they also purchase services from altnets in "Overbuild" areas) to have their performance against the "Order Mix Targets" (OMTs) assessed *excluding* such Overbuild areas.[1] Openreach claims that the Failsafe Mechanism removes any risk of ISPs being disincentivised from placing orders with altnets as a result of the OMTs (which require a minimum percentage of orders in a given quarter to be Fibre Only orders placed with Openreach).

In this note we explain that the Failsafe Mechanism does not remove the risk that the OMTs will serve as a potential barrier to ISPs' use of altnets. It cannot be relied upon to prevent Equinox 2 from impacting ISP incentives to deal with altnets for (at least) the following reasons.

- **Higher Fibre Only measures in Overbuild areas.** If an ISP's Openreach Fibre Only measure is *higher* in the Overbuild area than outside the Overbuild area, then the Failsafe Mechanism provides no protection for an altnet. That is, the ISP may still prefer to place orders with Openreach rather than an altnet to ensure that it reaches the OMTs because excluding the Overbuild area would *reduce* the prospect of meeting the OMTs. The anticipation of higher Fibre Only measures in Overbuild areas (whether systematically or from time to time due to quarterly variation) would be an incentive to prioritise Openreach

[1] See paragraph 3.14 in Ofcom's February 2023 consultation on Equinox 2. An overview of the Failsafe Mechanism can be found at https://www.openreach.co.uk/cpportal/content/dam/cpportal/public/images-and-documents/home/updates/Briefings/2022/EquinoxFailsafeMechanismSummary_v1.pdf (accessed on 4 March 2023). An Overbuild area corresponds to an area where Openreach's FTTP footprint overlaps with the FTTP footprint of an alternative network (altnet).

ex ante, e.g., when the ISP decides the extent to which it will commit to Openreach versus altnets.

- **The Failsafe Mechanism creates risk and uncertainty for ISPs which may deter them from using altnets.** At the start of each quarter, some ISPs will be uncertain about whether the Failsafe Mechanism will be effective. This is due to several reasons, including the possibility of higher Fibre Only measures in Overbuild areas, as discussed above, as well as practical difficulties around the process of invoking the Failsafe Mechanism.[2] Given the large sums of money at stake under Equinox 2, the costs and risks associated with invoking the Failsafe Mechanism successfully mean that the OMTs may discourage ISPs from using altnets. This may affect both how ISPs allocate their orders to altnets within a period but also, more importantly, their willingness to invest in integrating with altnets in the first place. In summary, given the costs and uncertainties involved, the Failsafe Mechanism may be unlikely to diminish an ISP's *ex ante* decision to prioritise Openreach over altnets in order to meet the OMTs.[3]

The rest of this note is organized as follows. Section 2 discusses the main issues associated with the Failsafe Mechanism. Annex A provides a worked example showing a number of scenarios in which the Failsafe Mechanism would *not* prevent ISPs from favouring Openreach.

2 Issues with the Failsafe Mechanism

Openreach claims that there is not "*any possibility of the Fibre Only measure having the effect of distorting incentives to use alternative network suppliers in areas where CPs have a choice between Openreach GEA-FTTP and other potential network suppliers*".[4] The Failsafe Mechanism is alleged to deal with any potential effect on ISPs' incentives to buy from altnets by allowing an ISP to declare an "Overbuild area" which is excluded from its Fibre Only measure calculation for the purpose of meeting the OMTs. However, in our view, the Failsafe Mechanism *does* leave scope for the OMTs to distort ISP incentives to use altnets. There are two reasons as discussed below.

Furthermore, Ofcom said that: "*the Failsafe Mechanism is similar to provisions already contained in other Openreach discount contracts (e.g. GEA volume agreement) that are already in effect*".[5] However, this is inaccurate. In particular, the GEA volume agreement has a mechanism named "Volume Target Relief" that Openreach describes as follows.

> *Volume Target Relief – If a CP acquires Superfast broadband connections with a Qualifying Alternative Network Provider[6] and the connections are in*

[2] These are discussed in section 3 of CityFibre's main response to Ofcom's consultation on Openreach's Equinox 2 offer.

[3] The Failsafe Mechanism is a mechanical exercise which *may* enable ISPs to meet the OMTs on an ex post basis. ISPs may choose to invoke the Failsafe Mechanism in an attempt to improve their performance in individual quarters, but only *after* they have implemented a general policy of prioritising Openreach FTTP over altnet FTTP.

[4] See https://www.openreach.co.uk/cpportal/updates/briefings/ultrafast/nga2010822 (accessed on 4 March 2023).

[5] See paragraphs 3.71 and 3.75 of the Equinox 2 consultation.

[6] "*Defined as a provider of fixed-access broadband internet services that offers a portfolio of products that has the capability to deliver the same or greater upload and download speeds to the Products that form part of this Special*

Openreach's fibre network footprint then the CPs volume commitment will reduce by the same number of connections.[7]

The description of the Volume Target Relief implicitly treats all FTTP connections (provided by Openreach or any other Qualifying Alternative Network Provider) *equally* for the purposes of the ISP achieving the volume commitment. This is *not* the case under the Failsafe Mechanism.

2.1 Higher Fibre Only measures in Overbuild areas

If an ISP's Openreach Fibre Only measure is *higher* in the Overbuild area than outside the Overbuild area, then the Failsafe Mechanism provides no protection. In that case, invoking the Failsafe Mechanism would not increase an ISP's Fibre Only measure (in fact, it would reduce it). Therefore, the Failsafe Mechanism would not enable the ISP to obtain larger discounts than would be the case absent the Failsafe Mechanism.

However, increasing Openreach FTTP sales in Overbuild areas could affect the discounts. For example, by increasing the share of Openreach FTTP *in the Overbuild area at the expense of the altnet*, the ISP may reach the 80% threshold and gain a substantial discount which applies on all eligible lines not only in that Overbuild area but also outside that area. In Annex A below we set out a worked example showing how (even with the Failsafe Mechanism in place) an ISP may prefer to source FTTP from Openreach instead of an altnet in order to meet the OMTs.

The likelihood of this depends on whether, in practice, Overbuild areas are likely to have higher fibre take-up rates (or could have in at least some quarters). Ofcom says: "*It is unclear whether this is plausible in practice. ISPs' sales systems and practices are likely to significantly influence whether a customer takes FTTP and it is not obvious why these would lead to significant differences in an ISP's mix of orders between areas*".[8]

In this regard we have the following comments. First, even if a risk to an ISP is "unclear" or "not obvious", the possibility that it may arise – and cause a very substantial reduction in the discounts available – is likely to influence an ISP's decision, as we discuss further below. In our view, therefore, this risk should not be dismissed unless there were compelling evidence to demonstrate that it is so small that ISP incentives are highly unlikely to be impacted.

Second, there are a number of reasons why fibre take-up rates could be higher in Overbuild areas.

Offer. For the avoidance of doubt, a Qualifying Alternative Network Provider will continue to be considered as such for the remaining duration of the contract, irrespective of if they merge with or are acquired by other Qualifying Alternative Network Providers."

7 Volume commitment special offer on GEA-FTTC, Gfast and GEA-FTTP, available at https://www.openreach.co.uk/cpportal/content/dam/cpportal/public/images-and-documents/home/products/fibrebroadband/ultrafast/documents/VolumeCommitment_special_offer_onGEA_FTTCGfastandGEA_FTTPcustomerdeckUPDATED120321.pdf, slide 4 (accessed on 4 March 2023).

8 Equinox 2 consultation, para 3.82.

- All else equal, altnets would be expected to prefer to enter areas which offer the greatest number of potential fibre orders (e.g., due to the number of premises in the area and/or due to the propensity of consumers in the area to take-up fibre as opposed to legacy products). If so, this would be a reason to expect Overbuild areas to have a greater share of Fibre Only orders, compared to Non-Overbuild areas.

- While we do not have the data to test this hypothesis directly, we note that Area 2 locations are (by definition) areas where Ofcom considers overbuild is more likely to occur. Based on figures published by Openreach,[9] it is notable that in FY 2021/22 (latest available) the rate of growth for external FTTP rental volumes (i.e., Openreach volumes with ISPs other than BT Retail) was higher in Area 2 than in Area 3, while for external FTTC rental volumes the growth rate was higher in Area 3 than in Area 2.[10] This is in line with the view that Overbuild areas would be proportionately more important to ISPs in terms of the Fibre Only connections they generate.

- One possible reason for a greater propensity of consumers to take-up FTTP in Overbuild areas would be due to more intensive marketing of FTTP products, which could raise consumer awareness of fibre products and thereby boost demand for Openreach FTTP connections. Such marketing activity may be due to ISPs in the area promoting the FTTP products of either Openreach or an altnet. Alternatively, it may result from direct marketing by Openreach or an altnet. In either case, this provides a mechanism that could result in Overbuild areas contributing disproportionately to an ISP's Fibre Only measure (and thus in ISPs relying more heavily on Overbuild areas to meet the OMTs).

- Further, even if such marketing efforts are not systematically undertaken but occur from time to time, they may still cause substantial quarterly volatility that mean that (in some quarters) an ISP would fail to meet the OMTs unless it obtained orders in Overbuild areas from Openreach at the expense of an altnet. Such volatility would provide a reason for the ISP to promote Openreach ex ante (as we discuss in section 2.2 below and in the scenarios in Annex A).

Third, ISP competition can render the Failsafe Mechanism ineffective in different ways. The preceding discussion hypothesised greater marketing activity in Overbuild areas (inter alia arising from ISP competition) that gave rise to higher fibre take-up in Overbuild areas. An alternative scenario would be ISP competition in Non-Overbuild areas causing an ISP to suffer a drop in FTTP volumes in Non-Overbuild areas, without any impact on its copper volumes, such that it relied more heavily on Overbuild areas to meet its OMTs. (Annex A provides a related example.)

In summary, plausible scenarios can be envisaged which demonstrate how the Failsafe Mechanism would not be fit for purpose. This calls into question Ofcom's apparent presumption that such scenarios would never arise in practice.

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9 See Openreach's 2022 Regulatory Financial Statements at https://www.bt.com/bt-plc/assets/documents/about-bt/policy-and-regulation/our-governance-and-strategy/regulatory-financial-statements/2022/regulatory-financial-statements-2022.pdf (accessed on 4 March 2023).

10 In FY 2021/22, the growth rate for external FTTP rental volumes was of 907% in Area 2 and 819% in Area 3. The equivalent growth rates for external FTTC rental volumes were 10% in Area 2 and 12% in Area 3.

2.2 Uncertainty and risk

Reliance on the Failsafe Mechanism involves some uncertainty, for several reasons, including:

- the possibility that invoking the Failsafe Mechanism would not assist ISPs to meet the OMTs, as described in section 2.1 above;
- the difficulties of measuring and monitoring Overbuild, especially as both Openreach and altnets continue to build out their FTTP networks;[11] and
- the fact that the approaches of Openreach and the Independent Verifier to the review process are entirely outside the control of the ISP, meaning that ultimately any attempt to invoke the mechanism may not be successful.[12]

Essentially, an ISP must make a three-stage decision as regards promoting connections with an altnet over Openreach.

- First, it has to decide whether to incur the sunk costs and internal resources required to integrate with an altnet. That is, it has to decide whether to make a *long-term commitment* with an altnet.
- Second, if it has chosen to do so, it then decides on the mix of Openreach versus altnet orders in any given Overbuild area.
- Third, at the end of each quarter, it can choose to invoke the Failsafe Mechanism for that quarter.

With this context in mind, we can compare the theoretical scenario of "ISP certainty" with a more realistic one in which ISPs perceive there is a risk and cost associated with the Failsafe Mechanism.

First, consider the theoretical "ISP certainty" scenario. Suppose that an ISP is *certain* that the Failsafe Mechanism will work as intended when invoked and that the costs of so doing are zero. Suppose also that the ISP will never need to rely on securing higher fibre orders in an Overbuild area to meet the OMTs. In this (extreme) scenario, the ISP can be confident that: there are no frictions around invoking the Failsafe Mechanism at stage three; the allocation of orders in the Overbuild area at stage two will not affect its fibre ratio; and, therefore, it can weigh up whether an altnet's offer will compensate over time for the initial investment at stage one.

Now consider a more likely scenario. Suppose (as seems likely) that invoking the Failsafe Mechanism is costly (e.g., in terms of substantiating the existence of the Overbuild area and providing any other information required by the Independent Verifier, plus the risk that any claim is ultimately not approved, preventing the ISP from recovering the substantial

[11] See section 3 of CityFibre's main response to Ofcom's consultation on Openreach's Equinox 2 offer.
[12] See section 3 of CityFibre's response to Ofcom's consultation on Openreach's Equinox 2 offer.

discounts).[13] This means that at stage three there are costs to dealing with an altnet even if the OMTs are met (i.e., the costs and risks of invoking the Failsafe Mechanism).

Suppose also that there is a degree of uncertainty over the operation of the Failsafe Mechanism (as Ofcom appears to acknowledge). This means that at stage two – in every quarter – there is some degree of risk in allocating orders to altnets – namely that so doing could involve the loss of a very substantial discount or at least the cost of invoking the Failsafe Mechanism.[14]

This in turn means that, at stage one, the benefits of integrating with the altnet are reduced, while the upfront costs of integration remain the same. Specifically, the ISP would be less confident in making a large-scale commitment to the altnet (since making that commitment might impact on its ability at stage two to meet the OMTs). Indeed, the mere need to use the Failsafe Mechanism creates a cost of using altnets.

This begs the question: is it plausible that these costs and uncertainties could influence ISPs to avoid (or limit) using an altnet? In that regard, we note that even if the perceived chance of the Failsafe Mechanism not working were small, *were it not to work*, the potential costs to an ISP are very significant. This is because of the features of Equinox 2, specifically: (a) its cliff-edge nature; and (b) the fact that the discount available in a quarter applies to *all* Openreach FTTP lines that the ISP is using (and not only to those connected in that quarter). As Ofcom acknowledges: "*The discounts if the OMT are met are substantial so ISPs are likely to be strongly incentivised to meet them.*"[15] This suggests that the Failsafe Mechanism would not prevent the OMTs from incentivising ISPs to obtain FTTP products from Openreach instead of altnets.

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13 If an ISP receives larger discounts as a result of the Failsafe Mechanism, it only does so once the process is complete. See Equinox 2 draft contract, Appendix 1, para 9.5.

14 Ofcom acknowledged in footnote 53 of the Equinox 2 consultation (updated on 14 February 2023 due to changes to consultation redactions) that: "*In the light of ISPs' practical experience now that the Equinox 1 Offer is in place, it appears that [redacted] may take longer to surpass the OMTs than originally expected.*" This reflects that there is a degree of uncertainty as to whether ISPs will achieve the OMTs, or not.

15 Equinox 2 consultation, para 3.84(a).

Annex A: A worked example showing that the Failsafe Mechanism may not prevent ISPs from favouring Openreach

This Annex presents a hypothetical example that illustrates points set out in section 2 above. The example shows that one can easily envisage scenarios where the Failsafe Mechanism would *not* prevent ISPs from favouring Openreach to the detriment of altnets. This indicates that, in order to consider the Failsafe Mechanism fit for purpose, Ofcom would (inter alia) need to provide compelling evidence that these scenarios would not arise.

Assumptions

Suppose that an ISP, which needs wholesale local access, is active in three areas: A, B and C. Wholesale local access for legacy services (using a copper line) can be provided only by Openreach in all the three areas. Wholesale local access for FTTP services is provided as follows:

- in Area A, the ISP can use Openreach or an altnet; and
- in Area B and Area C, the ISP can only use Openreach.

The only Overbuild area among the three areas where the ISP is active is, thus, Area A. The ISP faces competition at the retail level from BT in all the three areas. In Area C only, the ISP also faces competition from a retail-only (or vertically integrated) network (e.g., G-Network or Community Fibre). The retail-only network in Area C is focused on ultrafast broadband (i.e., FTTP services or equivalent). Hence, the ISP does not face competition from the retail-only network in respect of its copper offer.

Assume that the demand for new broadband connections provided by the ISP, in each quarter, is expected to be as follows:

- in Area A, 30 copper orders and 170 FTTP orders;
- in Area B, 15 copper orders and 85 FTTP orders; and
- in Area C, 15 copper orders and 45 FTTP orders.

Implications for Fibre Only measure

Below we discuss four scenarios to study the implications of the Fibre Only measure for ISPs in different circumstances. This matters because Ofcom indicates that there are ISPs who would meet the target even in the absence of the Failsafe Mechanism, and potentially some who would not.[16] The scenarios set out below seek to capture a variety of different circumstances that may apply to different operators.[17] We refer to ISP expectations because orders are likely to vary on a quarterly basis.

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[16] See paragraph 3.64 of the Equinox 2 consultation.
[17] See Annex 8 and paragraph 3.64 of the Equinox 2 consultation.

- **Scenario 1**: the ISP makes all orders in all the three areas exclusively with Openreach. This scenario applies to ISPs who would expect to meet the OMTs without the Failsafe Mechanism, assuming they deal only with Openreach.

- **Scenario 2**: the ISP, in Area A, assigns a portion of FTTP orders to the altnet and the remaining FTTP orders to Openreach, everything else is as in scenario 1 above. By comparing the Fibre Only measures in scenario 2 against scenario 1, we can observe whether the ISP has an incentive to assign a portion of FTTP orders to an altnet, or not. This scenario is for a "borderline" ISP who expects to require the Failsafe Mechanism to achieve the OMTs.

- **Scenario 3**: this is similar to scenario 2 above, except that there is a retail competitor in Area C that launches an aggressive offer on ultrafast broadband products. This scenario applies to ISPs who would expect to miss the target regardless of the Failsafe Mechanism.

- **Scenario 4**: this is similar to scenario 3 above, except that the ISP assigns *all* FTTP orders to Openreach in Area A. By comparing the Fibre Only measures in scenario 4 against scenario 3, we can observe whether, in the presence of a retail competitor in Area C, the ISP has an incentive to assign a portion of FTTP orders to an altnet, or not.

The ISP's Fibre Only measure is calculated as the ISP's number of FTTP orders in Openreach's network divided by the total number of orders (copper plus FTTP) that the ISP has in Openreach's network. Should the Failsafe Mechanism be activated, the ISP's Fibre Only measure is calculated considering only its orders in Openreach's network *outside* of the Overbuild area.

Scenario 1 – Failsafe mechanism not invoked, Openreach favoured

In scenario 1, the ISP makes all orders in all the three areas exclusively with Openreach, therefore achieving a Fibre Only measure of 83% and hitting the 80% OMT. For this scenario, Table 1 below shows the number of orders that the ISP wholesales from Openreach (both copper and FTTP) and from the FTTP altnet, in each area. Also, the table shows the Fibre Only measure in the Overbuild area (A), the Non-Overbuild area (B plus C) and for the areas combined. Given that the Fibre Only measure for the areas combined (83%) is higher than for the Non-Overbuild areas (81%), the ISP would *not* activate the Failsafe Mechanism.[18] In this scenario, therefore, Openreach is favoured (i.e., the altnet is not protected by the Failsafe Mechanism because the ISP would suffer a reduction in Equinox 2 discounts in the event that it switched orders from Openreach to the altnet as it will be shown in scenario 2 below).

[18] Given the proximity to the 80% threshold, if there was a degree of uncertainty on the number of legacy and FTTP orders in a quarter, that would be an additional incentive to the ISP to use Openreach and not the altnet in the Overbuild Area. See the discussion in section 2.2 above.

Table 1: ISP number of orders and Fibre Only measure per area, per quarter, in scenario 1

Areas	Legacy Openreach	FTTP Openreach	FTTP altnet	Total number of orders of ISP (legacy + FTTP)	Fibre Only measure
A (Overbuild)	30	170	0	200	85%
B (Non-Overbuild)	15	85	0	100	81%
C (Non-Overbuild, ISP competition)	15	45	0	60	
Total	60	300	0	360	**83%**

Source: RBB Economics.
Note: The Fibre Only measure is 83% (=300/(300+60), bold in the table), thus the ISP qualifies for the Equinox 2 discount on the FTTP rentals.

Scenario 2 – Failsafe mechanism invoked, Openreach potentially still favoured

In scenario 2, the ISP, in Area A, assigns 70 FTTP orders to the altnet and 100 FTTP orders to Openreach, everything else is as in scenario 1 above. For this scenario 2, Table 2 below shows that the Fibre Only measure for the areas combined (79%) would not allow the ISP to achieve the 80% OMT. However, the Fibre Only measure in the Non-Overbuild areas is 81%, which would allow the ISP to achieve the 80% OMT *if* the Failsafe Mechanism is successfully activated. Given how close the ISP would be to missing the OMTs as well as the risks associated with invoking the Failsafe Mechanism, the ISP may still be incentivised to promote Openreach in the Overbuild area *ex ante* if the figures below are thought of as averages and there is variation around the mean. That is, anticipating that it may need to rely on the Overbuild area to meet the OMTs, the ISP would be more likely to prioritise integrating Openreach over and above the altnet, which corresponds to a return to scenario 1 above.

Table 2: ISP number of orders and Fibre Only measure per area, per quarter, in scenario 2

Areas	Legacy Openreach	FTTP Openreach	FTTP altnet	Total number of orders of ISP (legacy + FTTP)	Fibre Only measure
A (Overbuild)	30	100	70	200	77%
B (Non-Overbuild)	15	85	0	100	**81%**
C (Non-Overbuild, ISP competition)	15	45	0	60	
Total	60	230	70	360	79%

Source: RBB Economics.
Note: The Fibre Only measure is 79% (=230/(230 + 60)), thus the ISP does not qualify for the Equinox 2 discount on the FTTP rentals, unless the Failsafe Mechanism is activated. If the Failsafe Mechanism is activated, then the Fibre Only measure (outside of the Overbuild area) is 81% (=(85 + 45)/(85 + 45 + 15 + 15)) allowing the ISP to qualify for the Equinox 2 discount on the FTTP rentals.

Scenario 3 – Failsafe Mechanism not invoked, Openreach potentially still favoured

In scenario 3, the retail competitor in Area C launches an aggressive offer on ultrafast broadband products in a particular quarter and the ISP's FTTP sales in C fall to 20, everything else is as in scenario 2 above. For this scenario 3, Table 3 below shows that the Fibre Only measure for the areas combined (77%) would not allow the ISP to achieve the 80% OMT. If the Failsafe Mechanism is successfully activated, the Fibre Only measure would increase to 78%. Thus, even under the Failsafe Mechanism, the ISP would still miss the 80% OMT.

As with the previous scenario, the ISP may still be incentivised to promote Openreach in the Overbuild area *ex ante* if the figures below are thought of as averages and there is variation around the mean. That is, anticipating that it may need to rely on the Overbuild area to meet the OMTs, the ISP would be more likely to prioritise integrating Openreach over and above the altnet.

Table 3: ISP number of orders and Fibre Only measure per area, per quarter, in scenario 3

Areas	Legacy Openreach	FTTP Openreach	FTTP altnet	Total number of orders of ISP (legacy + FTTP)	Fibre Only measure
A (Overbuild)	30	100	70	200	77%
B (Non-Overbuild)	15	85	0	100	**78%**
C (Non-Overbuild, ISP competition)	15	20	0	35	
Total	60	205	70	335	77%

Source: *RBB Economics.*
Note: *The Fibre Only measure is 77% (=205/(205 + 60)), thus the ISP does not qualify for the Equinox 2 discount on the FTTP rentals. If the Failsafe Mechanism is activated, then the Fibre Only measure (outside of the Overbuild area) is 78% (=(85 + 20)/(85 + 20 + 15 + 15)) but still insufficient to qualify the ISP for the Equinox 2 discount on the FTTP rentals.*

Scenario 4 – Failsafe Mechanism not invoked, Openreach favoured

In scenario 4, the ISP does not use the altnet and assigns the 170 FTTP orders in Area A to Openreach, everything else is as in scenario 3 above. For this scenario 4, Table 4 below shows that the Fibre Only measure for the areas combined (82%) would allow the ISP to achieve the 80% OMT. Given that the Fibre Only measure for the areas combined (82%) is higher than for the Non-Overbuild areas (78%), the Failsafe Mechanism is *not* activated.

In this example, therefore the Failsafe Mechanism does *not* prevent the ISP being incentivized by the OMTs to use Openreach FTTP instead of altnet FTTP. Favouring Openreach in the Overbuild area is critical to meeting the OMTs.

Table 4: ISP number of orders and Fibre Only measure per area, per quarter, in scenario 4

Areas	Legacy Openreach	FTTP Openreach	FTTP altnet	Total number of orders of ISP (legacy + FTTP)	Fibre Only measure
A (Overbuild)	30	170	0	200	85%
B (Non-Overbuild)	15	85	0	100	78%
C (Non-Overbuild, ISP competition)	15	20	0	35	
Total	60	275	0	335	**82%**

Source: RBB Economics.
Note: The Fibre Only measure is 82% (=275/(275 + 60)), thus the ISP qualifies for the Equinox 2 discount on the FTTP rentals.

CityFibre response to Ofcom's consultation on Openreach's Equinox 2 offer

Confidential Annex 3

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CityFibre response to Ofcom's consultation on Openreach's Equinox 2 offer

Confidential Annex 4

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