

The Effect of Equinox 2 on Incentives in Different Geographic Markets

Introduction

- 1) Openreach has notified Ofcom and industry of its intention to introduce new and additional discounts for its ISP wholesale customers (Equinox 2 (E2)), as an overlay on the existing Equinox discount scheme (now known as Equinox 1 (E1)) introduced in October 2021.
- 2) This paper is submitted to Ofcom on behalf of INCA and Zzoomm in advance of Ofcom's public consultation process to assess whether E2, if introduced, would be in breach of restrictions introduced on Openreach's pricing freedom as part of Ofcom's 2021 WFTMR Statement.
- 3) In its assessment of E1 in late summer 2021, Ofcom concluded that it did not have to include any specific analysis of potential impacts of E1 in the Area 3 geographic market as defined by Ofcom in the WFTMR.
- 4) In Ofcom's 30 September 2021 Statement on E1 (**E1 Statement**), Ofcom said:

44. "3.47 We recognise that prohibiting the Equinox Offer discounts in Area 3 (and effectively forcing geographically de-averaged pricing) would lead to higher FTTP prices in Area 3 which could encourage some altnet build. However, in the WFTMR Statement, we did not pursue an approach of setting higher wholesale FTTP prices in Area 3 given our conclusion that material and sustainable competition to Openreach in Area 3 was unlikely. While we were aware of plans for rival network build in some locations in Area 3, the relatively higher build cost per premises and the significant variation in these costs across Area 3 means this is unlikely to occur on a widespread basis. Therefore, the benefits of such a policy are likely to be small, relative to the costs imposed on all consumers in Area 3 who would face higher FTTP prices.[Footnote 55]

Footnote 55: We note the possibility that some alternative networks could decide to de-scope higher cost locations from their build plans in response to the pricing pressures arising from the Equinox Offer. If these locations are not covered by Openreach FTTP, then it is possible these locations may be unable to access FTTP. Given that Openreach's current FTTP rollout plans cover the majority of Area 3 (around 6 million out of a total of around 9 million premises), and since alternative networks are targeting areas where Openreach does not build, we consider the number of premises affected is likely to be relatively small. Further there are programmes in place which provide funding for coverage in high cost areas that are not commercially viable. *see <https://www.ispreview.co.uk/index.php/2021/05/openreach-boost-rural-ftp-broadband-build-to-6m-uk-premises.html> [accessed 28 September 2021]"*

- 5) We submit that Ofcom was wrong in not conducting a separate E1 impact assessment for Area 3 and that Ofcom now must do so for E2.
- 6) In the period since the E1 Statement there has been more network build in Area 3 than Ofcom expected. E2 can, therefore, be expected to have an effect on Area 3. As these areas have been defined as separate relevant markets, on the basis of different competitive conditions, it is important that Ofcom examines the likely impact of E2 in each market it has defined.

Background

- 7) On 18 March 2021 Ofcom published its statement on its review of the wholesale fixed telecoms market (**WFTMR**). In the WFTMR, Ofcom identified 3 distinct geographic markets for wholesale local access with different competitive conditions:
 - a) **Area 1:** has established broadband infrastructure competition
 - b) **Area 2:** has the potential for established material broadband infrastructure competition
 - c) **Area 3:** (in Ofcom's view at the time of WFTMR), has no potential for material and sustainable broadband infrastructure competition.
- 8) On 1 July 2021 BT notified Ofcom of a FTTP pricing offer, Equinox 1 (**E1**).
- 9) Whilst industry members (including INCA) argued that E1 would distort ISPs behaviour by encouraging ISPs to buy from BT in preference to altnets, thereby acting as a barrier and/or deterrence to competitive market entry and expansion by altnets, Ofcom rejected those arguments.
- 10) On 30 September 2021, Ofcom published a statement setting out its assessment of E1 and Ofcom's conclusion that it should take no action in respect of E1 Statement.
- 11) In the E1 Statement, Ofcom (inter alia):
 - a) recognised that build costs would be higher in area 3 than Area 2 (para 3.45, E1 Statement);
 - b) recognised that prohibiting E1 in Area 3 could encourage altnet build (para 3.47, E1 Statement);
 - c) declined to prohibit E1 in Area 3 on the basis that (para 3.47, E1 Statement)
 - i) it would introduce geographically de-averaged pricing, increasing wholesale FTTP prices in Area 3;
 - ii) Ofcom did not believe there was a prospect of widespread build in Area 3, so the benefits of limited altnet market entry in Area 3 would not outweigh the benefits of lower prices in Area 3 delivered by geographically averaged prices;

d) declined to analyse Area 2 and 3 separately in assessing order mix targets as Ofcom did not consider that relevant for assessing whether E1 would potentially create a barrier to using altnets (para 3.65, E1 Statement).

12) On 14 December 2022 BT notified Ofcom and industry of a further FTTP pricing offer, Equinox 2 (**E2**). E2 is yet to be assessed by Ofcom.

13) E2, in contrast to E1, contains a failsafe mechanism (**FM**). In theory, the FM allows ISPs to exclude areas, in which they can place orders with altnets, from fibre only performance measures in E2. However, as discussed at length in our separate paper, there are significant problems with the design and operation of the FM in practice.

Impact of E2 across geographic markets

14) It is important that Ofcom does not simply transpose its conclusion in the E1 Statement, to not conduct a separate E1 impact assessment for Area 3¹, to its E2 assessment. Ofcom's rationale for not presenting an E1 impact assessment for Area 3 (as stated above) were, in our view, insufficient to justify the departure from the standard and internationally recognised process to apply remedies in each defined relevant market based on the specific competition characteristics identified in that market and (consistently) assess compliance with those remedies for each separate market.

15) Ofcom's decision to apply the relevant remedies from the WFTMR in Area 3 was both rational and evidence-based. It would, therefore, be inconsistent for Ofcom to now argue that the possible benefits of wholesale discounts being passed through to end users would outweigh the potential harm from non-compliance with those remedies in Area 3, without any analysis to substantiate that position.

Area 3 market definition and market developments since the WFTMR

16) In the WFTMR Ofcom identified Area 3 as a separate relevant geographic market and published a list of postcode sectors it considered would fall into Area 3. INCA and several altnets submitted to Ofcom that it considered that Ofcom had included in Area 3 many locations for which the Ofcom characterisation of the market does not apply: In order words:

a) many locations within Area 3 are attractive for commercial deployment, and

¹ Which we consider to not be justifiable given that Ofcom had clearly defined separate geographic markets and subsequently applied the relevant SMP remedies in each of those markets.

b) it cannot be presumed that Openreach will be the network builder in areas where only one network is viable or will need public subsidy.

17) The consequence of Ofcom miscategorising locations into Area 3 means that material competitive deployment was always going to happen in parts of Area 3 and evidence is now proving that to be the case.

18) Ofcom has on several occasions stated publicly that Area 3 competitive deployment has exceeded its expectations and Ofcom's records understate FTTP deployment. This was reiterated in recent correspondence with INCA².

19) In conclusion, Ofcom underestimated the degree of altnet build in Area 3 that has taken place since the WFTMR. There has been substantially more build in Area 3 than expected. We submit that E2 is likely to harm competition in Area 3 as well as Area 2.

If Ofcom refuses to consider the effects of E2 in Area 3 then it will understate the level of harm to investment and ultimately to consumer outcomes. To properly address the level of harm Ofcom needs to extend its analysis into Area 3. It cannot simply turn the handle and repeat an impact assessment for Area 2 only in the mistaken belief that E2 will have no effect in Area 3.

² Email to INCA dated 16th December 2022.