KEYSTONE

The effect of BT Openreach's Equinox 2 on altnets

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EXECUTIVE SUMMARY

Ofcom has ambitions to deliver a shift away from the legacy copper broadband network monopoly long-held by Openreach and create a competitive wholesale full-fibre broadband market in the long-term. The benefits of introducing greater competition will be significant: driving forward the rollout of these networks, improving their quality (e.g., speed), encouraging innovation, providing genuine choice for customers and lower prices.

But this will not be easy. Openreach's significant scale and scope as the only national network operator, and its established large base of customers and relationships with wholesale ISPs, give it a substantial advantage. Conversely, altnets face considerable barriers to entry and expansion – foremost amongst these is the need to attract ISPs to make long-term commitments in sufficient volumes. Without this, altnets will fail to survive and become a credible competitive constraint on Openreach. Whilst not all altnets will flourish, there must be sufficient competitors remaining in the market with the confidence to continue investing and expanding, if there is any possibility of creating a healthy competitive market.

There have been some positive signs to date. A range of larger and smaller altnets have been entering and expanding – and this has driven Openreach to respond by upping its own rollout plans. But this is still a very nascent evolving market which is at a critical juncture. The macro-economic conditions have become significantly more challenging, impacting altnets much more than Openreach. Take-up rates also appear to be failing to keep up with rollout. It is fundamental that now, more than ever, continued investment by altnets is nurtured. This is critical not just for the health of the wholesale market but the wider retail broadband market and ultimately outcomes for consumers and businesses. Openreach, as the powerful and entrenched incumbent, must be prevented from taking any steps that could deter further investment and expansion by altnets, and undermine investor confidence in this market before they have established a proper foothold.

Nexfibre has the potential to become a significant competitor to Openreach. [•].

Against that backdrop, the unexpected advent of Equinox 2 has further ratcheted up the challenges facing altnets by offering even greater discounts. Importantly, it will significantly increase uncertainty amongst investors, critical to the survival of altnets. Equinox 1, agreed only 15 months ago, was hailed by Openreach itself as creating long-term market certainty, but this has now been shown not to be the case. There is now uncertainty over whether and when further changes may be made. Furthermore, under Equinox 2 the 'cliff edge' effect of the order-mix targets that ISPs must reach to qualify for these discounts, will become even greater and the financial penalties of losing them even more severe. This will increase the risk of using altnets for ISPs - indeed Ofcom's own analysis shows that ISPs using altnets may face difficulties meeting these targets. While the newly introduced Failsafe Mechanism is in theory beneficial, it has a number of design flaws which means it will be unlikely to

remove the uncertainty facing altnets and ISPs alike. These issues need to be properly addressed to give altnets and their investors sufficient confidence to continue investing in the coming years to create a competitive broadband market in the UK in the long-term.

1 INTRODUCTION

1. In the 2021 Wholesale Fixed Telecoms Market Review ('WFTMR'), Ofcom set out a framework to promote investment and competition in gigabit capable networks.[1] However, Ofcom also recognised a concern that BT Openreach ('Openreach') could set commercial terms that undermine new network build by alternative network operators ('altnets'), which Ofcom had previously assessed and approved in September 2021. Ofcom subsequently published for consultation its provisional assessment that it should not take any action at this time to prevent Equinox 2 and asked for responses by 4 March 2023. Ofcom intend to publish a final decision, by the end of March 2023.[1]

2. Nexfibre commissioned Keystone Strategy ('Keystone') to explore the potential issues raised by Equinox 2 and provide an independent economic assessment of the effects on the development of competition in wholesale full-fibre and the feasibility of alternative network roll out, with a particular focus on the risks of reduced and/or delayed levels of Internet Service Provider ('ISP') take-up with altnets and how this impacts Nexfibre's investment plans. This report forms part of the response provided by Nexfibre.

3. Keystone is a strategy and economic consulting firm that has partnered with companies, government agencies, and law firms to solve challenges in strategy and regulation, with a particular focus on digital, technology and telecoms sectors such as this. This report has been led by Dr Andrea Coscelli, Partner and co-head of Keystone's UK office, previously the CEO of the CMA and formerly a Director of Competition Economics at Ofcom – with over twenty-five years of competition economics experience and particular expertise in telecoms and the digital economy.

2 COMPETITION CHALLENGES IN THIS SECTOR

2.1 Significant benefits in wholesale full-fibre competition

4. Introducing competition into wholesale full-fibre broadband networks will bring significant benefits to businesses and consumers across the UK. This would enable a move away from the current reliance on the regulated predominantly copper-based broadband network owned by Openreach – a single large incumbent that currently has significant market power ('SMP'). Ofcom has recognized the benefits that competition would bring and set this as its strategic goal – stating that "**promoting competition is central to our efforts to stimulate investment in the UK's telecoms sector and the infrastructure the country needs**".[2]

5. Ofcom also recognized that the introduction of competition alongside regulation requires a careful balancing act, between "retaining the incentives to invest in new networks (leading to longer-term

[1] Ofcom defined these as 'gigabit-capable' networks able to provide download speeds of 1 Gbit/s typically delivered over full-fibre networks and the latest versions of hybrid fibre/coaxial cable networks.

[2] Ofcom's Wholesale Local Access Market Review – Volume 1, 2018 Statement, paragraph 1.5

benefits to consumers such as choice and innovation), and the risk of higher retail prices (with the associated shorter-term harm to consumers)".[3] However, Ofcom would "place weight on the risk of harm to consumers resulting from stifling investment by competing providers" and therefore **its starting point would be to "err on the side of promoting investment**".[4]

6. Ofcom's position on the importance of developing competition in this sector was reinforced in the last WFTMR in 2021. Here Ofcom emphasized that "network competition brings potentially significant benefits to consumers, compared to competition based on regulated access to BT's network and wholesale services" and that "**network competition is a more effective spur for innovation and investment in high quality networks than access-based competition**."[5] Unlike in other regulated industries, there is greater scope for product differentiation given the very important differences that could exist between the quality of full-fibre networks, for example in terms of access, connectability and speed. Ofcom recognized that while network competition could entail the replication of network investments (in terms of overlapping networks referred to by Ofcom as 'overbuild'[6]), the longer-term benefits from innovation (including innovation to increase efficiency and reduce costs), choice, stronger incentives to price keenly to attract customers, and higher quality of service, are significant.[7]

2.2 The challenges of creating a healthy competitive sector

7. Despite the benefits that will arise from competition, there are also fundamental inherent difficulties facing new competitors in this market. Ofcom itself have recognized the significant challenges that altnets need to overcome– including incumbency advantages, switching costs for customers (in this case ISPs) and barriers to entry and expansion. These factors put Openreach, as the dominant legacy incumbent, in a much stronger position in full-fibre rollout.

8. In its 2021 WFTMR review, Ofcom recognized the challenges facing altnets and the advantages Openreach has in the wholesale market. While noting the significant activity in deploying or expanding networks underway by altnets, Ofcom emphasized the ''significant competitive advantage

[3] Ofcom's Wholesale Local Access Market Review – Volume 1, 2018 Statement, paragraph 1.8

[4] Ofcom's Wholesale Local Access Market Review – Volume 1, 2018 Statement, paragraph 1.48

[5] Ofcom's Wholesale Fixed Telecoms Market Review 2021 – Volume 1, paragraph 2.20-2.21. Ofcom explained that "network providers have much greater scope for product differentiation and can strive to win customers and generate higher margins by offering a better service than their competitors. For example, differentiating on important attributes such as speed and reliability. The threat this poses to legacy networks of losing customers to new and existing network competitors is a powerful driver of continued investment in high quality networks, delivering long-term benefits to consumers. By exposing more of the value chain to competition, network competition also provides strong incentives for firms to innovate, to become more efficient and reduce costs. Network competition allows market forces to play a much stronger role in shaping decisions about what networks to build, what technologies to use, and how to deliver them more cost effectively. It also promotes more aggressive competition to attract and retain customers by offering them the services they want."

[6] 'Overbuilding' is the term used to describe the practice in the telecoms industry whereby one provider will build a network where a competing provider already has one.

[7] Ofcom's Wholesale Fixed Telecoms Market Review 2021 – Volume 1, paragraph 2.23

BT has arising from it being the largest and only nationwide network in the UK", meaning it will be able to service customers quickly and at significantly lower cost.[8]

9. Ofcom also found that there are significant structural barriers to entry and expansion for competing networks, as it requires very high levels of investment and takes considerable time – and this investment is largely sunk, as well there being large economies of scale and scope.[9] [10] Furthermore, Ofcom highlighted the challenges and uncertainties in accessing wholesale deals with larger ISPs that could help new entrants reach scale and gain necessary take-up:
    - In the absence of SMP regulation of the Wholesale Local Access markets ('WLA'), anti-competitive behaviour by BT could disincentivise ISPs from switching some of their business to new entrant network operators.
    - Securing deals with large wholesale customers can assist new entry, but there are challenges and uncertainties. For example, ISPs reliant on Openreach in some areas and using competing networks in others would need to multi-source, which carries additional costs.
    - Switching 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.[11]
10. Similar concerns about the inherent challenges facing new competitors have been echoed by altnets in recent regulatory submissions.[12]

2.3 Progress to date: some positive signs but competition still very vulnerable

11. Whilst it is clear there are challenges in developing competition, there have been some promising signs to date in relation to the rollout of full-fibre by altnets. There have been significant levels of investment from a growing number of new altnets entering and expanding into the market; including Nexfibre itself, supported by substantial investment partners (described in section 3.1). Research estimated that altnets had rolled out to over 4.5 million premises in aggregate and connected more

[8] Ofcom's Wholesale Fixed Telecoms Market Review 2021, Volume 2: Market analysis, paragraph 8.16

[9] Ofcom's Wholesale Fixed Telecoms Market Review 2021, Volume 2: Market analysis, paragraph 8.19 and 8.48-8.51

[10] Ofcom noted that whilst entry barriers could be overcome, this did not mean they were insignificant: for example "The investment will require significant costs to be sunk (in the hundreds of millions of £s) and take several years to complete; investment needs to be made before customers can be won and revenue earned and it will then take time for the entrants to win customers and grow their revenue base; the planned investment is geographically limited in scope, and significant parts of the market in the UK excluding the Hull Area (likely to be areas where unit costs are relatively high) will remain served only by BT and that even in the areas where investment by new entrants occurs, the result is likely to be a market served by three providers at most." Ofcom's Wholesale Local Access Market Review 2018 Statement, paragraph 4.60.

[11] Ofcom's Wholesale Fixed Telecoms Market Review 2021, Volume 2: Market analysis, paragraph 8.56 and paragraphs 8.57-8.74

[12] See for example, Virgin Media O2 response to Ofcom's WFTMR 2021-26 consultation, paragraph 41, CityFibre response to Ofcom's WFTMR 2021-26 consultation, paragraphs 4.8-4.14, TalkTalk response to Ofcom's WFTMR 2021-26 consultation, paragraphs 4.114 – 4.116

than 600,000 premises by the end of 2021[13] – and more recent estimates suggest altnet rollout has risen to over 6.2million premises.[14] Much of this investment to date has been supported by favourable financing terms in recent years and a relatively stable regulatory climate. More broadly the UK's FTTP coverage is significantly increasing, for example Thinkbroadband estimates that approximately 13.5 million homes were passed by full-fibre as of October 2022 (44% of UK homes), a 16pp increase since October 2021 (+4.8m).

12. Internal analysis of the competitive landscape by Virgin Media O2 last year recognized the growing number of altnets aiming to deploy significant FTTP volumes. This analysis estimated that altnets had long-term targets to rollout to over 30 million premises in the next 2-3 years (excluding Nexfibre's own plans), although it was considered this may be optimistic given the significant levels of 'overbuild' this would imply (estimated at a ratio of 2.3).

13. However, while there have been some positive signs, the market is still very nascent and there are signs that many altnets may be starting to struggle, due to high barriers in attracting ISPs/customers, which will only increase as a result of Equinox 2 (see section 4). The progress made so far cannot be taken for granted by Ofcom. For example, recent analysis by equity analysts suggests that the take-up rates have not matched the accelerated rate of buildout, leading to stabilization or even declines in penetration rates despite altnets retailing at a discount to incumbent operators and wholesale altnets offering significant discounts against Openreach's prices (as set out in the next section). This indicates that despite a flurry of investment, altnets are struggling to attract sufficient customers in order to achieve the penetration rates that are required in their business plans to cover their investment costs. As noted by Ofcom in its 2021 WFTMR, attracting sufficient wholesale ISPs and end customers is key to their success in achieving the required scale and scope.

14. Recent press commentary has also raised issues about the continued investment by altnets – citing concerns about overbuild and the extent to which they will be able to secure enough customers.[15] While a certain amount of market consolidation might be expected as the market matures and competition intensifies, it is also important that a sufficient number of competitors are able to continue investing and expanding in order to ensure that there is long-run competition with Openreach. This is not to say that inefficient entry needs to be in some way protected by Ofcom, but rather recognizing that, as Ofcom has highlighted, there is no level-playing field at this point and therefore it is important that new challenger competitors have the necessary regulatory conditions and support for sustainable competition to arise in the long-term.

[13] NSR Research report December 2022 slide 3

[14] Thinkbroadband estimates as of 11 February 2023

[15] See for example "UK 'altnets' risk digging themselves into a hole" – Financial Times, June 2022; BT faces down 'altnet' threat - Investors' Chronicle (investorschronicle.co.uk); AltNets Fear Openreach FTTP Price Cuts Put £20bn UK Investment at Risk UPDATE - ISPreview UK; "BT Chief warns Openreach fibre push will 'end in tears' for rivals" Financial Times February 2023; "Altnets are hitting our streets, but are they here to stay?"; The altnet challenge and likelihood of government intervention

15. Altnets are also facing increasingly tough broader economic conditions. For example, one recent analyst report highlights that altnets typically rely on a combination of equity and bank lending to fund their operations, however the cost of UK bank lending has increased dramatically during 2022, with 6m Libor at +4.1% (as of December 2022) (from +0.5% at December 2021).[16] Rising interest payments are likely to be putting further pressure on altnets – as noted by analyst John Karidis "They need cash at least to service and pay down the debt that part-funds their network rollouts, so not having an existing business generating cash is a disadvantage in this respect."[17] [•]. BT has a significant existing legacy business and a base of retail and wholesale ISP customers, by which it can generate significant cash flows. Compared to Nexfibre and other altnets, this gives Openreach the advantage of scale and lower cost of capital.

16. The increasing challenges for altnets stand in contrast to the continued inherent strength of Openreach as the existing large incumbent. Openreach has significantly increased the pace and scale of its full-fibre rollout (announcing that it has laid fibre to more than 9.6 million premises). Whilst this is beneficial in spurring greater investment and competition, there are signs that its speed and strength could be starting to squeeze out its wholesale rivals. BT's chief executive Philip Jansen has himself openly referred to BT's increasingly powerful competitive position; stating that **"no one else has got a machine anywhere near ours. It's unstoppable."**, that **"there is only going to be one national network…why do you need multiple providers"** and that BT is "**unquestionably on the front foot now."**[18]

17. These statements are supported by previous statements from BT about its inherently strong position in the market, as well as assessments by analysts (set out in section 2.4):

    - "we are the incumbent or the market leader. We can never be complacent and we're absolutely not a bit, but let's be honest, we're going to have almost double the footprint in almost half the time. And we've got decades of experience, one clean network, we've got fantastic service and the prices we're offering particularly right now are very attractive and we're giving long-term sustainability and visibility with people for 10 years" and "it needs two big players going head-to-head."[19]
    - **"The way I think about it is there is only one national network and that is Openreach**. It's going to be built 25 million homes by December 26th [2026] and then it's going to keep going and build that national network. **Nobody else can get anywhere near it in anywhere near that timeframe**."[20]

[16] NSR Research analyst report, 5 December 2022, slide 22

[17] BT faces down 'altnet' threat - Investors' Chronicle (investorschronicle.co.uk)

[18] "BT Chief warns Openreach fibre push will 'end in tears' for rivals" Financial Times February 2023

[19] BT Group trading update call, quarter 1 2021-22

[20] BT Group trading update call, quarter 3 2022

- In relation to wholesale premiums; "I don't think there's a way of undercutting us and making a fortune — I really don't…In that situation, all you're doing is bringing down the profitability of the whole industry, which then would mean poor returns for everybody else and average returns for BT."[21]

2.4 Analysts' reports highlight BT's strength and challenges facing altnets

18. Evidence from recent analysts' reports demonstrates the strengthening position of Openreach and its ability to leverage its legacy incumbency advantage into the full-fibre wholesale market – and that this strength will be further reinforced by the introduction of Equinox 2. Conversely, many of these reports highlight that the outlook for altnets is more pessimistic, with increasing challenges in their business models due to limited ISP take-up and, more broadly less favourable macro-economic conditions.

19. In summary, these reports suggest that:

- **BT's position is strengthening,** and its market value will increase to reflect this. As BT simultaneously ramps its full-fibre build and connections, the "first-mover" advantage for altnets in winning customers is falling.
- **Altnets are struggling to attract ISPs** - while altnets have been successfully rolling out, customer gains have not kept pace and have been stable or even declined – unlike Openreach penetration, which has increased, and there are inherent switching costs and complexities in ISP switching. Key wholesale ISP customers are difficult to attract for altnets – TalkTalk is currently the only scale player with a publicly-stated scaled commitment to a large full-fibre altnet.
- **Equinox 2 further impacts altnets' ability to attract ISPs** - there is wide-spread expectation that Equinox 2 will further shift customer and wholesale ISP volumes to Openreach, making it even more difficult for altnets to attract ISPs.
- **Altnets are facing broader economic challenges** – there is an increasingly difficult macro environment faced by altnets. However, Openreach as a large incumbent, is much less affected by these conditions.

2.4.1 BT's position is strengthening

20. A number of recent reports consider that concerns about rising network competition and its impact on Openreach's full-fibre returns are overplayed. In fact, this evidence points toward it strengthening its hand in this market.

21. For example, a recent Goldman Sachs report concludes that there is a bullish market outlook on BT: "BT's Digital Infrastructure fibre monetisation is running ahead of our bullish expectations. Ramping

[21] https://www.thetimes.co.uk/article/bt-boss-philip-jansen-we-will-compete-like-fury-on-broadband-kpcbrnsvg, October 2021

fibre demand, pricing power and reduced price regulation drive material Openreach wholesale ARPU growth." It further notes that "Despite overall BT broadband net adds falling for two quarters, and the weak macro backdrop, BT's growth and returns are accelerating sustainably, thanks to ramping fibre demand and pricing power."[22] Ultimately, it expects BT's shares to materially re-rate "as it shows investors its superior ability to leverage reduced regulation in a fibre world."[23] This report also highlights that Openreach is key to the bull thesis, as this represents c40% of EBITDA.[24]

22. A recent HSBC report is similarly optimistic about BT's position, noting that "BT is investing heavily in its FTTP network, so capex will be elevated for four more years, but **it is creating a strengthened market position** which is not yet reflected in its valuation".[25] Whilst it notes that the company faces some unavoidable headwinds, its view is that "**repeated pricing moves are creating long-term value for shareholders well in excess of these risks**."[26] The effect of repeated pricing changes is discussed in more detail in section 5.

23. One of the reports reviewed remains concerned about the impact of altnet competition, "We remain wary of rising broadband infrastructure competition for Openreach given continued line losses, and competitors still have notably lower wholesale pricing on fibre", though it also notes that Equinox 2 pricing removes an element of uncertainty and that BT shares may see some recovery after recent weakness.[27]

2.4.2 Altnets are struggling to attract ISPs

24. A number of these reports highlight the increasing challenges for altnets in attracting ISPs to switch to their networks, in contrast to Openreach. For example, analysis in one report indicated that **altnet full-fibre provider customer gains have not accelerated – but been stable for the last four quarters** and that as BT simultaneously ramps its full-fibre build and connections, the first-mover advantage for winning customers is falling (see section 3.2 for further consideration of first-mover and its impact on Nexfibre's investment plans).[28] Furthermore, the evidence suggests that the **volume of winnable customers is also falling further as the main participants are largely accounted for**.

25. Some of the reports highlighted inherent challenges attracting ISPs due to the complexity and switching costs, for example:

[22] Goldman Sachs Equity Research report, 11 January 2023, page 1 and page 5

[23] Goldman Sachs Equity Research report, 11 January 2023, page 3

[24] Goldman Sachs Equity Research report, 11 January 2023, page 6

[25] HSBC Equities Research, 17 January 2023, page 1

[26] HSBC Equities Research, 17 January 2023, page 5

[27] UBS Analyst report, 14 December 2022

[28] Goldman Sachs Equity Research report, 11 January 2023, page 8. This was supported by several other reports, with one considering that altnet penetration rates between 2019-2021 had fallen from 22% to 13% despite altnet prices for mid-level broadband services having fallen by 10-40% since Jan 2021. NSR Research analyst report, 5 December 2022, slides 3-4

- "Given switching to an altnet will lead to complications of in-home rewiring, it means that **consumers maintaining the status quo with either Openreach or VMO2 is a natural barrier for a lot of the altnets** with retail propositions."[29]
- "Sticking with Openreach is an attractive option even with a slight price premium, given the complexity of dealing with multiple suppliers with different wholesale systems, but if this were to change to a larger premium the balance may be tipped."[30]

2.4.3 Equinox 2 further impacts altnets' ability to attract ISPs

26. Many of the reports also consider the impact of Equinox 2 on the sector and that this will further strengthen Openreach's hand in attracting ISPs, whilst likely having a negative impact on competitors' ability to reach the necessary customer penetration levels. For example:

- "For those altnets relying on a retail proposition, the likely FTTP price reductions with Equinox 2 could make it even harder for them to succeed as existing major ISPs will now be incentivised to migrate their existing customers to Openreach FTTP, reducing the need for customers to consider a switch to an alternative FTTP provider."[31]
- "New lower fibre wholesale pricing 'Equinox 2' that BT announced in December is accretive, NPV position and should be seen in the context of ramping fibre demand" and that "**We expect Equinox 2 to improve customer volumes, as lower prices incentivise wholesale players to commit more customers to BT,** particularly those with price-sensitive customers such as TalkTalk, as well as customer mix (currently the only scale player without a scaled commitment to a large fibre operator). This will **also make it harder for altnet fibre builders to achieve the 40%-50% take-up of homes passed by their fibre that we estimate they will need to make a positive return, discouraging incremental fibre build.**"[32]
- "Assuming pricing is attractive enough, this [Equinox 2], in our view, will create an incentive for CPs such as Sky/TalkTalk to accelerate further their migrations to the Openreach platform, benefiting from lower fault rates, higher NPS, lower churn and hopefully higher ARPU. We believe this will likely place further pressure on AltNets in 2023."[33]

[29] NSR Research analyst report, 5 December 2022, slide 5

[30] Enders Analysis, 15 December 2022

[31] NSR Research analyst report, 5 December 2022, slide 32

[32] Goldman Sachs Equity Research report, 11 January 2023, page 1 and 5. This report also explains that "we find Equinox 2 to be meaningfully NPV positive - lower pricing presents a small headwind to FY24E Group EBITDA, but this is soon offset by improved customer mix (as it drives greater fibre take-up) and greater customer volumes (more scale wholesale players commit their customers to BT)" - page 5.

[33] Barclays Equity Research, 30 November 2022, page 8

- Discounting higher speeds within Equinox 2 not only incentivises ISPs even more to opt for higher speeds but also "limits the incentive to use other fibre wholesale partners (VMO2 or CityFibre) that specialize on FTTP and thus the top end offers."[34]

2.4.4 Altnets are facing broader economic challenges

27. There is also recognition in the analyst reports that the current macro environment will create an increasingly difficult economic outlook for altnets given that the low-cost finance environment has changed, interest rates are rising, costs are escalating and investors are likely to become more cautious.

28. For example, one report highlights three challenges:

    - Debt financing for new builders without an existing scale customer base has "nearly dried up."
    - Labour shortages increasing the cost to build, resulting in "higher prices at best and less building at worst" and this along with higher component spot prices, is harming the business case for altnets. Whereas incumbents are less exposed due to their in-house workforces and long-term third-party construction/component contracts.
    - Incumbents with more stable build costs are ramping up full-fibre coverage and connections i.e., Openreach is also able to accelerate its rollout.[35]

29. Another report also raised concerns around the changing economic conditions; noting that "There are two major risks to the FTTP business models that have emerged in 2022: a) deployment costs are rising driven by both labor costs and bottlenecks and b) credit conditions are worsening, which may severely impact future funding options. We expect these to impact both the pace of the deployment plans and the ultimate targets that have been set."[36]

3 [•]

3.1 Nexfibre current rollout plans

30. Nexfibre is a new investor in ultrafast broadband infrastructure with financial backing from Infravia Capital Partners, Liberty Global and Telefónica, as well as debt lenders, including the UK Infrastructure Bank. Its objective is to establish a wholesale FTTP network covering up to seven million homes in the UK beyond the existing Virgin Media O2 network. By wholesaling Nexfibre's network in combination with the current Virgin Media O2 footprint of 16 million FTTP homes (converted from current cable), this would result in the supply of wholesale Gigabit networks to ISPs of up to 23 million premises. If

[34] Citi Research 8 January 2023, page 4

[35] Goldman Sachs Equity Research report, 11 January 2023, page 11

[36] Citi Research 8 January 2023, page 1

achieved, this would make Nexfibre an important alternative wholesale network competitor with a nationwide footprint.

31. Nexfibre's existing investment plan, agreed by the JV partners in June 2022, outlines five million homes to be built by the end of 2026. There is an option to increase the rollout to approximately seven million premises in total, depending on attractiveness. The build plan remains under regular review.

32. Nexfibre estimates that a significant proportion of their investments in areas without pre-existing fibre infrastructure will be overbuilt in the future by other network providers (predominantly Openreach) - this overbuild creates infrastructure-level competition and means ISPs will have additional choice in placing new orders. To allow for the creation of Nexfibre infrastructure across the UK, [•]. This is primarily through attracting a sufficient proportion of wholesaling orders from large nationwide ISPs, other than from its day-one anchor tenant Virgin Media O2 (in a context where ISPs will want to minimise the costs associated with multi-sourcing). [•]

33. Nexfibre's investment plan is underpinned by its modelling on levels of likely market penetration. It estimated that by 2040, Nexfibre's overall market penetration (i.e., number of end customers connected on its network[37]) would be approximately [•]. This projection constitutes a blend of varying expected penetration levels across all areas included in the full-fibre rollout. The expectation was for Nexfibre to achieve [•] long-run penetration in areas where there is only its own fibre network, whilst in regions of joint presence with Openreach, this was projected to be approximately [•]. Where Nexfibre overlaps with [•] or other alternative networks but not with Openreach's FTTP offering, the projected market penetration was [•], respectively. Critically, the market penetration Nexfibre expects to achieve in individual regions depends not only on the anticipated rollout of other fibre networks, but also on the timing. In other words, Nexfibre expects to achieve higher market penetration in areas without existing fibre infrastructure, where it has the advantage of being first to rollout FTTP products. By contrast, overbuilding existing full-fibre infrastructure in regions already covered by another network is likely to yield delayed and lower long-run penetration of the local market.

3.2 The impact of reduced ISP switching on the planned rollout

34. An integral aspect of Nexfibre's investment plan is to [•].

35. Based on an analysis carried out by Nexfibre in the third quarter of 2022, [•] of the approximately seven million homes included in the rollout will be overbuilt by Openreach in due course, whilst some [•] of properties will be overbuilt by other alternative networks. A further [•] of premises will be overbuilt by Openreach, as well as alternative networks, such that only [•] of properties are not subject to overbuild. [•]

[37] Calculated with reference to the total number of homes connected divided by the total number of homes passed by Nexfibre on its FTTP network. This includes Virgin Media O2 customers as they shift to full-fibre.

36. Under the proposed Equinox 2 scheme, ISPs can take advantage of even higher wholesale price discounts than those granted under Equinox 1. Most notably, Openreach has further lowered the cost of the 55/80 and 115 Mbps products to levels below that of the regulated "Anchor Product" (40 Mbps). These discounts are subject to ISPs successfully meeting the Order Mix Targets ('OMTs') stipulated in the original Equinox scheme. As explored in the next section, there are serious concerns that Equinox 2 will actively deter ISP's from entering into wholesale agreements with altnets and lead ISPs to 'lock' into long-term deals with Openreach.

37. Nexfibre's existing business plan precedes the announcement of Equinox 2. [•].

38. [•].

3.2.1 The impact of a delay in ISPs switching and delayed investment

39. The more conservative scenario is where Equinox 2 delays the switching of ISPs. [•]. Figure 1 below highlights the dynamics of a year-by-year delay in Nexfibre's rollout in areas without existing fibre infrastructure.

Figure 1: [•]

40. The top line of the graph captures the market penetration achieved by the "first mover" and the projected market penetration is [•] after an initial seven-year period (which rises to [•] when extended to 2040). The lines below estimate the market penetration achieved by the "second mover" in the same area. The time that passes between the arrival of the first network provider and the arrival of the "second mover" varies from [•] to [•] years.

41. As is apparent from this analysis, the "first mover" is most vulnerable to the arrival of a second network provider within [•]. However, further delays in the investment of the "second mover" see the advantage of the "first mover" increase substantially. This result is intuitive, as delays in the arrival of the second network provider would be expected to give the incumbent network an opportunity to tighten its grasp on the local market.

42. The advantage of the "first mover" is twofold. By being the first network to rollout fibre infrastructure in an area, the "first mover" can incentivise ISPs to commit substantial order volumes to its network, as this is the only way for them to reach FTTP end customers in the area. However, committing to contracts with the "first mover" limits the flexibility of ISPs to do business with the "second mover" later on. Additionally, the "first mover" has the advantage that connecting local properties to its network generates substantial future switching costs for end-customers, thus locking them in to the first mover's network. This is because connecting a household to the full-fibre network requires the installation of an access point inside the property. As the access point is provider-specific, switching to a different full-fibre network will mean that a further access point is required. As the installation of an access point incurs a connection charge each time, end-customers have a clear incentive to stay with the same provider.

43. A delay in overbuilding existing full-fibre infrastructure implies that the "second mover" is limited to the residual full-fibre demand of those residents in that area, who have not already committed to the incumbent full-fibre network provider. Over time the number of these free agents (i.e., non-fibre customers) in the local market decreases, as more customers will already be on FTTP products. The ability of the "second mover" to establish a market presence is further hampered by the fact that ISPs have already entered into long-term contracts with the incumbent wholesale network provider, meaning that they are restricted in the order volumes they can commit to the "second mover". Therefore, the estimated market share of the "second mover" gets progressively smaller, the longer entry into the market is deferred.

44. [•]. Figure 2 below shows how delays of different lengths reduce the projected market penetration Nexfibre can expect to achieve by the end of 2026 (i.e., number of end customers connected on its network divided by the total number of homes passed by Nexfibre).

Figure 2: [•]

45. [•].

46. [•].

3.2.2 The impact of a reduction in ISPs switching

47. [•]. This section assesses the impact of a reduction in ISP customer volumes on Nexfibre's business plan.

48. As with the analysis on delayed switching, a permanent reduction in ISP customers will drive down the level of market penetration Nexfibre can achieve. [•]. Figure 3 below shows the impact of reductions in the volume of ISP customers on the market penetration Nexfibre could achieve over the initial eight-year period of the proposed rollout.

49. The top line captures the scenario simulated in Nexfibre's business plan, where the expected volume of ISP switching is realised. In the lines below, there is a reduction in the volume of ISP customers relative to the projections in the business plan. The bottom line of the graph refers to [•].

Figure 3: [•]

50. As is apparent from the graph, Nexfibre estimates that it could achieve a market penetration between [•] and [•] over the initial eight-year period of the proposed investment. Much like the impact of a delay in ISP switching, a reduction in market penetration (and revenue levels) would also impact Nexfibre's build plans, but this would be much more significant as set out in the table below. [•].

Table 2: [•]

51. [•].

52. [•].

53. [•].

54. [•].

4 EQUINOX 2 FURTHER UNDERMINES ISP SWITCHING

55. This section sets out how Equinox 2 will significantly increase the uphill battle that altnets face in establishing themselves in this market given Openreach's significant market power. Altnets are key to creating a competitive market and they cannot survive without attracting sufficient ISP orders, but there are only three large ISPs with significant wholesale requirements (already with long-term deals in place). Equinox 2 raises significant investment uncertainty for altnets because it heightens concerns over ISPs' incentives to switch. There are two fundamental concerns: the uncertainty created by repeated and heavily trailed pricing changes, and the inadequacy of the Failsafe Mechanism in addressing the risks arising from the OMT and the now even larger cliff-edge resulting in substantial loss of discounts for ISPs. This comes at a critical point in this nascent market, where fledging competitors are trying to establish a foothold.

4.1 Altnets already face an uphill battle to attract ISPs

56. Ofcom have already recognised that there are significant existing challenges for altnets in attracting ISPs, problems which will be reinforced and strengthened by Equinox 2.[38]

57. As discussed in Section 2, there is no level-playing field between competitors in the market at this stage and altnets have a substantial disadvantage to overcome. While altnets have nonetheless been pushing forward in rolling out their networks, they are on the backfoot in terms of winning customers which, as evidenced above, is crucial to their investment plans. Aside from Openreach's advantages in terms of scale and scope, as the incumbent operator with a national network **Openreach also has advantages in its ability to retain ISPs in using its network**:

- Openreach has already **established and ongoing relationships** with ISPs built over time through its legacy network and ISPs will inevitably continue to need to use substantial parts of Openreach's full-fibre network moving forward.
- ISPs will have to **actively choose to switch away** from Openreach (for the most part), creating a strong 'status quo' advantage.
- ISPs will **incur additional transactional costs** if they were to choose to order with altnets (including technical and system change costs), in addition to using Openreach.

[38] For example, in its recent consultation Ofcom stated that "alternative operators building new networks face considerable challenges in becoming established and overcoming Openreach's incumbency advantages. For example, Openreach benefits from economies of scale (meaning it has lower unit costs than an entrant); in relation to FTTP, a key advantage comes from Openreach having high existing customer volumes; and it has established relationships with ISPs and some level of system/process integration." Ofcom consultation on Proposed FTTP Offer starting 1 April 2023, February 2023, paragraph 3.20

58. When ISPs enter into a wholesale agreement with a network provider, several other factors come into play. These factors include the network's scale, the company's financial backing, network quality, the pace of build, and customer installation service levels. [39]

59. In terms of network scale, ISPs have emphasized the importance of having a network footprint that meets a certain threshold. Whilst ISPs partnering with more than one or two providers may be feasible in theory, evidence suggests that to date ISPs have been wary of the costs and complexity of dealing with multiple network providers. This is recognised by ISPs, for example at a recent conference Sky highlighted the complications caused by dealing with multiple network providers (e.g., in terms of administration, provisioning, management etc).[40]

60. Additionally, a company's financial backing plays a critical role in the selection process, as it determines the provider's ability to deliver on its commitments and invest in the network's ongoing maintenance and upgrades. Network quality is also a critical factor, as ISPs must ensure that the network can meet their customers' needs and provide reliable, high-speed connectivity. The pace of build is equally important, as a faster build out is preferred so that the ISP can start offering services to customers quickly. Ultimately, the decision to switch wholesale providers is a complex one that requires careful consideration of numerous factors. While pricing and quality are important, ISPs also consider the scale of the wholesale provider and how well it aligns with their specific needs and goals.

61. This difficulty attracting customers is starting to become evident as referenced in section 2.4.2, where recent analysis shows either the stabilisation of altnet customer penetration or even falls in penetration levels, despite altnets offering significant discounted rates in contrast with Openreach. Most of the main ISP wholesale customers already have established relationships with Openreach – while BT will make use of its own infrastructure, Sky, TalkTalk and Vodafone all have wholesale deals with Openreach (while TalkTalk also has an arrangement with CityFibre).

4.2 Equinox 2 will ratchet up the challenges in attracting ISPs

62. Against that backdrop, there are serious risks that Equinox 2 will further reinforce and deter ISPs from switching to altnets. It is already well understood and recognised by Ofcom that the 'cliff-edge' nature of the discount structure arising from the OMTs "could deter ISPs from moving volumes from Openreach to altnets if doing so jeopardised meeting these targets"[41], because the ISP would face a sudden and significant increase in its prices across the entire Openreach FTTP footprint.

63. Ofcom has previously stated that "After the first year, the incentive to meet the lower target to qualify for the rental discounts (80%) is particularly strong as just missing this target results in the loss of all rental discounts". Furthermore, Ofcom was clearly concerned about the impact on ISP

[39] Enders Analysis and Deloitte – Media and Telecoms 2022 and Beyond Conference, Session Eight: Infrastructure Challenge, minutes 23:00-25:00 Available at: https://www.deloitte.co.uk/mediatelecomsbeyond/ondemand/#videos

[40] Enders Analysis and Deloitte – Media and Telecoms 2022 and Beyond Conference, Session Eight: Infrastructure Challenge, minutes 23:00-25:00

[41] Ofcom's statement on Openreach Proposed FTTP Offer starting 1 October 2021, September 2021, paragraph 3.79

incentives, noting that "**If it were the case that moving volumes to new alternative networks jeopardised meeting the targets then, even if an altnet's proposition is more appealing in one area, ISPs may be deterred from using that altnet** in order to protect their discounts in other areas where they depend on Openreach for FTTP. The extent of those other areas where ISPs depend on Openreach for FTTP is significant."[42]

64. While the nature of these OMTs has not changed in Equinox 2, the discounts have become more "substantial"[43] and the impact of the 'cliff-edge' is even greater.[44] Therefore, the ability to meet these targets will become even more critical for ISPs (which, as Ofcom recognises, will have no choice but to place some FTTP orders with Openreach[45]). Ofcom's recent analysis demonstrates the magnitude of these discounts, and it recognises that ISPs will be "strongly motivated to meet the OMTs".[46] Furthermore, the relative importance of these discounts (and meeting the OMT) will only rise with time as FTTP volumes increase. Therefore, this concern will only become even more pressing for ISPs, inevitably increasing their anxiety about ordering with altnets and importantly also increasing uncertainty from altnets about gaining ISP orders.

65. Figure 4 below demonstrates the financial losses that an ISP could incur if they fail to meet the OMT thresholds and the increase in the cliff-edge effect. This is an illustrative analysis in which an ISP has 1,000,000 subscribers across each speed tier and relies on Openreach for their connectivity (although this is a simplified representation given that the precise order mix and number of subscribers for each ISP will vary). This calculates the discounted rental fee that Openreach would charge an ISP for both Equinox 1 and Equinox 2[47] and subtracts the amount charged from the standard list price in order to determine the difference in how much is lost by ISPs if the OMTs are not met under Equinox 1 and 2. Even in this simple example, it is evident that the ramifications of not meeting the OMTs and qualifying for the relevant rental discounts could be nearly twice as severe as those of Equinox 1. Consequently, the ISP would face significant additional pressure to satisfy OMT conditions. The greatest levels of discount are on the higher speeds, which more customers are expected to take-up over time. Therefore, the impact of not meeting the OMT could also increase over time.

[42] Ofcom's statement on Openreach Proposed FTTP Offer starting 1 October 2021, September 2021, paragraph 3.79 footnote 97

[43] Ofcom consultation on Proposed FTTP Offer starting 1 April 2023, February 2023, paragraph 3.58

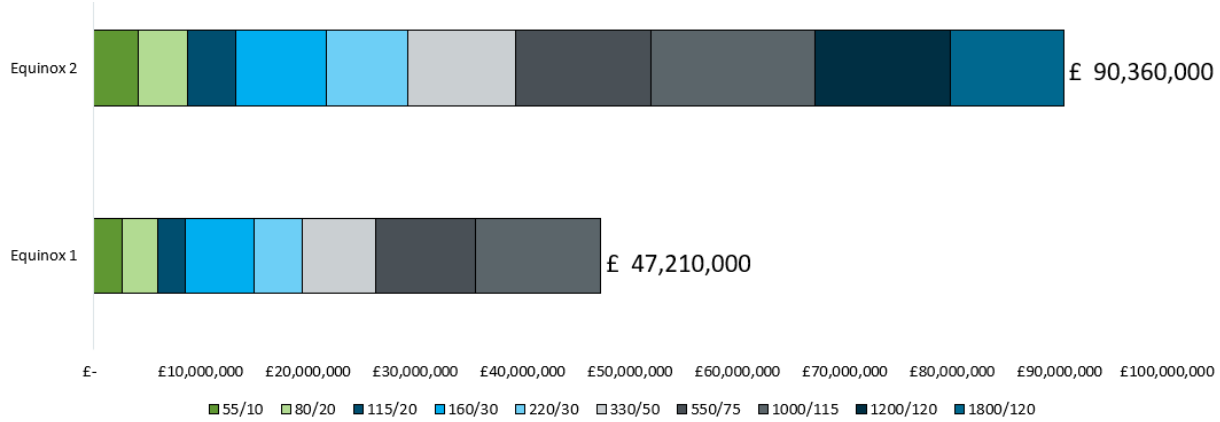
[44] As a result of the additional discounts, several prices for higher-speed FTTP connections have fallen below the 40/10 anchor price, which sits in contrast to Ofcom's statement that "if Openreach's FTTP prices are at or above this level then this is an indicator that such an altnet is able to profitably compete", footnote 86, Ofcom consultation on Proposed FTTP Offer starting 1 April 2023, February 2023.

[45] "ISPs wishing to offer FTTP on a UK-wide scale have no choice but to purchase access from Openreach in certain areas where infrastructure competition is not feasible and Openreach is the only provider." Ofcom consultation on Proposed FTTP Offer starting 1 April 2023, February 2023, paragraph 3.26

[46] Ofcom consultation on Proposed FTTP Offer starting 1 April 2023, February 2023, paragraph 3.59

[47] This maintained the same pricing as the standard list price for the 1200/120 and 1800/120 speed tiers when calculating the level of discounts for Equinox 1. It does not take into account any connection discounts.

Figure 4: Illustrative loss for ISPs if the OMT is not met



Source: Keystone analysis

66. There are two key concerns arising from Equinox 2 that further increase the indirect pressure on ISPs to continue to commit the majority of their volumes with Openreach:

    - The **unexpected advent of a further 'offer' to the market (despite being badged as an 'overlay') – trailed for several months beforehand - creates further uncertainty amongst altnets and their investors**. The result of this is that ISPs have been unwilling to commit meaningful volumes to altnets, before and during this consultation, and it is unclear for ISPs and altnets if, or when, there will be further revised 'long-term' offers; and
    - The **cliff-edge nature of the OMTs and resulting loss of discounts becomes even more problematic** given the increasing levels of overbuild over time as competition develops – this places further pressure on ISPs to stay with Openreach and raises further uncertainty from altnets that they can attract sufficient ISPs – **and while the Failsafe Mechanism in theory could help alleviate that concern it has a number of fundamental weaknesses**.

67. These two concerns are explained in further detail in the next two sections.

5 DRIP-FEED CHANGES TO PRICING TERMS & CONDITIONS

68. The introduction of Equinox 1 had a substantial impact on the UK communications sector. The scheme saw Openreach announce wide ranging wholesale price discounts on FTTP products, so long as ISPs largely stopped selling legacy broadband products in areas where Openreach full-fibre infrastructure was available. The offer was due to last for 10 years – ending on 30 September 2031, albeit with a revision period in year 6, and ISPs have the option to exit after five years or at year six if Openreach

increased its prices. At the time, Openreach positioned Equinox 1 as providing long-term certainty and stability in the competitive landscape.[48]

69. In its 2021 WFTMR statement Ofcom highlighted an urgent need for substantial investment by private companies to upgrade the UK's full-fibre infrastructure and deliver high quality broadband services to all British households and businesses in the future. [49] It also recognized the important role that its decisions and regulatory stability would have on the market at this crucial early stage, stating that "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."[50] Following the announcement of Equinox 1, altnets, such as Nexfibre, made plans to enter and expand in the market. Given the length of the offer period stipulated in Equinox 1, as well as Openreach's unambiguous commitment to predictable and transparent price changes, altnets developed their own pricing schemes on the basis of the wholesale price discounts contractually defined in Equinox 1.[51]

70. The announcement of Equinox 2 has been positioned by Openreach as merely an optional 'overlay' to the original scheme. As well as the introduction of the Failsafe Mechanism (discussed in the next section), Equinox 2 also notably features a number of substantial further wholesale price reductions. Crucially, these further reductions are not subject to more stringent performance targets, such that all providers achieving the current contractual OMT requirements laid out in Equinox 1 are able to benefit from the amended discount pricing.

71. As Equinox 2 does not change the benchmark ISPs have to outperform in terms of their order ratios, the additional discounting of wholesale prices can only be described as a 'drip-feed' change to the existing price mechanism. Rather than promoting more competition in the market and accelerating the migration of customers from legacy products to full-fibre, by focusing on lowering its prices again at this point in time, Openreach merely appears to be seeking to retain ISPs (preventing the loss of substantial order volumes to altnets). Whilst it introduces some further connection discounts, beyond this it does not contain any new provisions to incentivise migration of existing FTTC customers to FTTP despite its stated aim.[52] Therefore, the new pricing scheme outlined in Equinox 2 gives ISPs a

[48] BT stated that "Our new pricing gives ISPs *more long term certainty* (emphasis added), enables them to compete in a highly competitive market, and makes ultrafast Full Fibre technology the default choice wherever it's available" – see Rivals Sigh as Ofcom Clear Openreach FTTP Broadband Price Cut UPDATE3 - ISPreview UK

[49] Ofcom's Wholesale Fixed Telecoms Market Review 2021 – Volume 1

[50] Ofcom's Wholesale Fixed Telecoms Market Review 2021 – Volume 1, page 1

[51] For example, [•].

[52] A report by Enders analysis raised similar views, noting that whilst it is described as encouraging migration of existing connections to full-fibre, this is "hard to see" and that "it looks likely that the main purpose is a defence against loss of market share to wholesale altnets", December 2022. This report also noted that allowing annual special offer revisions could promote a "wait and see" attitude amongst ISPs.

further incentive not to switch to altnets, even in areas where full-fibre infrastructure other than Openreach is available.

72. In the economic literature, substantial price reductions by dominant firms are a well-established method of making entry into the industry less attractive. As market price levels drop, the profits a prospective entrant can reasonably expect decrease. Altnets that had previously been modelling their full-fibre investments based on agreed contractual Equinox 1 pricing, must re-evaluate all their previous projections, due to the announcement of further price discounts under Equinox 2. In addition, they now face the additional hurdle of a much more challenging macroeconomic environment, as the telecommunications sector has been heavily affected by recent increases in interest rates, labour costs and raw material prices (as set out in section 2.4.4).

73. There are close similarities with the attempted entry by Whistl into the UK market for bulk mail delivery in 2012. This constituted the first serious challenge to Royal Mail's position as the only supplier of mail delivery services with a nationwide network. Whistl announced its ambition to cover approximately 40% of British addresses by 2017 but restricted the initial roll out of its delivery operation only to London and other major UK cities. In those areas the company fully bypassed Royal Mail's delivery channels. In all other areas, Whistl depended on the use of Royal Mail access services for mail delivery. The prices Royal Mail charged for these wholesale services were subject to specific price plans, and in January 2014 Royal Mail issued contractual notices to change its wholesale prices which would have resulted in Whistl having to pay around 1.2% more per letter than companies using Royal Mail across the whole of the UK.[53] Following notification of these new wholesale prices, Whistl suspended its plans to extend delivery services to new areas, as it would have faced higher prices in the remaining areas where it relied on Royal Mail for delivery. Whilst this price increase initially appeared modest, Ofcom subsequently ruled that competition in the mail delivery sector was inherently limited. Also, Ofcom accepted that entrants faced exceptionally high barriers to entry, as the mail delivery industry was declining. This meant that even small increases in the wholesale prices Royal Mail charged its access customers were sufficient to make entry less likely to occur.[54]

74. Ofcom itself has recognized the parallels and lessons to be learned from the Royal Mail/Whistl case, having stated in the 2021 WFTMR that "Our *ex post* case found that Royal Mail abused its dominant position but, by the time of the infringement decision the potential benefits of end-to-end

[53] Royal Mail's 2014 price changes involved different price plans for wholesale customers, depending on whether they were able to hit mail volume targets for areas covering the whole of the UK. In practice this meant that if a company wished to start delivering bulk mail in some parts of the country (as Whistl did), it would have to pay Royal Mail 1.2% more per letter.

[54] As Ofcom summarised; "competition in the bulk mail delivery market was already very limited as at January 2014. The emerging competition in the bulk mail delivery market from Whistl was the first example of competition to Royal Mail's delivery network that could potentially grow to scale. Any attempt to enter the bulk mail delivery market at scale, or at all, faced high barriers before the price differential was introduced. That growth would also have to be achieved in the context of a declining market. This meant that entry and expansion in the market would become increasingly difficult and risky over time. **In such circumstances, the potential for entry to occur could be affected by even small or relatively small changes in the profitability of entry or expansion, which could be material in this context and thus could reduce an entrant's incentives to roll out and make entry less likely to occur** (emphasis added)." Ofcom (2018). Discriminatory pricing in relation to the supply of bulk mail delivery services in the UK, paragraph 7.162

competition in the bulk delivery market were forgone. **We are concerned that a similar scenario could arise in relation to ultrafast network rollout if we were to rely solely on *ex post* competition law"** (emphasis added).[55]

75. In the case of Equinox 2, Openreach has to date not produced any evidence that the introduction of Equinox 2 is necessary to facilitate a more efficient deployment of fibre infrastructure across the whole of the UK. Instead, the introduction of additional wholesale price discounts raises considerable uncertainty for altnet investors that ISPs will be further disincentivised to commit significant volumes to altnets at this critical point.

76. It has long been recognised in the economic literature that entry deterrence can be profitable for dominant companies. For instance, Milgrom and Roberts[56] show that the incumbent's behaviour towards prospective entrants in the early stages constitutes a powerful signal to subsequent firms seeking entry into the industry. As a result, the incumbent has the ability to develop a reputation for being committed to deterring market entry. Whilst price cuts in the early stages are costly to the incumbent, it crucially lends credibility to further aggressive price strategies against future entrants.

77. It is in the nature of competitive markets that price levels decrease over time and excess profits are competed away. However, a fully-fledged competitive market has yet to be established in fibre infrastructure. Against the backdrop of fresh discounts in Equinox 2, ISPs have limited incentives to engage in lengthy negotiations with altnets, while speculation over further potential Openreach price discounts is occurring in the market. Indeed, Openreach had trailed the potential Equinox 2 reductions for several months before formally announcing them. By offering additional wholesale price discounts without advance notice, Openreach is effectively pursuing a strategy of "bait and switch". Altnets were initially encouraged to make substantial investments in full-fibre access infrastructure by the pricing scheme Openreach seemingly committed to under Equinox 1. They were further assured that any forthcoming amendments to the incumbent's pricing would be based on the Equinox framework, thus allowing them to develop robust investment projections for a period of up to ten years. The sudden announcement of Equinox 2 effectively overrides parts of the original scheme. This not only delays negotiations between altnets and ISPs, but in some cases may void provisional agreements that had been struck already between altnets and ISPs. ISPs are now likely to expect further reductions to Openreach's wholesale prices in the future, making them even more reluctant to make any long-term commitments to switching substantial order volumes away from Openreach.[57] However, there is a clear risk that having attracted ISPs initially to stay with Openreach, to the detriment of altnets, Openreach will increase its future prices and without sufficient remaining

[55] Ofcom's Wholesale Fixed Telecoms Market Review 2021, volume 3, paragraph 7.55

[56] Milgrom, P. and Roberts, J. (1982) 'Predation, Reputation, and Deterrence', Journal of Economic Theory.

[57] A recent analyst report highlighted this concern, noting that "we think there is one question that analysts and investors might legitimately raise with management. If a pricing cut has taken place 18 months after launch, what is the risk of a subsequent (downward) pricing adjustment in, say, another 18 months?", HSBC Equity Research, 17 January 2022

competition, ISPs will have no choice but to use Openreach. As one article noted "Once a few of the altnets fail and the competition is thinned, BT would then be able to raise prices again."[58]

78. The decision taken by Ofcom in this matter will also set an important regulatory precedent in the market for full-fibre infrastructure, and beyond. If Openreach is permitted to implement Equinox 2 in its current form, this may well result in the use of similar discount schemes by Openreach over the coming years. Ongoing uncertainty such as this risks undermining Ofcom's previous policy striving for stability and regulatory certainty, which it declared to be an important part of encouraging investment and allowing competing providers to earn a fair return on investments made in upgrading the UK full-fibre network.[59]

6 FAILSAFE MECHANISM - BENEFICIAL CONCEPT BUT FLAWED IN DESIGN

6.1 Plausible risks arising from cliff-edge nature of OMTs and even greater loss of discounts from Equinox 2

79. In its 2021 WFTMR Statement, Ofcom clearly recognised the risks arising from the incentives OMTs create, particularly in areas where there will be overbuild. It explained that in locations where the altnets that provide access to third party ISPs overlap with the Openreach FTTP network (which it expected at the time would be very few in the short term), moving volumes from Openreach to altnets could "jeopardise an ISP's ability to meet the targets if doing so skews the mix of orders that the ISP continues to place with Openreach from FTTP to legacy products." It concluded that:

    a. due to the limited (expected) overlap of the Openreach FTTP footprint by altnets in the next 12-24 months, placing orders with an altnet is likely to have very little effect on an ISP's mix of new Openreach orders across the whole Openreach FTTP footprint; and
    b. an ISP's ability and incentive to sell legacy products would also sharply decline as increasing areas would be subject to 'stop sell' and strategically ISPs would largely cease placing new orders for legacy products.[60]

80. However, Ofcom at the time also recognised that its assessment may be ''overtaken by changing circumstances" such that it would "still be open to intervene to prevent terms which create a barrier to using altnets".[61] This is important as Ofcom's dismissal of these concerns relied on two

[58] BT faces down 'altnet' threat - Investors' Chronicle (investorschronicle.co.uk), November 2022

[59] Ofcom's Wholesale Fixed Telecoms Market Review 2021 – Volume 1

[60] Ofcom's statement on Openreach Proposed FTTP Offer starting 1 October 2021, September 2021, paragraphs 3.78-3.87

[61] Ofcom's statement on Openreach Proposed FTTP Offer starting 1 October 2021, September 2021, paragraph 3.89

assumptions which have not been borne out: limited overbuild and ISPs entirely stopping selling legacy products.

81. In the case of ISPs' being disincentivised to use altnets as a result of OMTs and Equinox 2, Ofcom has now in its latest consultation recognised that this is, in fact, a significant concern and not as Openreach state simply a "theoretical possibility".[62] Ofcom has reviewed evidence on the rates of overbuild and accepted that these will be much higher than it had previously expected, which heightens the problem created by the OMTs.[63] [•].

82. It is also evident from Ofcom's own analysis of ISPs' ability to meet OMTs, that where at least one ISP does use Virgin Media O2/Nexfibre's network [•] then Ofcom accepts that this ISP "might face difficulties in meeting the OMTs".[64] This creates a **plausible likelihood that for an ISP "there is uncertainty about whether using an altnet might affect its ability to meet the OMTs even in the very long term**".[65] Furthermore, Ofcom also admits that at least in one case "there may be **points in the future where using an altnet potentially affects the discounts** received by [redacted] (absent the Failsafe Mechanism)" and recognises that "In 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."[66]

83. This illustrates that it is critical that there is an **effective** working mechanism in place that completely removes the possibility that there is **any disincentive** for ISPs to use competing wholesale providers. Significant reliance is placed by Ofcom on the proposed Failsafe Mechanism to address this concern, which is explored in more detail below. Moreover, it is misplaced simply to focus on the risks and perceptions that ISPs alone may have about the OMTs, as importantly Equinox 2 also creates significant uncertainties amongst altnets that they will be able to attract sufficient ISPs.

84. Furthermore, Equinox 2 does not simply further distort ISPs' short-term incentives to take-up altnets where there is currently network overlap, but it also creates a longer-term distortion in the risks involved in committing significant volumes to altnets as this would significantly reduce their flexibility

[62] Openreach Equinox 2 GEA –FTTP Equinox 2 Offer NGA2018/22 14 December 2022

[63] Ofcom's analysis on overbuild concludes that it is reasonable to assume that approximately 15% of Openreach's FTTP network is likely to be overlapped during the first year or so after Equinox 2 (ie spring 2023-2024) and this will increase to 25% in two-three years (ie 2024-2026), but that if ISPs began using Virgin Media O2/Nexfibre's networks then this could be over 60%. Ofcom consultation on Proposed FTTP Offer starting 1 April 2023, February 2023 paragraph 3.61

[64] Ofcom states that (emphasis added) "Provided an ISP is comfortably exceeding the OMTs, then it is unlikely to be deterred from making use of a mixture of cable and FTTP from VMO2 and Nexfibre for a significant proportion of its orders, notwithstanding the higher overlap. It is possible that [redacted] will be in this position, particularly as we expect that: (i) an ISP is unlikely to switch all its FTTP orders from Openreach to altnets in such a large overlap area; and (ii) the time it would take to reach and implement such an agreement may give the ISP a future opportunity to improve its Order Mix. 55 *However, this is not certain, so even [redacted] might face difficulties in meeting the OMTs as a result of shifting large numbers of orders to VMO2 cable and altnet FTTP*, absent the Failsafe Mechanism. It is *more likely* that [redacted] might face these difficulties" Ofcom consultation on Proposed FTTP Offer starting 1 April 2023, February 2023, paragraph 3.65

[65] Ofcom consultation on Proposed FTTP Offer starting 1 April 2023, February 2023, paragraph 3.66

[66] Ofcom consultation on Proposed FTTP Offer starting 1 April 2023, February 2023, paragraph 3.64

in future. **If an ISP in future fails to meet the OMTs, it loses *all* its discounts rather than just for that quarter – making this future risk a significant concern**. This raises barriers to switching and thereby raises rivals' costs as they need to offer even bigger incentives to switch.

6.2 An effective well-designed and workable measure is critical

85. It is evident that there are significant concerns about the impact of using an altnet on an ISP's ability to meet OMTs (both now and in the future). Therefore, if left unaddressed Equinox 2 will not only deter take up from altnets (particularly in any significant volume) but also significantly increase the investment risk for altnets, which can only survive if they attract sufficient ISPs. Therefore, it is critical that an effective measure is put in place to address this concern. This issue will be heightened by the advent of even greater discounts offered under Equinox 2, meaning the financial losses for ISPs could now be almost twice as severe for ISPs, as illustrated in the previous section.

86. In theory, it is a welcome development to see an attempt to address this risk through the introduction of the Failsafe Mechanism by Openreach, which in principle is designed to break the link between OMTs and use of altnets. However, in order to adequately address this concern, it is important that this mechanism has the effect of **wholly removing any uncertainties altnets have about the impact of Equinox 2 on ISP incentives to commit volumes to altnets**. If they remain concerned that Equinox 2 will only further disincentivise ISPs to use competing networks, then this will make investors highly reluctant to continue building. Having considered the design of the current mechanism proposed by Openreach, there are various weaknesses which could seriously undermine its effectiveness.

87. As it stands in its current design, it is far from evident that this will create the certainty altnets need, such that they feel confident that in all scenarios taking up reasonable volumes on their networks would not jeopardise an ISP's ability to meet the OMTs, placing them at an even greater disadvantage to Openreach.

6.3 Key concerns in the design and implementation of the Failsafe Mechanism

88. In this section we set out a number of potential concerns in relation to the design and practical application of the Failsafe Mechanism, which in combination cast significant doubt over its effectiveness in fully alleviating the disincentive arising from the OMTs. These are in summary concerns about the:

- **sequencing of the Failsafe Mechanism** i.e., being applied retrospectively once an ISP has already committed volumes and as a result potentially risks its discount if it is not certain of the application of the Failsafe Mechanism;
- **lack of clarity around the scope and certain definitions creating significant ambiguity** about how the Independent Verifier (IV) will assess and calculate overbuild, which is crucial in recalculating the OMT;

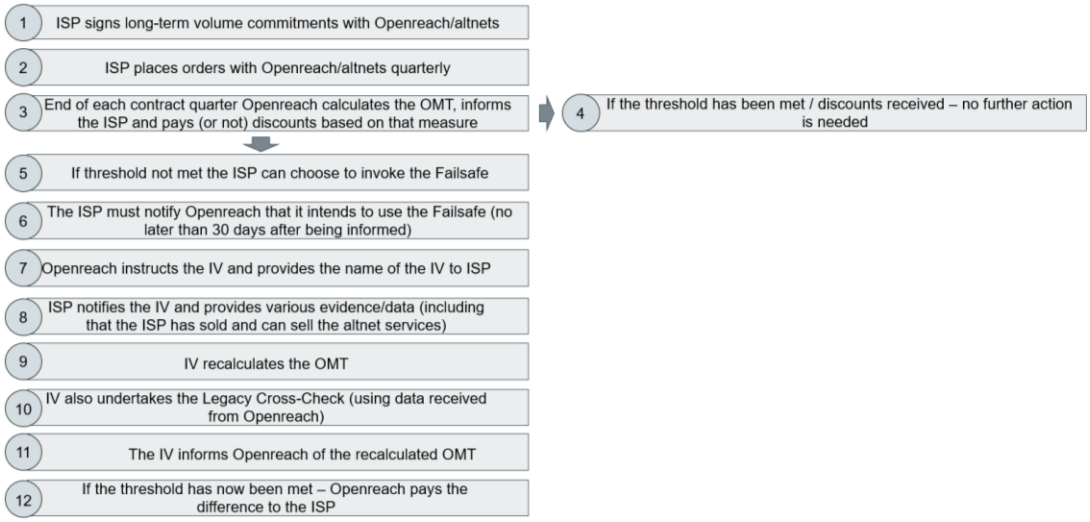
- IV being appointed by Openreach and lack of transparency on its identity raising questions about its independence and the effects of not knowing in advance who the IV would be; and
- lack of appeal process should ISPs wish to challenge or query the assessment of the IV.

89. We set out each of these concerns in turn. We believe that unless these concerns are adequately considered and ultimately addressed by Ofcom, altnets will not be sufficiently convinced that the Failsafe Mechanism removes the disincentive for ISPs to use their networks created by Equinox 2, reducing the switching costs and financial risk for ISPs.

6.3.1 Sequencing of the Failsafe Mechanism

90. One of the key concerns arising from the current design of the Failsafe Mechanism is that it will be applied ”retrospectively”. The sequencing of the process for ordering and applying the Failsafe Mechanism, and the multiple steps involved, is summarized in Figure 5 below.

Figure 5: Failsafe Mechanism sequencing



Source: Keystone

91. ISPs must have already entered into contracts with altnets to use their services and have ordered from that altnet in an overlap area, before having to wait until the end of each contract quarter in order to find out if they have met their OMTs and only then can they trigger the Failsafe Mechanism. In practice this means that ISPs must first have sufficient confidence that they are willing to sign contracts with altnets and have already placed volumes, without knowing; a) who they can apply to; b) whether their application will be granted; and c) whether this would lead to a sufficient increase in their OMT threshold such that they would qualify for the discount.

92. ISPs must not only have sufficient ‘faith’ in the mechanism but also importantly will have no knowledge or visibility about its impact and outcome on their discounts, in advance of committing volumes with altnets. This creates significant uncertainty for altnets that ISPs will nevertheless be

willing to commit volumes with an altnet at an early stage – making them reluctant to continue investing in this market. This sequencing weakness was not considered or addressed by Ofcom in its consultation.

93. In theory, there is a rationale for the retrospective nature of its design (any mechanism would need to base its final determination off the actual levels of overlap and ISP usage of an altnet). However, the existence of a solely retrospective mechanism will, by its very nature, create uncertainty over the outcome. In practice, ISPs and altnets make long-term contractual commitments and investments on a forward-looking basis, therefore **both parties need some level of reassurance in advance of making these commitments** that this would not trigger the 'cliff-edge' reduction in discounts.

94. While some ISPs may *currently* be meeting the OMTs relatively easily (though the details of ISP performance against the OMTs are excised from Ofcom's consultation) – it will clearly become increasingly tougher for ISPs as the level of overbuild increases, even as demand for copper also decreases. The effects of losing the 'substantial' discounts are so significant that there is a real risk that any remaining uncertainty will deter altnets from investing.

6.3.2 IV being appointed by Openreach and after the Mechanism is triggered

95. It is evident that the IV will play the central role in gathering, reviewing and determining the recalculated threshold. Given the significance of this role it is surprising that it will be left to Openreach to determine who will be appointed to this position, there is no clarity in advance about who would be assessing this and no oversight from Ofcom to ensure a suitable appointment is made. There is no clarity on this until an ISP has already committed to altnets, triggered the process and asked Openreach to initiate this process, and only at that late stage will the ISP be informed who Openreach has decided to appoint.

96. While there are provisions in the contract that stipulate that Openreach must ensure its instructions to the IV require it to carry out the process accurately, fairly and to the best of its abilities and the IV must be independent to the ISP/Openreach[67], the decision over who is appointed and whether they have indeed carried out their assessment to these standards, remains in the hands of Openreach. By its very nature, Openreach cannot be an independent and fair arbiter regarding the implementation of the Failsafe Mechanism given their incentives and position as a competitor. It is not appropriate in our view to allow Openreach to have any influence on this process (even indirectly) by appointing the IV, despite the contractual requirement for the IV to be independent.

97. There are parallels here to other similar mechanisms by regulators. For example, in the case of merger investigations, where a monitoring trustee must be appointed, the CMA maintains a list of suitable organisations and the appointed trustee must be approved separately by the CMA. Once appointed,

[67] Draft Equinox FTTP Offer Contract – Supplemental Agreement, Appendix 1, paragraph 9.9 and Appendix 4.

the monitoring trustee will typically provide regular reports which provide reassurance to the CMA that it is fulfilling its role and the CMA maintains oversight throughout.

6.3.3 Lack of clarity around scope/certain definitions and sufficient guidance

98. There is also some ambiguity in the scope and certain definitions set out in the draft contract, which creates further uncertainty over how the IV will calculate overlap and any recalculation of the discounts.

99. For example, it is not clear precisely how an 'Overbuild Footprint' would be defined and therefore how many homes would be removed from the numerator and denominator used in the OMT calculation. In Appendix 4 of the draft contract, paragraph 2 requires that the ISPs provide details of 'Premises' where they *could* sell 'Eligible Services' – but this is defined as services in respect of which the provider *has* contracted for with an altnet. It is therefore not clear to what extent overlap areas would include premises only contracted for or ones that could be contracted for. Precise definitions and further explanation to illustrate how the IV will calculate the Overbuild Footprint are critical given that the size of this area will impact the recalculated threshold and resulting discounts. Further definition on this point, together with a more detailed worked example (in significantly more detail than the example provided by Openreach in Appendix 3), would be highly informative and provide reassurance that all parties have a shared understanding about how this will be calculated.

100. Furthermore, there is also potentially some ambiguity over how the level the Overbuild Footprint will be calculated, i.e., to a geographic "area"[68] or at the level of individual "premises".[69] It appears to be defined at the premise level (and this would be most logical), but this should be explicitly clarified as this could impact how expansive the Overbuild Footprint is deemed to be by the IV and therefore the number of homes removed from the OMT calculation. To the extent that there is any remaining lack of clarity or confusion this could serve to create uncertainty over the effectiveness of the mechanism.

101. Ultimately it appears to be in the discretion of the IV precisely how it will define an overlap area – which was a factor recognised by Ofcom which stated "there is likely to be an element of judgment in how the IV carries out its duties"[70]. Despite this weakness (and bearing in mind the importance of clarity given the impact of a recalculation of discounts), Ofcom appears to rely on the reassurance that the IV would be expected to "act in a fair and reasonable manner". This provides no further specific clarity other than a general reassurance about the broad behaviour expected of the IV. In this case we believe there should be clear and precise definitions on an overlap area set out in advance, for the benefit of all parties involved, altnets, ISPs and Openreach.

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[68] See for example paragraph 3 of Appendix 4 to the draft Equinox 2 contract, which states that the IV will 'exclude Premises in an *area* (emphasis added) where the CP is able to provide reasonable evidence…' Draft Equinox FTTP Offer Contract – Supplemental Agreement

[69] See for example paragraph 2a) of Appendix 4 which stipulates 'full and accurate details of all those Premises' and as implied in the definition of an 'Overbuild Footprint' on page 6 of the draft contract which states 'those Premises within an overbuild area established by the IV.' Draft Equinox FTTP Offer Contract – Supplemental Agreement

[70] Ofcom consultation on Proposed FTTP Offer starting 1 April 2023, February 2023, paragraph 3.72

102. There is no reason why a clearer definition cannot be agreed and set out in more detail in guidance prior to Equinox 2 coming into force.

6.3.4 Lack of appeal process

103. Given the lack of clarity over scope and definitions that the IV will use in recalculating the OMT threshold, there is a real risk that there will be differences of interpretation between various parties. Whilst an IV must act fairly, there is a level of "judgement" [71] involved which could be subject to different reasonable interpretations. Given this, there should be a process built into the mechanism to enable parties to appeal the IV's decision and for there to be a 'second pair of eyes' to review the evidence/data used by the IV in determining the recalculated performance. Relying on a 'black box' with no visibility or process in which the judgement formed by the IV can be scrutinized if needed, would be inherently unfair and leave uncertainty for altnets and ISPs alike.

104. Putting in place a fair appeal process from the start, would provide significant reassurance should an ISP consider that an overbuild area has not been correctly determined and therefore their performance has not been correctly recalculated. This is considered further in section 7.2.

7 SUGGESTED CHANGES

105. We believe that there are range of steps that Ofcom could take using its regulatory powers to address the concerns set out above.

7.1 Preventing further uncertainty

106. To promote continued rollout of full-fibre infrastructure across the UK, it is imperative for Ofcom to ensure there is sufficient regulatory certainty and to provide the stability required for long-term investment. Whilst markets are clearly dynamic and conditions are bound to evolve, there also needs to be a balance between flexibility and ensuring there is sufficient certainty to enable the negotiation of long-term deals with ISPs. This is only possible without a constant threat of further changes to the Equinox terms and conditions.

107. The announcement of unplanned changes to the original Equinox scheme saw Openreach effectively renege on its previous commitment to predictable wholesale pricing. It is therefore the expectation of many prospective investors and ISPs alike that further wholesale price cuts may follow in years to come. There is concern that these changes could be trailed for many months prior to the official announcement, as Openreach has done with Equinox 2. This has a detrimental effect on investment planning by private companies and cripples the ability of altnets to engage in meaningful long-term negotiations with ISPs on their future partnership. To reassure prospective investors, Ofcom must eliminate the possibility of Openreach pre-empting the emergence of effective infrastructure competition to its fibre network. This means removing the ambiguity surrounding future price

[71] Ofcom consultation on Proposed FTTP Offer starting 1 April 2023, February 2023, paragraph 3.71

reductions and further unilateral changes by Openreach to the original Equinox offer. In other words, **ideally Ofcom would prevent Openreach from making any further unplanned changes to the Equinox contract, until the pre-defined review point in 2026** (only three years away).

108. In the absence of a full regulatory intervention to rule out further unplanned changes to the original Equinox offer, there is a spectrum of alternative restrictions that Ofcom can impose to create a market environment conducive to investment by altnets:

- **Restrict pre-price announcement signalling**
  A crucial aspect of an appropriate regulatory response to Equinox 2 is for Ofcom to prohibit, or at least limit, any indicative signalling by Openreach, which precedes an official announcement of further changes to the Equinox scheme. This is because the uncertainty and anticipation associated with further changes are particularly harmful to decision-making over investments by altnets. The regulator should set out guidelines (with a view to codifying with an SMP condition in the next market review), which stipulate that Openreach is required to submit all proposed amendments to the Equinox offer to Ofcom, prior to engaging in any formal or informal discussions with ISPs about these changes. The requirement to notify the regulator in the first instance stops the spread of noise in the wider market, which undermines the negotiating position of altnets in talks with ISPs. Restricting Openreach's ability to engage in pre-announcement signalling will therefore, at least partially, alleviate the adverse impact that any further changes to the Equinox offer have on altnets. It will create a more level playing field and greater transparency in the market (one of the original aims behind Equinox).

- **Set expectations that Openreach should not make continued amendments to Equinox**
  Whilst it is clearly beneficial to retain some level of flexibility to respond to changes in the market environment or wider macroeconomic fluctuations, repeated yearly changes have a significant negative impact on investment decisions by altnets. Importantly, the uncertainty created by frequent unexpected changes to the Equinox offer increases the perceived riskiness of investing in fibre infrastructure. Ofcom should therefore, at the very least, express the unequivocal expectation that further changes to the Equinox offer be kept to a minimum. It must also be very clear that moving forward any proposed changes must be supported by clear, evidence-based reasoning for why these are necessary. The expectations should also highlight that further annual changes to the scheme would be inadvisable and may result in regulatory intervention.

- **Modify the SMP condition to shift the burden of proof onto Openreach**
  The current regulatory framework results in altnets having to prove that the terms outlined in Equinox 2 are anti-competitive. This gives Openreach a significant strategic advantage when making changes to the terms of the Equinox offer. It is inherently difficult for altnets to prove that the proposed changes are anti-competitive for two reasons. Firstly, many of them are prospective entrants, who have yet to or have only very recently entered the market. It is

therefore challenging to provide substantial evidence of the harmful effect of the proposed changes on their business. Secondly, as the changes proposed by Openreach have yet to be implemented, it is likely that their anti-competitive effects are not fully apparent at this stage. Shifting the burden onto Openreach in the next market review will address this imbalance and reduce Openreach's incentives to propose further amendments.

- **Impose a cooling-off period following the announcement of changes to Equinox**
  Under the current framework all amendments to the Equinox offer immediately come into effect following the notification process and review/acceptance by Ofcom. This short timeframe means that altnets are at a significant disadvantage, as they are effectively unable to respond to the amendments and extend counteroffers to ISPs, prior to the new terms offered by Openreach coming into effect. The introduction of a cooling-off period (e.g., 3-6 months), which delays the introduction of the changes to Equinox, would allow altnets to scrutinise the impending changes and adjust their pricing/terms if needed. This would give altnets a reasonable opportunity for a competitive response before ISPs make any long-term commitments with Openreach. In addition, the introduction of a cooling-off period would also be highly beneficial to end customers, as altnets would have a clear incentive to match price reductions by Openreach or even offer more substantial discounts.

7.2 Improving the Failsafe Mechanism to ensure it is 'fit for purpose'

109. There are easily implementable but important changes that can be made to the Failsafe Mechanism which could significantly improve its effectiveness. This would provide greater certainty for altnets about the impact of OMTs on ISP incentives and ultimately their ability to attract ISPs to switch. Only if these issues are properly addressed will altnets and their investors have sufficient confidence to continue investing beyond Equinox 2.

- **Addressing the retrospective concern with a pre-notification process**
  The most significant improvement to the current design, would be to introduce an advance pre-notification process. This would be an optional step which would enable ISPs to request an advanced estimation of an overbuild area and approximate impact on its OMT *before* committing volumes with altnets and placing quarterly orders. This would provide advance visibility on the likely outcome of an ISP using an altnet and give additional reassurance prior to committing volumes to an altnet, that this would not be likely to have any detrimental impact on its OMT. This could be introduced alongside the current Failsafe Mechanism, that would need to be retained in order to calculate the precise overlap/final discounts once the ISP had actually placed its orders. While this would introduce an additional optional step, the benefits of advanced estimation would give greater upfront reassurance to both altnets and ISPs.

- **Upfront identification of IV and independence from Openreach**

Instead of relying on Openreach to appoint the IV (and the assumption that contractual requirements for independence are sufficient), we believe that there is a strong case for Ofcom either to directly appoint the IV or at the very least approve and oversee the appointment of the IV. This will ensure Openreach cannot indirectly influence the appointment and assessment of the IV, recognising for example that the IV would itself be funded by Openreach. Instead, Ofcom would be able to ensure directly that a suitably fair and independent IV has been appointed. Ofcom would also be able to provide ongoing oversight of the IV and use of the Failsafe Mechanism. This would provide reassurance to all market participants that the IV is acting fairly and proportionately and being independently held to account. ISPs and altnets would also be able to raise concerns and questions regarding the IV and the functioning of the mechanism. Appointing the IV upfront, in advance of any ISP triggering the Failsafe Mechanism, would also ensure that ISPs have full visibility over who would be responsible for determining the Failsafe Mechanism. In the case where an advanced pre-notification stage is introduced, it will in any case be necessary for an IV to have been appointed proactively (rather than reactively).

- **Inclusion of an appeal process and detailed guidance**
  Given the complexity and element of judgement entailed, it will be critical that there is a process in place from the start whereby ISPs (and if needed altnets) can review and dispute IV decisions, should they wish to do so. To reduce the likelihood of needing to use this dispute mechanism, there would also be significant benefits in producing a clear and detailed set of guidance, with illustrative examples to benefit all those involved in the process (including altnets). This would reduce the risk that the rules are interpreted differently.

7.3 Exploring alternatives to the OMTs

110. Beyond the incremental changes set out above, there would also be some value in Ofcom exploring more fundamental changes to the design of the Equinox pricing scheme and in particular the OMTs, at this critical juncture, to ensure that this does not become an additional barrier to entry and expansion by altnets.

111. This would go further than simply mitigating the increased risk arising from the OMT's cliff-edge effects and loss of discounts as the level of overlap increases, but instead more broadly address the core risk that there is ongoing and potentially varied latent demand for copper between areas. This creates a plausible concern that some ISPs will continue to struggle to meet the OMTs if they start using altnets in any significant volume, even if overlap areas are effectively removed from the calculation. It is highly uncertain whether the potential growth of stop sell areas and other 'strategic' measures that ISPs could take (such as seeking to end all sales in FTTP areas), will be sufficient to address this risk. As noted in the report prepared by the Gigabit Take-up Advisory Group, there may

be several factors which could deter customers switching to full-fibre even where there this is available.[72]

112. Rather than introduce an additional complex 'opt in' Failsafe Mechanism to try and remove the impact of altnet usage on the OMTs (*ex post*), a simpler alternative would be to amend the OMTs such that take-up of full-fibre with altnets is included upfront in the ISP targets, in addition to Openreach's FTTP services. This is akin to the current Volume Target Relief[73] in Openreach's GEA-Volume Agreement Special Offer, which takes altnet FTTP usage into account in the upfront calculation (rather than attempting to try and remove this demand only once it has been taken up).

113. This would require the use of an independent body (such as an IV or Ofcom) to oversee the calculations, given that this would entail handling confidential information (much like the Failsafe Mechanism). Whilst this would require resourcing, it would fundamentally address the current risk of disincentivizing altnet take-up, in a much simpler way without for example, the need to define overlap areas ex-post and it would remove the element of judgment and ambiguity created by the current proposed Failsafe Mechanism. Furthermore, given that this method is already used by market participants, it also appears in the long run to be easier and less burdensome. Ultimately introducing this measure will ensure there is a network-agnostic approach to incentivizing ISPs to shift to full-fibre.

[72] gigatag_report_v5.pdf (cbi.org.uk), June 2021

[73] The Volume Target Relief, is where an ISP acquires Superfast broadband connections with a 'Qualifying Alternative Network Provider' and the connections are in Openreach's full-fibre network footprint then the ISPs volume commitment will reduce by the same number of connections. This ensures that the use of altnets full-fibre services does not impact the ISPs ability to meet the volume commitments.