



Why Ofcom must perform a separate impact analysis of Equinox 2 for Area 3. A supplementary submission.

INCA

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1 Background

- 1 INCA and individual Altnets have submitted to Ofcom on a number of occasions (for both Equinox 1 (E1) and Equinox 2 (E2)) that it is necessary for Ofcom to assess the impact of the discount offers in all the relevant markets for which the offers apply and where Ofcom has applied the relevant SMP condition¹.
- 2 Despite this, Ofcom has consistently refused to engage in an impact assessment of the Equinox offers in Area 3, citing that Ofcom did not set out to encourage competition to Openreach in Area 3 and that Ofcom did not expect to see **material** and **sustainable** competition to Openreach in Area 3.
- 3 During the Wholesale Fixed Telecoms Market Review (WFTMR) INCA and Altnets asked Ofcom repeatedly to define what it meant by the term ‘material competition’ as it was used to define the Area 3 geographic market. Ofcom consistently refused to engage and offer clarification. In particular, there was concern that Ofcom would look at the materiality of selective/individual Altnets rather than the collective competitive impact of Altnets as a group.

2 Level of competitive activity in Area 3

- 4 In the INCA E2 response, we presented some market research showing that material Altnet deployment has already taken place in Area 3. Based on our limited research we said that at least 1.2m premises in Area 3 were covered by Altnet fibre networks.
- 5 We can now update that data based on the annual INCA Point Topic “Metrics for the UK independent network sector” report, scheduled for publication on May 17th. The report shows that **2.3m premises in Area 3 had been passed by Altnets by the end of 2022²**, nearly equal to the 2.7m premises Openreach claims to have passed in Area 3 at the same time.
- 6 The evidence that 2.3m premises (out of an approximate total of 9.4m premises ~ 25%) in Area 3 are already covered by Altnets collectively is material. Particularly in light of the fact that Openreach claims to have covered approximately 2.7m premises in Area 3 at the same time. In racing terms this could be described as “neck and neck”.

¹ SMP Condition 8.6.

² Please treat this information in confidence until the report has been launched.

- 7 Our E2 response also showed an ambition from Altnets to cover approximately 6m premises in total in Area 3. That equals to approximately 2/3 of total premises and under no circumstances could be described as immaterial.

2.1 Confidence in Altnet business plans

- 8 It would seem apparent that, at the time of the WFTMR Statement in March 2021, Ofcom did not anticipate this level of build in Area 3 by Altnets. From this, and many conversations with Ofcom, we conclude that Ofcom simply did not have confidence in the Altnet business plans. In fact, Ofcom makes this lack of confidence clear in the WFTMR Statement.

“Other altnets are significantly smaller, and their business plans are often more speculative.”³

And

“The competitive impact of other altnets is of an order of magnitude smaller and we have decided that areas where they operate (but CityFibre and/or Virgin Media do not) are unlikely to have the potential for material and sustainable competition to BT for WLA services (Area 3).”⁴

- 9 It can be debated whether Ofcom’s lack of willingness to embrace the possibility that Altnets would deliver what they had publicly stated (and for which substantial levels of funding was already secured) was appropriate back in March 2021. What cannot be debated is whether Ofcom now has to revise its level of confidence in Altnet plans and ability to deliver and that Ofcom’s forward-looking decisions need to reflect the facts today rather than (what has turned out to be) erroneous assumptions of more than two years ago.
- 10 Altnets have proven their ability to attract finance and to deliver fibre network builds at scale in all the UK’s different terrains and economic market conditions.

2.2 Competition at aggregate or individual Altnet level

- 11 When measuring the level of competition and the extent to which an incumbent retains a dominant position, the measure commonly referred to is the level of market share retained by the incumbent. Although the strength of individual competitors is relevant in the assessment of the strength and sustainability of competition, it is the level of coverage or

³ WFTMR V2 paragraph 7.44.

⁴ WFTMR V2 paragraph 7.51.

market share of the incumbent relative to the collective group of competitors that is the first line of assessment.

- 12 Whilst the Altnet sector remains fragmented with several relatively recent entries and a large group building their network coverage from a small base, the existence of challenger infrastructure is what really denotes the level of competition Openreach is likely to experience over the coming years.
- 13 Inevitably, there will be consolidation amongst Altnets, a process that has already started and is expected to continue over the next few years. It is inappropriate for Ofcom to assess the level of present/likely future competition in Area 3 based on the merit of individual Altnets having/reaching sufficient scale to pose a competitive threat to Openreach, Ofcom must instead look at the aggregate position.

2.3 Sustainability of competition in Area 3

- 14 In a similar vein as the assessment of collective or individual Altnet competition to Openreach (now and in the future), it is important to look at the likely Altnet sector development before drawing any conclusions that current market players are, perhaps, unable to pose a material and sustainable competitive threat to Openreach.
- 15 The investment being made into new competitive fibre networks is real and tangible (and perhaps significantly in excess of Ofcom's expectations). At present it is not possible to predict whether the market will settle with 5, 10, 25 or 50 Altnets across the country (whether regional or national) and it should not be Ofcom's concern to attempt to predict that, nor to create conditions that steer the sector towards either end of that spectrum.
- 16 What is certain, however, is that the physical networks are there. They represent real value to current and future investors and operating entities and, unless the market conditions are imbalanced against the challenger network operators, those investors and operators are entitled to compete for customers to deliver a return on the very substantive investment made to date and planned for the coming years.
- 17 Sustainability of competition should therefore not be linked to the sustainability of the individual network builder and/or operator. Ofcom's lack of confidence in Altnet business plans and the sustainability of the competition they collectively represent to Openreach led to Ofcom's presumption against material and sustainable competition in Area 3. This presumption was made despite the presence of evidence of committed finance and, under the **direction from Government to actively encourage network competition is as much of the country as possible**. That presumption has been proven wrong and it is now

incumbent on Ofcom to ensure that current and future analysis and decisions are not influenced by a previous error.

3 How regulation influences sustainability of competition and competitors

- 18 It cannot be disputed that Ofcom seriously underestimated the level of Altnet network build in Area 3 (and in the rest of the country as well, as evidenced by the significantly higher level of network overlap between Openreach and Altnets across Areas 2 and 3). Ofcom itself has made public statements to this effect.
- 19 In the face of the current facts, however, for Ofcom to proceed with policies based on assumptions that are blatantly wrong would be irrational and not in accordance with Ofcom's role as an evidence-based regulator. Ofcom must accept that the analysis of Area 3's geography does no longer align with the assumption that Area 3 cannot or will not support competition at a network level.
- 20 Whilst Ofcom did not expect material and sustainable competition to Openreach in Area 3, it did choose to apply the SMP condition 8.6 in Area 3. In doing so, Ofcom created a **legitimate expectation with stakeholders that any competition that did emerge in Area 3 would be as equally protected against Openreach discount schemes as competition in Area 2**. Ofcom did not say in the WFTMR that the application of SMP condition 8.6 in Area 3 would be subject to different criteria or a different assessment framework, with a starting point that even if Openreach's special offer discounts did deter competition in Area 3, that would be acceptable. If Ofcom had done so it would have exposed that those two components are incompatible and would render the SMP condition null and void at the outset.
- 21 Ofcom's did not in any way signpost that it intended to apply the tests described in Volume 3 section 7 of the WFTMR differently between Areas 2 and 3 and that approach could not have been predicted or anticipated from reading the WFTMR, neither in the formal SMP condition, nor the text explaining the intent and logic behind the SMP condition in the main WFTMR Statement. Ofcom's choice to apply the SMP condition differently in the two geographic markets was therefore neither predictable, nor consistent with its explicit application of identical SMP conditions in the two markets.
- 22 As a consequence of Ofcom's position on Equinox 1 and proposed position on Equinox 2, **the regulatory uncertainty created by Ofcom is the single largest threat to the**

sustainability of competition and competitors in Area 3, and we are told by our members that this is actively creating a disincentive to invest in some of the higher build cost geographies within Area 3. This is particularly pertinent for Altnets who focus predominantly on building within Area 3 and therefore do not have the luxury of offsetting lower ROIs linked to the higher CAPEX build against the faster returns typical achieved in Area 2 (as allowed by Openreach's incumbent copper position). For competition in Area 3 to continue to flourish, providing the best consumer outcomes, it is vital that a detailed Area 3 assessment is completed by Ofcom. Not doing so places Ofcom at likely risk of failing to meet the obligations set out for them in the Statement of Strategic Priorities.

3.1 Ofcom assumed ubiquitous Area 3 coverage by Openreach

23 In the WFTMR, Ofcom made one other very significant assumption for Area 3. Namely that Openreach would deploy fibre everywhere. Whilst Ofcom overtly had little confidence in the already financed business plans of Altnets, Ofcom has full confidence in the (at the time) unfinanced assertions by Openreach. This assumption is specifically important for Area 3, because some parts of Area 3 can only sustain a single network.

24 Ofcom's definition of Area 3 was "where Ofcom did not expect there to be material and sustainable competition to Openreach". This definition was developed by Ofcom despite evidence that there were already at the time locations where Altnets had already deployed (or were advanced in their deployment of) fibre network in 'single network locations'⁵. Thus, Ofcom evidently assumed that Openreach would overbuild the Altnets in those areas and that the Altnet network investment would be stranded. In our view this shows considerable bias in favour of Openreach and conflicts with Ofcom's stated objective of being fair and evidence-based. It should also be highlighted that significant number of properties in Area 3 are already served by infrastructure from more than two networks.

25 Further to the above, Ofcom should note the slowed pace of Openreach's build, and that Openreach's build plans do not yet include total UK coverage. With bandwidth demands continuing to increase exponentially, and the increased work-from-home culture placing those without access to strong connectivity at a growing socio-economic disadvantage, **it is imperative for the consumer that Ofcom maintains a regulatory environment that will allow Altnets to invest faster in the areas where Openreach is not.**

26 This submission does not ask for the Area 3 definition to be revisited or changed. The explanation above is to illustrate that regulatory bias (conscious or otherwise) resulted in a

⁵ Locations where only a single network could be commercially viable.

regulatory structure that was built on a presumption of continuous ubiquity of the incumbent. This despite it being clear that the government was planning to award state funding to providers other than Openreach in locations where more than one single network could ever be viable (with public subsidies). Ofcom's assumption of Openreach ubiquity was therefore fundamentally flawed from the outset.

27 Now it is Ofcom's responsibility to ensure that forward-looking decisions do not perpetuate what was clearly wrong even at the time of building the WFTMR framework. **This does not mean undoing the WFTMR, only adjusting the assumptions that have been proven wrong before they are applied to new decisions, rather than perpetuating them.** There is nothing in the WFTMR to stop Ofcom from taking into account current facts when implementing the WFTMR framework during the period the WFTMR is applicable. Not doing so, would however constitute a significant error.

3.2 The concept of the 'fair bet'

28 Ofcom has typically used the fair bet principle in the context of BT/Openreach being able to reasonably recover its efficient investments, sometimes with a risk premium.

29 The fair bet principle is, however, much wider. It is referred to in the Government's Statement of Strategic Priorities (SSP)⁶ as applicable to all investment in new risky fibre infrastructure, **not just that of Openreach.** The relevant reference is copied below:

30 *"The regulatory environment should ensure there is clarity regarding the application of the 'fair bet' principle over an extended time scale. The Government's view is that an effective 'fair bet' regime would be one that allows firms making large and risky investments to have confidence that any regulation will reflect a fair return on investment, commensurate to the level of risk incurred at the time of making the investment decision. Ofcom should publish clear guidance that sets out the approach and information it will use in determining a 'fair bet' return"*⁷

31 Through Ofcom's presumptions in favour of Openreach and clearly stated lack of confidence in (and willingness to embrace) the substantial ambitions and funded business plans of Altnets, Ofcom did not apply the broader fair bet principle to Altnets in the WFTMR, and in particular not to Altnets in Area 3 where the presumption of ubiquitous Openreach coverage was the overriding base point for Ofcom's policy.

⁶ https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/952627/SSP_-_as_designated_by_S_of_S__V2.pdf

⁷ SSP paragraph 20.

32 As stated above, we cannot and **do not want to undo the past decisions made**, but it is Ofcom's duty to observe factual developments and to ensure that its decisions are, at all times, evidence-based. There was limited evidence of FTTP deployment in Area 3 at the time of the WFTMR Statement, but there is plenty now and it is Ofcom's duty to ensure an equally fair bet for Altnets as for Openreach.

4 Equinox 2 in Area 3

33 Having chosen to determine the separate geographic markets (Areas 2 and 3) and established the boundaries between those markets and applied SMP Condition 8.6 in both markets, it now seems that Ofcom proposes not to accept the consequences of those actions. Regardless of whether it was Ofcom's policy to encourage network competition in Area 3, it applied SMP condition 8.6 equally to Area 2 and to Area 3, and Ofcom's policy for Area 3 therefore now cannot be a defence of abdicating responsibility for the implementation of its own decision.

34 It is widely acknowledged that unit costs in Area 3 are higher than in Area 2 and that unit costs within Area 3 vary considerably due to terrain and density of premises. Ofcom has, however, determined that Area 3 is an area with sufficiently homogenous market conditions for it to constitute a single market, and it is inconsistent with that framework for Ofcom to state that, if some parts of Area 3 can sustain competition, then they may be similar to Area 2 and, therefore, Ofcom's impact assessment of Area 2 is therefore equally applicable to parts of Area 3.⁸ Ofcom needs to treat Areas 2 and 3 as separate markets. If Ofcom made a mistake in defining separate geographic markets or in how it defined the delineation between them, then it needs to address that problem rather than conflating them when it seems convenient to do so. Therefore, Ofcom must perform separate Equinox 2 impact assessments on the two geographic markets.

35 This principle applies to the use of Ofcom's fibre costing model (FCM) in the assessment of the actual price levels resulting from Equinox 2. Regardless of whether Ofcom's measure is that individual prices or the weighted average price resulting from Equinox 2 should not fall below the maximum calculated from the FCM⁹, the FCM should reflect the specific conditions in the relevant market to which it is applied. To do otherwise is nonsensical.

⁸ Ofcom Equinox 2 consultation footnote 85.

⁹ For the avoidance of doubt, INCA does not agree that the relevant measure could reasonably be the weighted average price.

36 **Ofcom's preference for national pricing cannot override the application of standard and sound economic tests** and the transparent and evidence-based implementation of the remedies devised by Ofcom (and applied to the markets defined by Ofcom). To do so would throw to the winds the principles of transparency and predictability.

37 Ofcom cannot reasonably define separate markets and assume that prices cannot differ between the two. In fact, when the markets were initially defined, Ofcom envisaged differentiated pricing, only the agreement by BT Openreach to the Area 3 Commitment resulted in Ofcom not imposing different price regulation on the two markets. Thus, even if Ofcom had (and has) a preference for national pricing, it was clearly willing to forego that in its initial proposals.

4.1 Ofcom's discretion

38 INCA understand and respects that Ofcom has a certain level of discretion in how it implements its decisions and, indeed, how it reaches those decisions in the first place. That discretion should, however, be exercised within the framework of evidence-based transparent and predictable regulation.

39 Much effort was put into submissions to and discussions with Ofcom during the WFTMR process to ensure that the terms applicable to special offers with conditional pricing were applicable to Area 3 as well as to Area 2 (which was not the case in the initial draft). When Ofcom proceeded to do that, a sigh of relief was heard from Altnets building and planning to build competitive fibre networks in Area 3.

40 It would seem to be stretching the elasticity of the principles of discretion beyond their limits that Ofcom should be able to arbitrarily disapply SMP conditions from markets with only general policies as a justification. Particularly so when the SMP condition was applied at a time where those principles were well known and even articulated in the same document. If Ofcom perceived a conflict, then it should have alerted stakeholders to that and qualified the application of the conditions to Area 3.

5 Summary and conclusions

41 Evidence shows that Ofcom's assessment that only Openreach would build viable networks in Area 3 is flawed.

- 42 The only two arguments Ofcom has presented against the application of the same tests for special offers with conditional pricing between Area 2 and 3 are that Ofcom's policies were to encourage Openreach build in Area 3 and for national pricing across the two markets.
- 43 Whilst very helpful as context, policies do not have the same legal weight as the specific decisions made by Ofcom, including the definition of relevant markets, determination of SMP in those markets and the application of appropriate and proportionate remedies in markets where SMP was found.
- 44 Having not qualified its application of the same conditions in Area 3 as in Area 2, it would be unreasonable and irrational for Ofcom to abdicate its responsibilities to apply its rules and decisions in a transparent, evidence-based and consistent manner simply because it finds that doing so could compromise a principle it had itself been willing to forego.
- 45 Ofcom created a legitimate expectation that it would act rationally and consistently with its formal WFTMR decision and must now proceed to do so by performing a separate Equinox 2 assessment in Area 3 including the assessment of the absolute price levels against costs modelled to reflect the characteristics of Area 3.

Failure to perform a separate Equinox 2 assessment in Area 3 would likely put Ofcom at odds to the directive laid out in the Statement of Strategic Priorities that it should foster infrastructure completion and would likely be in breach of Ofcom's duties to operate in a predictable, transparent and evidence-based manner.