

VULA pricing

INCA Submission to the Ofcom TAR 2026-31

July 2024

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1 Executive Summary

- 1 The UK Government, in the SSP,¹ set a strategic priority, to support its full fibre connectivity ambitions, of “stable and long-term regulation that incentivises network investment and ensures fair and effective competition between new and existing network operators”. It also described a fair bet regime whereby firms making large and risky investments would have confidence that any regulation or change in regulation will reflect a fair return on that investment commensurate to the level of risk.
- 2 In the WFTMR², Ofcom implemented charge controls for the VULA 40/10 anchor product with the aims of promoting network competition, incentivising investment from both Altnets and BT, allowing sufficient margins for competing operators, encouraging Openreach to use profits from copper services to invest in fibre and to protect consumers and downstream competition from excessive prices.
- 3 INCA continues to support these objectives and notes that the approach taken in the WFTMR has, by December 2023, allowed combined Altnet deployment of fibre to 12.9 million premises and BT deployment to 12.8 million premises. Although Ofcom believed that material competition was unlikely to develop in Area 3, Altnets have deployed fibre to more than 3 million Area 3 premises.
- 4 INCA notes that, while Openreach has increased the price of the 40/10 anchor product to the maximum allowed, the prices of higher speeds appear to have been constrained by competitive pressure rather than by the price anchor or willingness to pay.

¹ Statement of Strategic Priorities for telecommunications, the management of radio spectrum and postal services, 29 October 2019

² Promoting competition and investment in fibre networks: Wholesale Fixed Telecoms Market Review 2021-26, Statement 18 March 2021

- 5 While Ofcom specified a price cap for the anchor product, it did not implement a minimum price, relying instead on a restriction on geographic pricing and other commercial terms to prevent anti-competitive behaviour.
- 6 During the current charge control period, Ofcom has approved two discount schemes (Equinox 1 and 2) which have enabled Openreach to reduce VULA prices for 55M, 80M and 115M speeds below the 40/10 anchor price, and also below the REO cost projected from the level used as a cross-check in the WFTMR.
- 7 BT has many advantages over its competitors in having established retail and wholesale customer bases, high existing market share, huge profits from deregulated services in markets where it remains dominant, financial strength and a lower cost of capital. These factors mean that BT has both the ability and incentives to engage in pricing tactics which would foreclose Altnet investment in new fibre deployment and harm existing competitors, leading to a continued dominant position for BT and failure to meet Government and Ofcom objectives for network competition.
- 8 INCA therefore believes that Ofcom must develop an ex ante price control in the form of a price floor to be applied to all fibre VULA products at all speeds. This will be a key component in supporting the fair bet principle for Altnets.
- 9 There are a number of economic rationales for the introduction of price floor remedies in telecoms:
 - 1) Prevention of predatory pricing: price floors can prevent dominant operators from temporarily lowering prices to drive competitors out of the market, then raising them again when this is achieved, reducing competition and harming consumers in the long run.
 - 2) Ensuring cost recovery and incentivising infrastructure investment: ensuring that operators can earn a reasonable return on the considerable up-front investments required for telecoms networks and encouraging ongoing investment in maintaining and enhancing networks to improve service quality.

- 3) Promoting fair competition: a price floor can create a level playing field by preventing large, established operators from using their financial strength to engage in anti-competitive practices which new entrants or smaller competitors cannot match; this promotes diversity and innovation in the market.
 - 4) Protecting consumer welfare: In the long run, ensuring fair competition through price floors can lead to better services and innovation, ultimately benefiting consumers; otherwise, short term gains from low prices may be outweighed by long-term harms from reduced competition and higher prices.
 - 5) Maintaining service quality: low prices may force operators to cut costs in ways that degrade service quality, such as reducing investment in infrastructure or ongoing maintenance.
- 10 To ensure that it aligns with Ofcom’s objectives to incentivise and sustain network competition, the price floor should reflect the costs of a Reasonably Efficient Operator (REO) rather than be based on either Openreach prices or costs.
- 11 A new or significantly modified fibre cost model (FCM) will be needed to provide a robust estimate of REO costs; development of this will require significant engagement with Altnets to inform the approach and assumptions.
- 12 Ofcom should maintain the existing ban on geographic pricing; without this, even with a REO price floor, Openreach would be able to target price cuts which would harm competitors in specific regional areas. Targeting the cuts in limited areas would reduce the cost to BT compared to national price cuts which would be harder for BT to justify commercially.
- 13 While Ofcom’s existing anchor approach to setting a price cap does not address any competition issues arising from Openreach’s price reductions, INCA believes that its suggested price floor approach could co-exist with such a price cap to provide a safeguard to protect consumers and ISPs from excessive pricing by Openreach.

14 Given the range and complexity of issues to be addressed in setting the VULA charge controls, INCA believes that Ofcom should carry out an initial consultation on its proposed approach in advance of the main TAR consultation.

2 Introduction

15 In the WFTMR³, Ofcom found that BT had SMP in the WLA market and for the VULA products set a price remedy. This was based Openreach's actual price at the time, projected forward in flat real terms. The price cap was imposed on an anchor FTTC product at the 40/10 speed, with an equivalent cap for 40/10 FTTP but including an additional fibre premium.

16 The same price cap regulation was imposed in Area 2 and Area 3.

17 Ofcom did not impose any minimum price regulation, other than a prohibition on geographic pricing and restrictions on 'other commercial terms'.

18 This submission presents INCA's views on the VULA price remedies that will be needed in the TAR in order to support Ofcom's objectives of encouraging network investment and sustainable competition.

19 The following sections consider Ofcom's regulatory objectives in setting the VULA charges, describe what has happened during the WFTMR period so far, and present INCA's views on how Ofcom should approach setting the VULA charge controls for the TAR.

³ Promoting competition and investment in fibre networks: Wholesale Fixed Telecoms Market Review 2021-26, Statement 18 March 2021 Volume 1 para 2.39, Table 2.3

3 Regulatory objectives

20 The UK Government, in the SSP,⁴ set a strategic priority, to support its full fibre connectivity ambitions, of *“stable and long-term regulation that incentivises network investment and ensures fair and effective competition between new and existing network operators”*.

21 The Government stated that promoting investment should be prioritised over interventions to further reduce retail prices in the near term, and that it expected Ofcom to adopt and engaged, proactive approach to monitoring any anti-competitive behaviour.

22 The Government also set out its view of the fair bet principle, stating that *“an effective ‘fair bet’ regime would be one that allows firms making large and risky investments to have confidence that any regulation will reflect a fair return on investment, commensurate to the level of risk incurred at the time of making the investment decision.”*

23 In the WFTMR⁵, Ofcom stated that its strategy was to “promote investment in gigabit-capable networks through network competition in areas where this is sustainable”, noting that:

- *“Network competition brings potentially significant benefits to consumers, compared to competition based on regulated access to BT’s network and wholesale services”;*
- *“Network competition is a more effective spur for innovation and investment in high quality networks than access-based competition”;* and
- *“Network competition allows market forces to play a much stronger role in shaping decisions about what networks to build, what technologies to use, and*

⁴ Statement of Strategic Priorities for telecommunications, the management of radio spectrum and postal services, 29 October 2019

⁵ WFTMR Decision para 2.20

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.”

24 Ofcom implemented charge controls in the WLA market with the aims of:

- Promoting competition by making it attractive for telecoms providers to build new competing networks, allowing sufficient margins for competing operators and providing a stable and consistent regulatory environment;
- Promoting investment from Openreach, who would have the incentive to invest given the threat from competing networks;
- Encouraging Openreach to use its profits from copper services to invest in new networks; and
- Protecting consumers and downstream competition by providing an upper constraint on wholesale access prices.

25 INCA supports these objectives and believes that they continue to be relevant for the TAR review. We do however believe that Ofcom’s objectives should be reinforced by ensuring that, in line with the SSP, the fair bet principle is explicitly applied to competing operators building networks as well as to BT. The TAR regulations should ensure that these operators are able to make a fair return on their investments, and Ofcom should set out an explicit objective to that effect.

26 INCA notes that, as the incumbent, BT has many advantages over the Altnets including:

- an established retail base;
- an established ISP wholesale base;
- huge profits from deregulated services in markets where it is dominant but does not have SMP;
- lack of equivalence;
- existing large scale and network ubiquity;

- access to finance from self-generated funds; and
- a lower cost of capital.

27 After BT has deployed its fibre network, and during rollout, BT will have the incentives and the ability to engage in anti-competitive behaviour to gain market share. A level playing field is not sufficient to deliver a fair bet for all parties. The inherent advantages enjoyed by BT (as outlined above) must be compensated for by providing advantages to the Altnets via the regulatory framework.

28 It is therefore essential that Ofcom imposes strong ex ante remedies to protect Altnets against anti-competitive behaviour. Full fibre networks are at an early stage of adoption, are all operating at a loss and are extremely vulnerable to anti-competitive tactics from BT. Exclusion of Altnets, without the benefits enjoyed by BT, from viably competitive areas is a real and looming possibility.

29 The barriers to entry and levels of sunk costs for a fibre operator are considerably higher than those of a downstream competitor such as an ISP; any damage to competition caused by anti-competitive behaviour is therefore likely to be much more severe and enduring. Accordingly, the benefits to the dominant operator of successfully harming competition are also strong and enduring, and so the incentive to do so is extremely high. Regulatory actions will therefore need to be much stronger than what might be needed to address, for example, ISP margin squeeze.

30 The best way to achieve this will be through the introduction of a price floor on VULA FTTP products, set at a sufficiently high level to allow efficient Altnets to continue to deploy fibre networks and to achieve acceptable margins through the forthcoming TAR period.

31 This is of crucial importance to the success of the TAR in meeting the Government's and Ofcom's objectives. The risks are high, and failure to protect efficient competitors would result in an entrenched monopoly position by Openreach in many areas, which would then be denied the long-term dynamic efficiencies afforded by a competitive outcome. There would also be an ongoing requirement for stringent regulation in those areas for the foreseeable future.

4 Price controls in the WFTMR

4.1 WFTMR decisions

Price caps

- 32 In the WFTMR, Ofcom implemented a charge control on the FTTC VULA 40/10 product which provided price continuity in real terms (i.e., a CPI-0% annual control starting from the existing 2021 prices). Where a copper 40/10 product was not available, then the FTTP 40/10 product was subject to the same charge control, but with a fibre premium of £1.70 per month intended to reflect the additional benefits of fibre over copper.
- 33 The 40/10 product was intended to provide an anchor, whereby the prices Openreach could charge for higher speeds would be constrained, thereby providing protection for consumers against excessive pricing.
- 34 Although Ofcom applied these same price controls in Area 2 and Area 3, the rationale was different in each case.
- 35 In Area 2, where Ofcom expected material network competition to develop (or already exist), the anchor price was intended to allow sufficient margin for competing operators to build and operate fibre networks as well as to incentivise BT to invest in FTTP.
- 36 In Area 3, where Ofcom did not expect material network competition to develop, the price controls were intended to reflect the costs of a forecast regulated asset base (RAB) covering Openreach's copper and fibre networks. Ofcom analysed this cost base over a 20-year forecast period, taking into account BT's commitment to deploy FTTP to 3.2 million premises by 2026, and concluded that the CPI-0% control applied over 20 years (with an option to move to flat nominal pricing after 2031) would result in recovery of the copper and fibre costs over this period.

37 While the WFTMR price caps were applied only to the period 2021-26, Ofcom expected they would continue to adopt an approach which does not hamper fibre investment until at least 2031 in both Area 2 and Area 3. It was decided that, if a move to cost-based prices was required in future, then Ofcom would ensure that the fair bet principle for operators was taken into account.⁶

REO cross-check

38 Ofcom used the outputs from the fibre cost model (FCM) to perform a cross-check against the 40/10 price control. For the REO scenarios, the FCM estimated a cost range of between £9.53 and £13.67 per month in 2020/21 prices and concluded that the upper end of this range was below the 40/10 VULA FTTP price at that time of around £14.⁷

39 The REO scenarios used in the FCM applied to Area 2 only, and the upper boundary case assumed a REO would roll out to eight million premises with a final take-up of 30%.

Discounts

40 Ofcom acknowledged that Openreach had an incentive to use geographically targeted price reductions to undermine Altnet rollout, and that, while lower prices in competitive areas may reduce Openreach's returns, such a strategy could still benefit Openreach in the longer term as reduced competition resulted in higher market share.

41 Ofcom also stated a preference for ex ante remedies to address anti-competitive behaviour as competition law was not considered to be a sufficiently timely deterrent to prevent Openreach from acting in a way which deterred new network rollout.

⁶ WFTMR Decision: paragraph 1.114

⁷ WFTMR Decision: paragraph 1.38

42 The WFTMR decision prohibited Openreach from using geographic discounts in each of Area 2 and Area 3 but did include a provision whereby Openreach could apply for consent to specific proposals for differential geographic pricing. Ofcom's review under the consent process would consider the objective justification by Openreach for the scheme and whether it was consistent with Ofcom's overarching policy objectives, including the strategy to promote network competition.

43 Regarding other commercial terms, Ofcom decided to impose a process whereby Openreach is required to provide 90 days' notification of commercial terms where the price or other contractual conditions are conditional on the volume and/or range of services. Ofcom will then make a decision on whether or not to allow the scheme, and provided an analytical framework as a starting point for their review:

- the impact on nascent network competitors is unlikely to be material; and
- the arrangements will generate clear and demonstrable benefits, such as being essential to Openreach's business case for fibre roll-out or being necessary to offer more efficient prices that would deliver benefits for consumers.

4.2 Developments since 2021

Openreach financial performance

44 Figure 4-1 below shows the profits and ROCE Openreach has made on FTTP and copper broadband services under the WFTMR so far.⁸ The price controls have allowed Openreach to make a substantial return of over 17% on its legacy copper products, whereas the FTTP products, which are the focus of current investment, made a substantial loss.

⁸ This table is extracted from BT's 2023 Regulatory Financial Commentary accompanying the 2022/23 RFS, and shows adjusted returns to remove the impact of high inflation. This provides a more meaningful view than the RFS itself where the resulting high asset holding gains distort the charges between the PI and WLA markets.

Figure 4-1: Openreach adjusted returns in the WLA market

Product	Return £m	MCE £m	ROCE %	Return £m	MCE £m	ROCE %
	FY23			FY22 Restated		
FTTP	(571)	3,685	(15.5)%	(475)	2,818	(16.9)%
Legacy (Copper/FTTC)	625	3,505	17.8%	624	3,551	17.6%
WLA Total	54	7,190	0.8%	149	6,369	2.3%

45 This trend appears to be in line with Ofcom’s intention in the WFTMR that excess profits in copper services would support BT’s investment in FTTP.

46 This raises the question of whether cross-subsidies such as this may be considered as anti-competitive. Under the Competition Act, “any conduct on the part of one or more undertakings which amounts to the abuse of a dominant position in a market is prohibited if it may affect trade within the United Kingdom.”⁹

47 In a case investigated by Oftel in 2002, Oftel considered cross subsidy as¹⁰:

“...where an undertaking uses revenue from one market to subsidise losses in another market. Where the undertaking uses revenues from a market where it is dominant there may be a breach of the Chapter II prohibition”, and further noted that:

“There are no decisions of the Commission or judgments of the EC courts finding that cross-subsidy is, in itself, an abuse of a dominant position. However, the OFT held in its non-infringement decision under the Competition Act 1998 in the Companies House case of 25 October 2002 **that a cross-subsidy by a dominant undertaking could be abusive without necessarily being predatory.**” (emphasis added), and also stated:

“The source of the financing for the subsidy may not always be the important consideration and the focus may instead be on the subsidised service and the effect on competition. This issue is stressed by the OFT in OFT 4148:

“... cross-subsidy (or any subsidy, however it is financed) may significantly affect competition...”

⁹ Competition Act 1998, Chapter 11 clause (1)

¹⁰ Oftel: Analytical Framework for New Freeserve Case, 14 August 2003, paragraphs 16, 17, 18

48 INCA believes that BT's over-recovery on legacy products gives it the ability to engage in anti-competitive pricing strategies. Whilst over-recovery by BT from legacy products is an inevitable consequence of Ofcom's strategy to encourage Altnet investment, Ofcom must ensure that strong remedies are included in the TAR which prevent any possibility of such anti-competitive behaviour.

Fibre deployment

49 By the end of 2023¹¹, Openreach had deployed full fibre networks to 12.8 million premises, while Altnets had covered a combine total of 12.9 million premises (11.3 – 11.6 million after allowing for overbuild). Over 6.9 million premises are served only by Altnet full fibre.

50 In Area 3 Altnets have deployed fibre to 3 million premises, representing 32% of the Area 3 footprint, while Openreach has deployed to 3.7 million premises (having already achieved and surpassed its commitment of deploying to 3.2 million premises by the end of the WFTMR period).

51 It is therefore clear that Ofcom's assumption that there would be no material competitive deployment in Area 3 was incorrect. Looking forward, PointTopic estimates that Altnet deployment will continue in Area 3, reaching 4.5 million premises (46%) by the end of 2025. Nationally, by the end of 2024, PointTopic estimates that Altnets have plans to cover a further 16.7 million premises.

52 Overall, during the WFTMR period, deployment of fibre by both BT and Altnets has accelerated. Although financial conditions and access to funds have recently become tighter, material Altnet deployment is expected to continue.

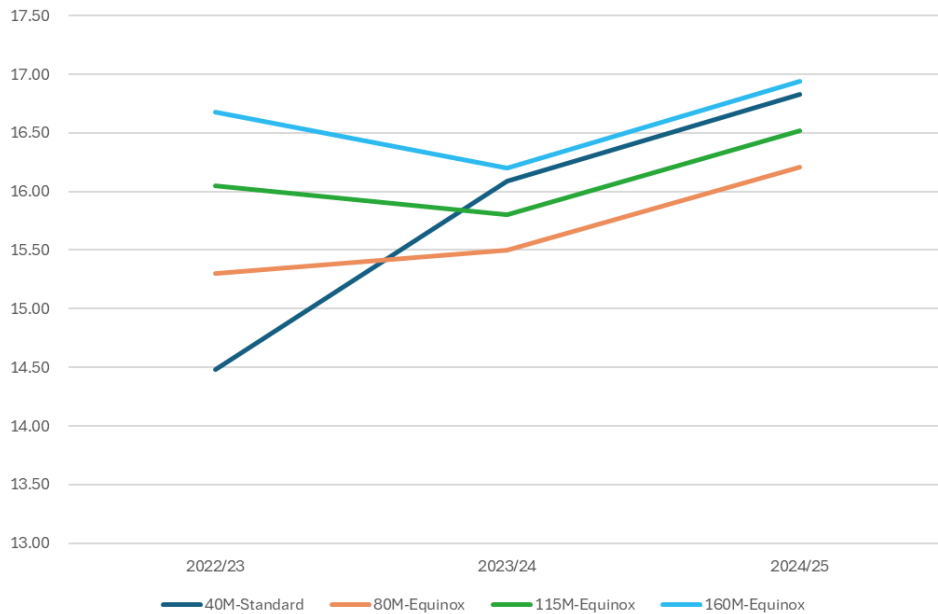
Pricing trends

53 Since the WFTMR, Openreach has launched two discount offers (Equinox 1 and 2) which have resulted in reduced prices for FTTP rental products at speeds above the 40/10 anchor product.

¹¹ Point Topic report for Altnets – Metrics for the UK independent network sector, results from Spring 2024 survey

54 Figure 4-2 below shows the price changes for some of the products at lower speeds.

Figure 4-2: Openreach FTTP prices¹²



55 While the price for the 40/10 anchor product has increased in line with the CPI-0% charge control (and the Equinox schemes did not offer a discount on this speed), under Equinox the higher speeds have substantial discounts from the standard prices, to the extent that the 80M and 115M products are priced below the anchor.

56 In its decision on BT's Equinox 1 offer, Ofcom dismissed claims that the scheme was anti-competitive by arguing that none of the discounted prices were below the anchor price.¹³ Ofcom then changed its criteria in its decision on Equinox 2, where it compared BT's average price for 2023/24 to the upper REO range of £15.93.¹⁴

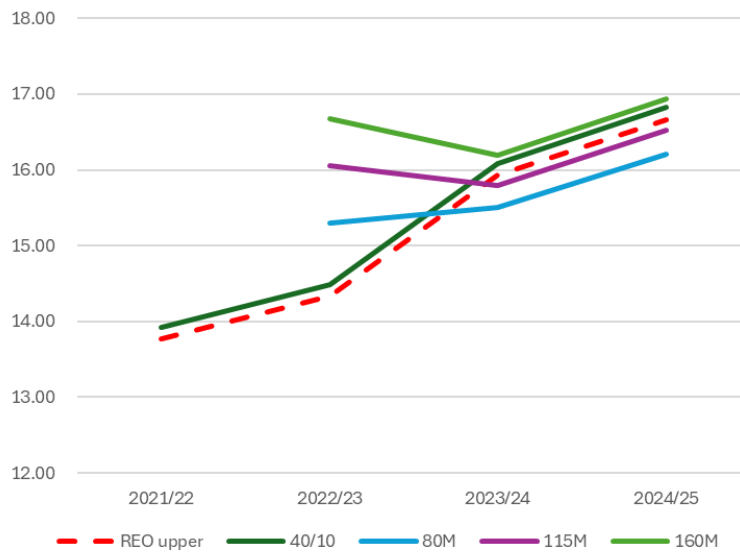
57 In fact, the prices for the 80M and 115M products had fallen below this REO level by 2023/24 and this has continued into 2024/25, as illustrated in Figure 4-3 below.

¹² This analysis excludes the impact of the additional revenue-share discount.

¹³ Ofcom Statement: Openreach Proposed FTTP Offer starting 1 October 2021, paragraph 3.44

¹⁴ Ofcom Statement: Openreach proposed FTTP offer starting 1 April 2023, paragraph 4.40

Figure 4-3: Equinox prices vs REO upper range



58 Under Equinox 2, rental prices of speeds below 160M are scheduled to increase by the same increments as the anchor product (CPI), and so the price differentials compared to the anchor are likely to endure for the duration of Equinox 2. Speeds of 160M and higher are indexed at CPI-1.25%, which suggests that over time these prices will fall relative to the anchor.

5 Issues to be addressed by the TAR

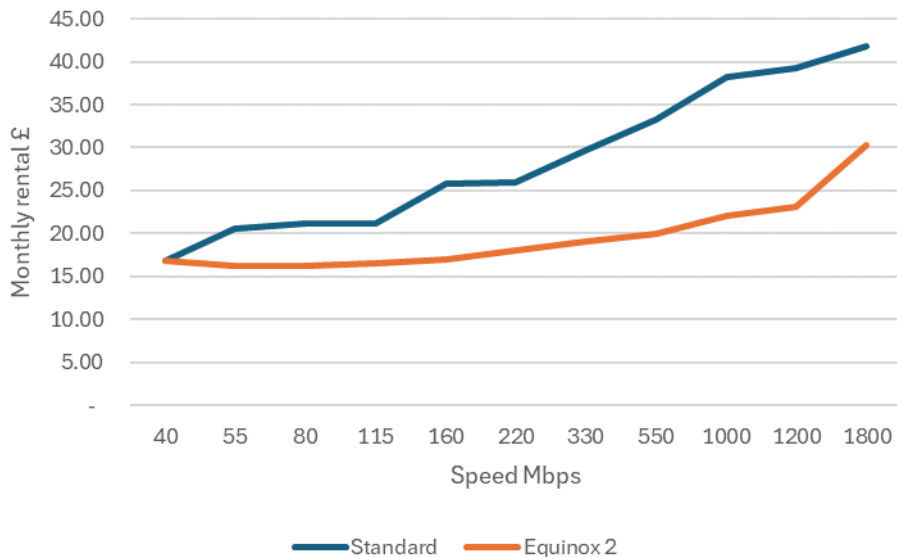
5.1 Anchor pricing

59 In the context of the VULA charge controls, anchor pricing was intended to provide a constraint on the maximum amount Openreach can charge for products with speeds higher than that of the anchor product, based on the limit to consumers' willingness to pay for such extra functionality.

60 In practice, over the first two years of the WFTMR charge control, Openreach has increased the standard rental prices of each of its FTTP speeds by the proportion allowed under the CPI-0% formula, which amounts to 16% in nominal terms, meaning that the price-speed gradient has remained the same for the standard

prices. However, the two Equinix discount schemes have resulted in a considerable flattening of the gradient, with higher speeds generally receiving bigger percentage discounts from the standard prices. This is shown in Figure 5-1 below.

Figure 5-1: Openreach standard and Equinox 2 rental prices from 1 April 2024



61 This suggests that Openreach has prioritised the migration of customers from copper to fibre, and from lower speeds to higher speeds, rather than simply maximising profit in the short term by sticking to the standard price gradient. This approach is also likely to incentivise ISPs to remain with the Openreach network rather than switch to competing Altnets. It is unlikely that Openreach would have felt the need to adopt this approach had it not faced Altnet competition.

62 It seems that the competitive threat from Altnets has been the main factor in constraining Openreach's VULA prices, rather than the price ceiling specified for the anchor product. It would be entirely rational for Openreach to adopt pricing strategies which, in the short to medium term, cause reduced Altnet margins and investment incentives, followed by price rises at a later date once Openreach's dominant position is reinforced. The maximum price cap on the anchor product does nothing at all to address this issue; the threat to the development of sustained competition is from price reductions rather than price increases.

63 While INCA understands that, Ofcom may wish to retain the anchor pricing approach to define a safeguard price ceiling to ensure that consumers are protected, and to provide continuity with the WFTMR. In this case it will be important to consider the choice of anchor product speed; this is discussed in Section 5.3 below. However, INCA believes that in the TAR Ofcom may wish to consider whether an Economic Replicability Test (ERT), which constrains wholesale prices by regulating the retail margin may be a more appropriate measure.

64 Regardless of the method Ofcom decides to use to constrain maximum prices, in order to maintain investment incentives and ensure ongoing network competition, it is essential that Altnets and their investors have confidence that Openreach is not able to price below the level at which this is sustainable for the Altnets. This requires a clear and stable definition of a minimum price.

65 During its review of Equinox 1¹⁵, Ofcom applied a criterion that the minimum discounted price should remain above the anchor price, whereas in Equinox 2¹⁶ a looser standard was applied, whereby the average Openreach price across all speeds was above the REO range despite some products going below this level. This latter average price was confidential and therefore not available to stakeholders.

66 Such moving goalposts and lack of transparency do not provide confidence that Ofcom's consent process for other commercial terms is sufficient to prevent anti-competitive pricing by Openreach.

5.2 Price floor

67 During the WFTMR consultation, Ofcom considered the adoption of “adaptive regulation”¹⁷ whereby Openreach's prices would be subject to a cost-based charge control in the absence of competition but would be forced to increase to a price floor based on REO costs once an Altnet had deployed network in a given area. This

¹⁵ Ofcom: Openreach Proposed FTTP Offer starting 1 October 2021, Statement, 30 September 2021, paragraph 3.44

¹⁶ Ofcom: Openreach proposed FTTP offer starting 1 April 2023 (Equinox 2), Statement, 24 May 2023, paragraph 4.2

¹⁷ WFTMR Decision paras 1.69-1.75

option was dismissed, in part because Ofcom believed that the initial cost-based prices would deter Altnet investment from the outset.

68 INCA agrees with Ofcom that an adaptive approach would not be effective in maintaining investment incentives. Ofcom did not, however, consider a more conventional approach to price floors whereby a minimum price is set for all areas with current or prospective competition.

Rationale for a price floor

69 There are a number of economic rationales for the introduction of price floor remedies in telecoms:^{18 19 20 21 22 23}

- 1) Prevention of predatory pricing: price floors can prevent dominant operators from temporarily lowering prices to drive competitors out of the market, then raising them again when this is achieved, reducing competition and harming consumers in the long run.
- 2) Ensuring cost recovery and incentivising infrastructure investment: ensuring that operators can earn a reasonable return on the considerable up-front investments required for telecoms networks and encouraging ongoing investment in maintaining and enhancing networks to improve service quality. This is particularly important in markets which are in a start-up phase and making losses, where the already fragile new entrants are particularly vulnerable to a double -whammy from anti-competitive practices by the incumbent.
- 3) Promoting fair competition: a price floor can create a level playing field by preventing large, established operators from using their financial strength to engage in anti-

¹⁸ "Price regulation and incentives", David Sappington, December 2000

¹⁹ Viscusi, W. Kip, Joseph E. Harrington, Jr., John M. Vernon. "Economics of Regulation and Antitrust." MIT Press, 2005

²⁰ Vogelsang, Ingo. "Incentive Regulation and Competition in Public Utility Markets." Journal of Regulatory Economics, 2002

²¹ Armstrong, Mark, and David E. M. Sappington. "Recent Developments in the Theory of Regulation." Handbook of Industrial Organization, Vol. 3, 2007

²² Church, Jeffrey, and Roger Ware. "Industrial Organization: A Strategic Approach." McGraw-Hill, 2000

²³ Laffont, Jean-Jacques, and Jean Tirole. "Competition in Telecommunications." MIT Press, 2000

competitive practices which new entrants or smaller competitors cannot match; this promotes diversity and innovation in the market.

- 4) Protecting consumer welfare: In the long run, ensuring fair competition through price floors can lead to better services and innovation, ultimately benefiting consumers; otherwise, short term gains from low prices may be outweighed by long-term harms from reduced competition and higher prices.
- 5) Maintaining service quality: low prices may force operators to cut costs in ways that degrade service quality, such as reducing investment in infrastructure or ongoing maintenance.

70 In order to allow pricing flexibility while preventing excessive prices and safeguarding competition, the EU²⁴ specified the Economic Replicability Test (ERT) as one of a suite of non-discrimination obligations in SMP markets. This specifies a minimum margin that must be maintained between retail and wholesale prices, and so, with retail prices constrained by competition, it effectively provides a cap on the related wholesale prices.

71 While such an ERT does not provide a lower constraint on wholesale prices, it is possible to take a similar approach by regulating the margins between wholesale products at different layers, for example between either passive infrastructure or dark fibre and active VULA products. This is generally known as a wholesale margin squeeze test (MST) or a wholesale replicability test.

72 The effect of a wholesale MST amounts to a price floor on the active products, where the price of the upstream wholesale products (eg, passive infrastructure) is fixed. Such an approaches have been used by telecoms regulators in a number of countries:

²⁴ "COMMISSION RECOMMENDATION of 11 September 2013 on consistent non-discrimination obligations and costing methodologies to promote competition and enhance the broadband investment environment" (2013/466/EU)

- Ireland: Comreg²⁵ imposed a wholesale margin squeeze test (MST) between the FTTH VULA bitstream products in order to encourage investment. This is intended to allow other access seekers to invest with confidence in their own core network facilities and use the VULA product without fear that they would be undercut by the bitstream prices.
- France: ARCEP²⁶ currently applies a wholesale MST on high quality FTTH access for business customers; this defines the margin between passive access offered by the SMP operator and the wholesale active offers.
- Czechia: the NRA²⁷ applies a wholesale MST, described as an “economic space test”, which aims to ensure an appropriate margin between the wholesale broadband access price and the bitstream price.
- Italy: AGCom²⁸ has proposed a replicability wholesale test in order to prevent any anticompetitive behaviours in terms of prices/margin squeeze at the wholesale level, ensuring competitiveness on the market and encouraging wholesale migration from the legacy copper network to the fibre network.

73 INCA believes that a price floor will be an essential part of the TAR price controls as it is the only way Ofcom can ensure that Openreach is not able to adopt pricing strategies which deter network competitors from deploying FTTP networks into new areas nor, in existing deployments, damage the ability of Altnets to attract sufficient customers to ensure long-term viability.

74 A report produced for the European Commission in 2021²⁹ following a consultation on the latest access recommendations noted that some respondents considered that “price floors may be justified to avoid the risk of predatory or discriminatory pricing

²⁵ Pricing of wholesale broadband services - Wholesale Local Access (WLA) market and the Wholesale Central Access (WCA) markets - Response to Consultation Document 17/26 and Final Decision, 19 November 2018

²⁶ ARCEP, Decision no 2020-1448 of 15 December 2020

²⁷ ČTÚ Decision REM/3a/05.2018-03 of 15 May 2018

²⁸ Del. 348/10/CONS

²⁹ Study on Regulatory Incentives for the Deployment of Very High Capacity Networks in the Context of the Revision of the Commission’s Access Recommendations, 2021

which could affect infrastructure rivals³⁰ and that “price floors are an underused regulatory tool despite their usefulness to promote infrastructure competition”.³¹

75 The report also notes that where a prohibition on geographic discounts proves to be insufficient to address a specific problem, an outright price floor on wholesale access services could be considered³²; although it is then suggested that this will likely only apply in extreme circumstances, the report cites Ofcom’s approach in banning geographic discounts to support this view. We suggest that, in the light of Openreach’s extreme price reductions under Equinox which have occurred since the report was produced in 2021, despite the ban on geographic discounts, the case for a price floor is now much stronger.

76 While the prohibition on geographic pricing in the WFTMR has not been sufficient to constrain Openreach from pricing below REO costs, INCA believes it is important that this prohibition is maintained in the TAR. If not, there is a high risk that BT would be able to target price cuts in specific regional areas where competition is present or expected; even if such prices remained above the average REO price floor, costs may be materially higher than the average in some competitive areas. Altnets do not have as wide a geographic spread as BT and may therefore be vulnerable to such tactics.

Setting the price floor level

77 Given the purpose of the price floor would be to ensure the viability of efficient, sustainable network competition, it is essential that the floor level is determined by reference to REO costs, not Openreach’s costs. The fibre cost model (FCM) developed for the WFTMR, was used as a cross-check against the starting prices for the charge control. The FCM was designed using Openreach’s network as a starting

³⁰ Oxera

³¹ Eurofiber

³² Study on Regulatory Incentives for the Deployment of Very High Capacity Networks in the Context of the Revision of the Commission’s Access Recommendations, 2021, page 276

point, with adjustments made to a limited set of assumptions to estimate some REO scenarios.

78 For the TAR, in setting the price floor, a more robust approach will be needed in the FCM (whether developed as a new model or adapted from the WFTMR version). As part of its TAR submissions, INCA has provided two papers which describe the approach that should be taken to the structure and input assumptions for the TAR FCM.^{33 34} The key areas to be addressed are:

- Scope of model to address the full economic replicability costs of an Altnet providing FTTP connectivity in competition to BT;
- Level and timing of operating costs should reflect realistic REO assumptions;
- Realistic asset lives and replacement capex should be included;
- REO scenarios should reflect the range of services offered, network scale and topology, take-up levels, market segments, geographic footprints and degrees of overbuild; and
- Network design should reflect current and developing technologies deployed in a modern network architecture providing resilience, flexibility and capacity to meet uncertain levels of future demand.

79 INCA notes that the WFTMR FCM included a mix of new build and duct and pole re-use in its cost stack, using PIA prices as an input. INCA supports this approach, but it is essential that the assumptions driving the proportions of PIA are grounded in the reality of Altnet usage.

80 At the time of the WFTMR consultation, Altnet deployment was at a relatively early stage, but is now sufficiently advanced to allow Ofcom to obtain much more comprehensive data to ensure that the FCM provides a realistic and robust view of REO costs.

³³ Structure of Fibre Cost Model. INCA submission for Ofcom TAR 2026-31, June 2024

³⁴ Assumptions for Fibre Cost Model, INCA submission for Ofcom TAR 2026-31, June 2024

81 INCA anticipates that Ofcom will wish to model REO scenarios which represent the costs of Altnets of sufficient scale and footprint to be viable in the long term. A process of consolidation is under way in the Altnet sector, but it will be important to take account of the short and medium term viability of smaller Altnets prior to consolidation.

82 There is a risk that, if the price floor were set too low such that it reflected only the long-run costs of larger operators post consolidation, then BT could foreclose the market in some areas in the shorter term, harming network competition to the benefit of Openreach market share in the long run.

Scope of price floor

83 As described in Section 4.2, competitive fibre deployment has occurred widely across Areas 2 and 3, and this is set to continue. Whereas the REO cross-check performed for the WFTMR was restricted to Area 2, in line with Ofcom's understanding that there would be no material competitive deployment in Area 3, it is essential that, for the TAR, the REO analysis should cover all areas of actual or prospective competitive deployment.

84 Setting an ex ante minimum price level across all of these areas, including those which are currently served only by Altnets, is vitally important in maintaining incentives for Altnets to invest in new areas (both to encourage competition in those areas which currently have only Openreach fibre and to protect Altnets in existing areas from foreclosure by BT). It is also important in allowing Altnets a fair bet return on their existing investments.

85 To be effective, it is essential that the price floor applies to all VULA speeds, regardless of Ofcom's decision on the anchor speed to be used for setting the price cap. If a floor price were set for only a lower-speed product, this could be easily circumvented by Openreach reducing the price of one or more higher speeds below the anchor, as indeed has happened with Equinox 2.

86 INCA understands that Openreach will have many legitimate reasons for adjusting the price-speed gradient, such as to encourage migration from legacy copper services or from lower to higher fibre speeds; we do not believe that setting a price floor at REO costs would remove freedom for Openreach to set prices to achieve these aims.

5.3 Definition of charge control

Price ceiling

87 Ofcom will wish to consider demand (willingness to pay for different speeds) in determining the appropriate speed of the anchor for the TAR period, but it is important to find the right balance between the effectiveness of the anchor as a price constraint on higher speeds and providing sufficient price flexibility.

88 Willingness to pay for higher speeds is likely to be limited by bandwidth bottlenecks such as home wifi speeds, as well as the impact of advances in compression technologies which allow greater performance over lower speeds.

89 If the speed for the anchor product is set too high, then pricing freedom is restricted; it is important that competitive forces and market dynamics are able to determine the optimum pricing at higher speeds, encouraging dynamic efficiency which will lead to the best consumer outcomes in the longer term. Such issues were considered in a report for Chorus in New Zealand in 2017,³⁵ which proposed an anchor speed of 30M, with a strong preference against 100M.

90 INCA therefore believes that any increase in the anchor speed from the 40/10 product must be considered with caution by Ofcom and that, in the light of Ofcom's desire that the TAR review should provide continuity with the prior period, such an increase should be made only to an adjacent product speed rather than providing a sudden discontinuity.

³⁵ "Ensuring that anchor product regulation is effective; or how to avoid a regulatory Chimera", Brian Williamson, 2017

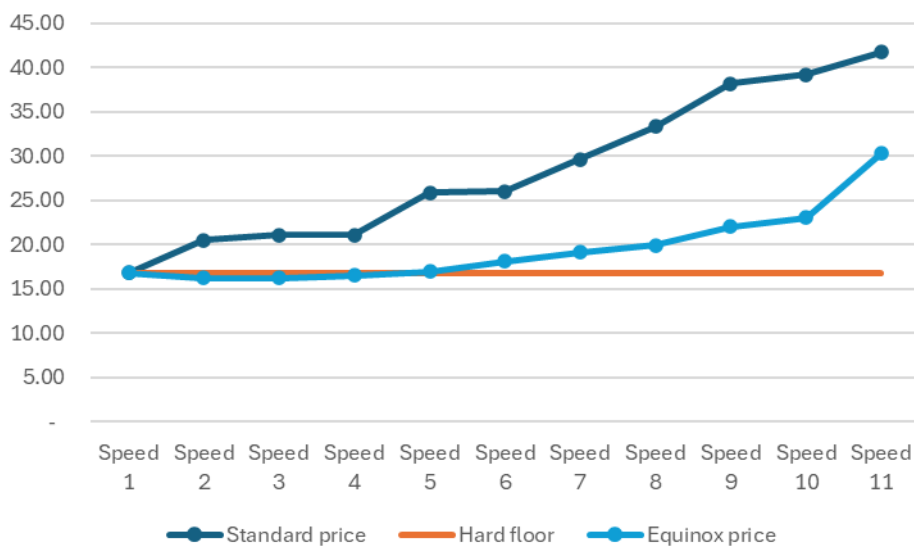
Price floor

91 The definition of a price floor control involves a balance between first ensuring adequate flexibility to allow pricing strategies which aim to stimulate demand, migration from legacy services and migration to higher value services, and second, providing sufficient safeguards against the potential for predatory pricing with the aim of excluding efficient network competitors.

92 As discussed in paragraphs 26 to 31 above INCA believes that, given the enormous incentive BT has to engage in such exclusionary practices as well as its disproportionate financial muscle compared to Altnets, a hard price floor for all VULA speeds is needed, set at the level of REO costs.

93 The form of such a price control, in the context of the current price gradients, is illustrated in Figure 5-2 below.

Figure 5-2: Illustration of hard price floor at REO costs



94 INCA recognises that, depending both on the price level which is determined by Ofcom's modelling of REO costs for the TAR, and the changes in Openreach prices for the remainder of the current charge control, the price floor may turn out to be higher than some of the prices currently set by Openreach under the Equinox scheme. In this case it may be necessary to impose an upwards starting adjustment to the TAR price control.

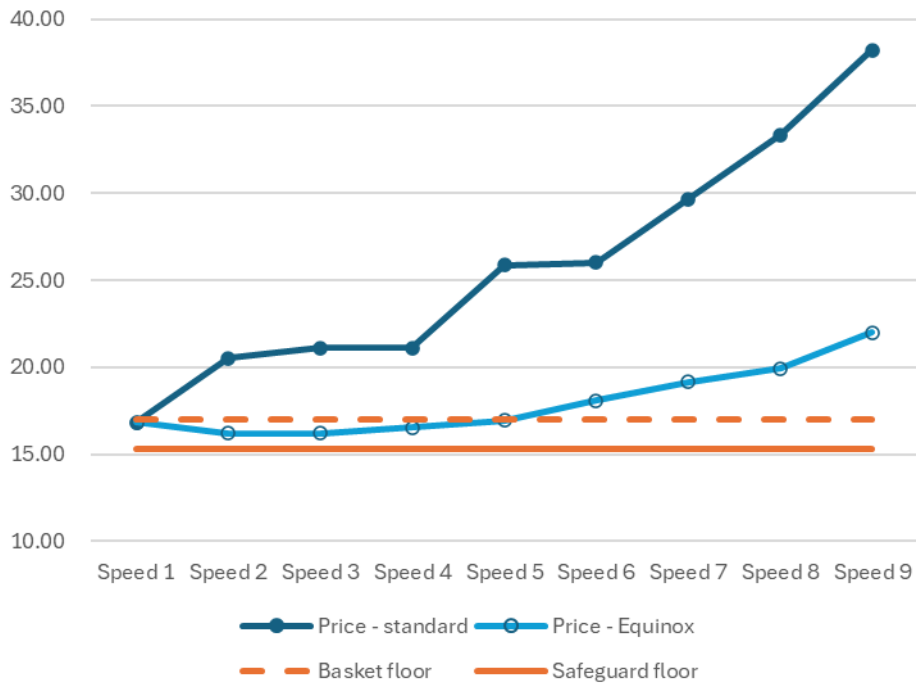
95 As an alternative, Ofcom may wish to consider a price floor applied to a basket reflecting the weighted average price across all VULA speeds. Under this approach, BT would report and demonstrate compliance annually, as it currently does with the price cap charge controls for the anchor product. INCA believes that such an approach carries significant risk that BT could, while complying with the control, nonetheless still engage in exclusionary pricing by strongly reducing the price of one or more key products while maintaining the average basket level above the floor.

96 It has been suggested that such an approach may be expected to result in migration of volumes to the reduced-price products, thereby limiting the level and/or duration of the discount, and ensuring that competitors remain protected by the aggregate test.³⁶ However it seems likely that this could take some time to occur; meanwhile customers and ISPs would be strongly incentivised by the price reduction to migrate to the BT network.

97 INCA therefore believes it is essential that, if Ofcom opts for a basket approach to defining the price floor, it should also consider defining a hard floor beneath the basket floor, which would define a minimum price for any of the VULA rental products. The margin between the basket floor and the hard floor should be minimised to limit Openreach's ability to deter competition. Figure 5-3 below illustrates this approach.

³⁶ The law and economics of price floors in regulated industries, Dennis L. Weisman, 2002

Figure 5-3: Basket price floor with safeguard floor



5.4 Consultation

98 There are many issues to be addressed in the setting of the VULA charge controls in the TAR which will require inputs from all stakeholders including Altnets. As well as the definition and structure for anchor pricing and a price floor, the modelling required to determine the REO cost base will be a critical component.

99 INCA therefore believes it would be appropriate for Ofcom to carry out an initial consultation to cover its proposed approach to setting the VULA charge controls in advance of the main TAR consultation.