

The importance of absolute price levels to Ofcom's Equinox 2 assessment

Introduction

1. This paper is submitted to Ofcom on behalf of Zzoomm and INCA in advance of Ofcom's expected consultation setting out its analysis and preliminary conclusion about the possible competition impact of Openreach's proposed new discount offer Equinox 2 (E2).
2. We hope that this and the other submissions made in recent days will assist Ofcom in its analysis and deliberation and would be please dot meet with Ofcom to discuss any elements of those papers or any other aspects of E2 where Ofcom considers we can be of assistance.
3. In accordance with its WFTMR Statement, Ofcom plans to consult on Openreach's new proposed discount scheme - E2.
4. We submit that Ofcom should review the terms of E2 in their entirety and not just selected elements. Failure to undertake a comprehensive review of the possible competitive impacts of the offer risks significant harm to infrastructure competition and long-term choice and benefits to consumers.
5. In particular, Ofcom should include a detailed analysis of the impact of the absolute price levels resulting from the E2 offer. If the pricing offered by Openreach under E2 deters efficient network deployment by Openreach's competitors (for reasons including, but not limited to, competitors being at an earlier stage in their life-cycles, not currently having retail and wholesale relationships similar to Openreach's status, or other legitimate differences between new entrant challengers and the incumbent provider), then we submit that absolute price level in E2 is of equal concern to any potentially loyalty-inducing pricing structures.
6. We suggest that Ofcom should address absolute price levels in its consultation on E2. However, if Ofcom concludes that the obligations it imposed in the WFTMR to prohibit offers and discounts that could deter competitive network build do not specifically address absolute price levels, then Ofcom should use its Competition Act powers to conduct a parallel investigation as to whether the E2 pricing constitutes abusive behaviour by BT pricing constitutes abusive behaviour by BT. If Openreach reduce prices below a level allowing competitive market entry by altnets this will exclude potential rivals from the WLA market.
7. Specifically, we believe that Ofcom should address the following two points:
 - a. Does the reduction in prices for 80/55 Mbps and for 115 Mbps to a price below the regulated price of the 40 Mbps Anchor Product result in a price below the cost of provision estimated by Ofcom in the fibre cost model in each of Areas 2 & 3?
 - b. Price reductions for higher speed products (160 Mbps upwards) are greater than the rate of inflation as measured by the Consumer Prices Index (CPI) in October 2022. Does the resulting real terms price cut for these products means they are priced below the cost of provision by a reasonably efficient

operator in each of Areas 2 & 3?

Background

8. On March 18th 2021, Ofcom issued its WFTMR decision within which were provisions that restricted Openreach's pricing freedom, including prohibition of geographic discounts and restrictions on what Ofcom termed 'Other Commercial Terms' (OCTs).
9. Ofcom explains that the purpose of the OCT pricing/discounting restrictions are to prevent Openreach from designing "*commercial terms which undermine alternative network operator rollout*".¹ Whilst Ofcom proceeds to quote examples such as loyalty discounts and volume discounts, the level of prices resulting from the discount is also a part of the commercial terms offered. For example, Ofcom should consider the monetary impact on an ISP (and the consequential impact on an ISP's incentives to buy from new entrants) of missing the thresholds for achieving the loyalty or volume discounts.
10. Ofcom further states: "*If Openreach uses commercial terms that undermine new network build, our starting point is that they are likely contrary to the interests of consumers in the long term.*"² And whilst pricing structures such as loyalty and volume discounts would be of particular concern, pricing designed to exclude new entrants from the market is of equal concern (whether predatory pricing, or pricing short of predation but nevertheless deterring market entry). Whether the issue is loyalty inducing discounts, or pricing below the cost of a reasonably efficient operator, the adverse exclusionary impact on actual and potential new market entrants should be Ofcom's concern in assessing E2.
11. Ofcom also states that: "*we expect some new alternative network build in Area 3. Consequently, our concerns also apply here in that Openreach could use commercial terms which applied in Area 3 alone to deter such build, potentially depriving consumers of greater choice and competition.*"³ This statement shows clearly that, at the time of designing the OCT provisions within the WFTMR, Ofcom had concerns about the impact of any offers, discounts or prices that could deter competitive build in Area 3. This concern clearly applies to OCTs applied across Areas 2 and 3 or to Area 3 only.
12. The concept "commercial terms", as used by Ofcom in the WFTMR, covers all aspects of the proposed discount scheme, including the specific absolute price level offered.

Ofcom's application of the OCT rules to Equinox 1

13. In its Equinox Statement⁴ (E1 Statement) Ofcom stated that "*the 90 days' notification requirement is for commercial terms where the price or other contractual conditions are conditional on the volume and/or range of services purchased. It is not intended to address general concerns about low wholesale prices.*"⁵

¹ WFTMR V3 paragraph 7.18.

² WFTMR V3 paragraph 7.29.

³ WFTMR V3 paragraph 7.31.

⁴ https://www.ofcom.org.uk/_data/assets/pdf_file/0021/226092/statement-openreach-proposed-ftp-offer.pdf

⁵ E1 Statement paragraph 3.40.

[emphasis added]

14. We would agree that the 90-day's notification requirement is not intended to address **general** concerns about low wholesale prices, but we contend that it IS intended to address concerns of low wholesale prices that are **specific** to the offer under investigation.
15. This is supported by Ofcom proceeding to state why it considers that the specific levels of prices resulting from Equinox 1 (E1) are not a cause for concern, quoting the following reasons:
16. *"Under the Equinox Offer, the price for the 40/10 anchor product is set at the regulated price ceiling, i.e., it is not discounted. Further, all the other FTTP rental prices under the Equinox Offer are set at a level above this, including when ARPU-related discounts are taken into account. Therefore, we consider that the Equinox Offer prices are set at a level above our estimate of the price that an altnet would need to charge in order to recover its efficiently incurred costs in Area 2. [redacted]. We consider that the level of the Equinox Offer discounts do not undermine our objective to promote investment in gigabit-capable networks by Openreach and other operators in Area 2."*⁶
17. Ofcom further stated:
18. *"We decided to set a price ceiling for the FTTP 40/10 'anchor' product but not to regulate the prices of Openreach's higher speed products or set a minimum FTTP price. When setting the price ceiling for the FTTP 40/10 anchor product, we compared it with our estimate of the price that an entrant operator would need to charge in order to recover its efficiently incurred costs. Our focus was on FTTP build costs in Area 2, given that this is where we expected the majority of new altnet build to occur."*⁷[emphasis added]
19. The above statements from the E1 Statement are clear evidence that Ofcom considers it important to understand any impact of the specific price levels resulting from any offer or discount by Openreach to its wholesale customers. Further, there is no suggestion that such impact should be limited to whether ISPs have reduced incentives to use altnet wholesale services as it could equally impact the overall viability of competitive network deployment of vertically integrated and wholesale providers alike and both would be to the detriment of consumers.
20. Further, and in the alternative, if Ofcom declines to address the absolute level of pricing in its consultation on E2, the prima facie setting of certain product prices below the fibre cost model (see in particular 80/20 to 155/20 E2 price being set below the 40/10 anchor price) should cause Ofcom to initiate a separate Competition Act investigation into the absolute level of prices proposed in E2.

Ofcom's E2 assessment

⁶ E1 Statement paragraph 3.44.

⁷ E1 Statement paragraph 3.43.

21. Ofcom's position in the E1 Statement on absolute price levels resulting from Openreach discounts appears to confirm that, whilst not a vehicle for general wholesale price level concerns, the 90-days' review process is intended to address specific concerns relating to the specific price levels resulting from an offer under review. In the E1 Statement, Ofcom sets out a rationale for why the specific E1 price levels are not of concern. In doing so it created some useful criteria, thresholds and benchmarks which we believe Ofcom should continue to apply in its E2 analysis and for any future offers.
22. Whilst Ofcom found that it had no concerns about the absolute price levels resulting from E1⁸, E2 clearly does not meet the criteria Ofcom stated in the E1 Statement for why it considered that actual price levels were not of concern.
23. This is because the proposed E2 discounts result in several products being priced below the 40/10 anchor price ceiling. The nominal price reductions of higher speed products are greater than the CPI rate of inflation in October 2022, meaning that there is a real terms reduction in prices for higher speed products. Further, as we set out in a separate submission to Ofcom, the model deployed by Ofcom to estimate the price that an entrant operator would need to charge in order to recover its reasonably efficiently incurred costs⁹ is flawed and unsuitable for that purpose.

E2 discounted price levels

24. Below is a table that compares Openreach's standard FTTP prices with prices resulting from the E1 and E2 discounts¹⁰.

⁸ Which, for clarity we do not agree with.

⁹ Ofcom's Fibre Costing Model (FCM).

¹⁰ Note that these prices do not include the impact of the ARPU-share discount. The potential impact of the ARPU-share discount was significant under E1, but appears to be less so under E2, although the ARPU-share discount impact depends significantly on the blend of products sold by the individual ISP with increasing impact the more high-speed the ISP sells.

Rental product (£/month)	Standard price 1-4-2023	Equinox 1 1-4-2023	Equinox 2 1-4-2023	Reduction E1 - E2
40Mbit/s / 10Mbit/s	16.09	16.09	16.09	0%
55Mbit/s / 10Mbit/s	19.62	16.90	15.50	8%
80Mbit/s / 20Mbit/s	20.19	16.90	15.50	8%
115Mbit/s / 20Mbit/s	20.19	17.65	15.80	10%
160Mbit/s / 30Mbit/s	24.71	18.31	16.20	12%
220Mbit/s / 30Mbit/s	24.86	20.35	17.30	15%
330Mbit/s / 50Mbit/s	28.37	21.48	18.30	15%
550Mbit/s / 75Mbit/s	31.87	22.61	19.20	15%
1000Mbit/s / 115Mbit/s	36.55	24.87	21.30	14%
1200Mbit/s / 120Mbit/s	N/A	N/A	22.30	N/A
1800Mbit/s / 120Mbit/s	N/A	N/A	29.30	N/A
Connection products (£/connection), 40M - 1G speeds	Standard price 1-4-2023	Equinox 1 1-4-2023	Equinox 2 1-4-2023	
New-to-network Area 2	114.78	28.94	28.94	
Migrations (80/20 and above) - Area 2	114.78	114.78	28	
Migrations (80/20 and above) - Area 3	114.78	114.78	78	
All other connections - Area 2	114.78	57.88	57.88	
All other connections - Area 3	114.78	114.78	114.78	

25. As shown in the table above, the discounted prices for products between 80/20 and 155/20 are below the regulated 40/10 price ceiling and the discount rate on products including and above 160 are greater than the rate of inflation. Whilst it is understood that the regulated 40/10 price is a ceiling, not a floor, it is clear from Ofcom's E1 Statement that it would likely consider prices below that level to potentially undermine Ofcom's objective to promote investment in gigabit-capable networks by Openreach and other operators in Area 2.
26. As set out in our separate submission about why Ofcom must perform impact assessment for both Areas 2 and 3, Ofcom should have the same concerns, as those expressed above for Area 2, for Area 3.

Conclusion

27. Having reviewed Ofcom's rationale and design of the OCT provisions in the WFTMR Statement together with Ofcom's implementation of those provision in its E1 Statement, our view is that the specific price levels resulting from an Openreach offer or discount are directly relevant to the impact of such offers or discounts and any assessment of the offer or discount that does not exclude actual price level impact assessment would be incomplete and flawed.
28. In any event, Ofcom should not allow the introduction of any new offer or discount scheme by Openreach until it has satisfied itself that the prices offered are not designed to deter competitive market entry by reasonably efficient network builders and operators.