

Openreach's Equinox 2

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A risk of re-opening old wounds

Openreach's Equinox 2: A risk of re-opening old wounds?

On the 14th of December 2022, Openreach unveiled its latest round of wholesale price discounts (known as "**Equinox 2**") for its wholesale fibre-to-the-premises (FTTP) broadband products. SMP Condition 8.6 of the Wholesale Fixed Telecoms Market Review requires Openreach to provide OFCOM with 90 days' notice of changes to its prices or other contractual conditions on which it provides network access where the change is conditional on the volume and/or range of services purchased.

On the 3rd of February 2023, OFCOM published its provisional conclusion that the Equinox 2 offer would not have a material adverse impact on competition, and that therefore OFCOM should take no action to prevent Equinox 2 from being introduced. OFCOM also announced a further consultation period following the release of its provisional conclusion, to close on the 4th of March 2023, after which OFCOM will publish its final decision by the end of March 2023. If OFCOM's conclusion remains the same, then the Equinox 2 offer will take effect from the 1st of April 2023.

The Equinox 2 Offer

Openreach's Equinox 2 offer is an optional supplemental agreement to Equinox 1 that introduces new rental and connection discounts and certain new terms and conditions. Openreach's stated intention is to provide additional commercial incentives to Communications Providers ("**CPs**") in order to encourage and accelerate the adoption of its FTTP products through the migration of customers on legacy products to the FTTP products.

Openreach has been keen to highlight that there are no volume targets or exclusivity requirements within the Equinox offer(s) for orders placed or retained on Openreach FTTP. Any such requirements would undoubtedly draw greater scrutiny from OFCOM, which has expressed concerns that Openreach could use such mechanisms to tie-in market demand and reduce competition from altnets. Particularly where OFCOM has also previously acknowledged that there is a "*relatively small window of opportunity to encourage new network build*". Openreach's stance is also not surprising given the level of attention received by Openreach's Equinox 1 offer made in July 2021, which took effect on 1st October 2021.

The Equinox 1 Offer

Equinox 1 was Openreach's initial offer to CPs which provided discounts on wholesale access to its network intended to incentivise the adoption of FTTP products over Openreach's copper-based (legacy) products. The discounts offered to CPs are based on "Order Mix Targets" ("**OMTs**") which are calculated by reference to the proportion of new FTTP orders placed by a CP with Openreach when compared to the total number of new FTTP and legacy orders (in areas where the FTTP product was an option) placed by the CP with Openreach. CPs are entitled to various discounts on connection charges and rental discounts if certain thresholds for the proportion of new FTTP orders are met.

OFCOM's consultation ("Consultation") and its 'Call for Inputs' on the Equinox 1 offer received heavy scrutiny from various alternative network providers ("**altnets**") that shared concerns that the Equinox offer would lead to consumer harm through the reduction in competitive fibre infrastructure investment and deployment as a result of the loyalty-inducing effects of the Equinox offer. In short, many altnets were concerned that the Equinox 1 offer had the potential to deter CPs from placing orders for FTTP products with altnets because of the risk that this would have an impact on the CPs ability to meet its OMTs with Openreach.

As part of OFCOM's Wholesale Fixed Telecom Market Review, OFCOM gave an indication of the way it would propose to approach an offer notified pursuant to SMP Condition 8.6. In its consultation statement ("**Statement**"), OFCOM summarised this approach as three questions:

1. Does the Equinox Offer potentially create a barrier to using Altnets?
2. Is the Equinox Offer likely or unlikely to have a material impact on nascent network competition?
3. Is the Equinox Offer likely to generate clear and demonstrable benefits?

OFCOM concluded that the answer to question one was no, and thus it was not necessary to further consider questions two and three. OFCOM's conclusions were summarised in paragraph 3.78 of its Statement. OFCOM considered that the strategies adopted by CPs (and the anticipated "stop sell" regime which would permit Openreach stop selling legacy products where FTTP adoption hit the requisite threshold in a geographic area) meant that the Equinox

offer did not cause any concern in the medium term. OFCOM accepted that in the short term, some CPs may struggle to hit the targets in the first 12-24 months due to technical constraints (and therefore could be deterred from moving volumes from Openreach to altnets if doing so jeopardised meeting these targets). However, OFCOM considered that due to the limited overlap of the Openreach FTTP footprint by altnets in the next 21-24 months, placing orders with altnets was likely to have very little effect on a CPs mix of new Openreach orders across the whole Openreach FTTP footprint. CPs would therefore not be deterred from doing so, even in the short term.

CityFibre's Appeal to the Competition Appeal Tribunal

One of the key aspects of CityFibre's appeal to the Competition Appeal Tribunal ("**Tribunal**") concerned OFCOM's "Overlap Conclusion", as noted above, being that "*in the next 12-24 months the overlap of altnets within the Openreach FTTP footprint is likely to be limited*". CityFibre submitted that the Overlap Conclusion required proper investigation and consultation and that OFCOM should have asked CityFibre and other altnets to provide evidence relevant to this assertion where it is clear that OFCOM has relied on it in reaching its overall conclusion.

The Tribunal considered that "*given the significance of the Overlap Conclusion, we find it surprising that OFCOM did not ask CityFibre if it had information about its short term network build plans and the anticipated overlap with Openreach*". Ultimately, the Tribunal considered that it was not necessary for OFCOM to establish some form of re-consultation, after its initial Consultation and prior to the publication of its Statement, in order to test OFCOM's evolving thinking and that failing to do so fell short of establishing unfairness to CityFibre. The Tribunal also considered that the Overlap Conclusion was "*one part of a patchwork of reasoning in relation to a number of variables*" which resulted in OFCOM's conclusions – more on this below.

Equinox 2 – Failsafe Mechanism

CityFibre's appeal to the Tribunal sought to demonstrate that the process and basis on which OFCOM reached its conclusions was not sufficiently robust and did not take into consideration relevant evidence of CityFibre and other altnets, particularly in relation to the Overlap Conclusion. If CityFibre had been successful in its appeal, we might have expected some further consultation period in which OFCOM would be required to reconsider the merits of its assessment following further enquiry and information gathering.

In some ways, the Equinox 2 offer could be seen to present an opportunity to CityFibre and other altnets to once again express their concerns about the implications of Openreach's discounts. It is clear that Openreach themselves may have seen this as a potential risk. In addition to the pricing discounts offered, a key aspect of Equinox 2 is the introduction of a so-called Equinox "Failsafe Mechanism" which Openreach state has been introduced to "*remove any theoretical risk of CPs being dis-incentivised from placing orders with alternative network providers (altnets)*" as a result of the Equinox 2 offer. The Failsafe Mechanism is designed to allow a CP to define an "Overbuild Area" where it is able to place orders with an alternative network supplier. Any orders placed with Openreach in this area (on copper or fibre) would be excluded from the calculations for the purposes of the CPs OMTs.

The operation of the Failsafe Mechanism requires CPs to submit evidence in confidence to an independent third party appointed to process claims made by CPs to adjust the CPs performance against the OMTs by excluding calculations based on orders placed within the "Overbuild Area" submitted to the independent third party. Where the third party confirms addresses within the Overbuild Area, it will recalculate the CPs performance against the OMTs and provide this calculation to Openreach for the purpose of applying the discount. Although the use of a third party prevents Openreach from obtaining key information on the precise areas in which its competitors are working with Openreach's customers, altnets have still raised concerns about their CPs sharing information with an independent third party for the purposes of the CPs obtaining discounts from the altnets' main competitor.

Equinox 2 – Altnet Concerns and OFCOM's Provisional Conclusion

After considering comments from Openreach and participating altnets, OFCOM announced on the 3rd of February 2023 that it had reached a provisional conclusion that Equinox 2 would not have a material adverse impact on competition, and should therefore be allowed to proceed.

The concerns raised by the altnets again focussed heavily on the impact of the OMTs, which they argued would incentivise CPs to place FTTP orders with Openreach rather than altnets in Overbuild Areas, and therefore created a barrier to altnet entry and expansion. A number of altnets were also critical of the Failsafe Mechanism, which they argued would not alleviate their concerns because:

- reliance on the mechanism by CPs would be unworkable in practice, due to the number of steps involved and the complexities in identifying an Overbuild Area;
- the third party responsible for assessing CP claims under the Failsafe Mechanism would be appointed and funded by Openreach, and therefore could not be truly independent;
- A CP's eligibility for discounts would only be determined at the end of the assessment, therefore leaving the CP with less working capital while the assessment was ongoing; and
- Openreach would be entitled to remove or modify the Failsafe Mechanism where the number of legacy product orders placed by the CP in an Overbuild Area is more than 50% greater than in the rest of the Openreach FTTP footprint (the "**Legacy Cross-Check**" mechanism).

In response to the altnet's concerns, OFCOM did acknowledge that the discounts under Equinox 2 if the OMTs are met would be substantial, and that in theory this could deter some CPs from moving FTTP orders from Openreach to the altnets, if this would jeopardise the CP's ability to meet the OMTs.

However, OFCOM noted that the risk of a CP falling below the OMTs would depend partly on the extent of any overlap between the altnet and Openreach FTTP

network. In what was largely a re-hashing of its Overlap Conclusion from the Equinox 1 Statement, OFCOM surmised that most large CPs would not be at risk of falling below the OMTs if they shifted FTTP orders to the altnets in the Overbuild Areas, based on OFCOM's current projections for the level of network overlap between Openreach and the altnets in the years immediately following the Equinox 2 effective date (which it estimated at 15% in the first year, and 25% in two to three years).

In those cases where a CP might be at risk of falling below the OMTs, OFCOM's view was that the Failsafe Mechanism would be a workable solution for CP's to mitigate that risk. While OFCOM acknowledged there was some complexity to the Failsafe Mechanism, it was not convinced that larger CPs would find the process unmanageable, and found that the requirements were similar to those already contained in other Openreach discount contracts. OFCOM also gave short shrift to the altnet's concerns around the independence of the third party assessor, by noting that there was a contractual requirement for the assessor to act in an independent, fair, and reasonable manner (although we expect the altnet's to challenge whether this contractual requirement translates into practice, and is perceived by CPs as being effective). On the Legacy Cross-Check mechanism, OFCOM's assessment was that none of the large CPs were at risk of exceeding the 50% threshold due to natural variation in the sales of legacy services within the Openreach FTTP footprint, and that therefore this was a non-factor.

Briefly, some of the other arguments raised by the altnets that were rejected by OFCOM were:

- The Failsafe Mechanism would not apply to scenarios where Openreach deploys FTTP to an area before an altnet, where CPs may be less willing to migrate customers already on Openreach FTTP to an altnet due to the cost and inconvenience in doing so. OFCOM's view was that this was an inherent advantage of being first to deploy in an area, and was not specific to Equinox 2;
- The stricter forecasting requirements under Equinox 2 would create a barrier to entry for altnets. A similar argument had been raised in response to Equinox 1 and, for largely the same reasons, was rejected by OFCOM again.
- The discounted pricing under Equinox 2 was itself a barrier to entry for altnets. OFCOM noted that the 90 day notification requirement applied only to commercial terms where the price was conditional on the volume or range of services purchased, and was not intended to address general concerns about low wholesale prices. Nevertheless, even

taking into account the discounted pricing, OFCOM did not consider Openreach's discounted FTTP pricing was at such a level so as to prevent material and sustainable competition from emerging.

- Equinox 2 formed part of a practice of repeatedly amending FTTP pricing so as to create uncertainty for CPs, and therefore deter them from committing meaningful volumes to altnets. Again, OFCOM responded that the 90 day notification requirement was not intended to address general concerns about Openreach's prices and related behaviours.

How might the altnet's respond?

We expect the altnets will continue to press OFCOM to reconsider its Overlap Conclusion, by highlighting potential deficiencies or inaccuracies in its analysis. In particular:

- OFCOM's projections on the degree of FTTP network overlap between Openreach and the altnets was limited to the first three years following the Equinox 2 effective date, despite Equinox 2 continuing until 2031. Even then, OFCOM conceded that there was considerable uncertainty in its projections due to the limited information available to it. If the altnets are able to provide sufficient evidence to OFCOM of their growth plans so as to convince OFCOM that its projections on network overlap were too low, then this might cause OFCOM to re-consider its conclusion.
- OFCOM's analysis on the impact of Equinox 2 on CPs was limited to just the three largest CPs (Sky, TalkTalk, and Vodafone). Altnets will likely pick up that OFCOM did not consider the impact Equinox 2 might have on smaller CPs, which still represent a significant market opportunity for newer entrants. Altnets are also likely to highlight that smaller CPs are less likely to be able to avail themselves of the Failsafe Mechanism, due to the complexities of that process.
- OFCOM's assessment of the extent of network overlap between Openreach and the altnets excluded any overlap with the VMO2 and Nexfibre networks, on the basis that neither of these altnets currently supply FTTP services to the three largest CPs. If one or both of these altnets began supplying FTTP services to the large CPs, then the extent of network overlap would be significantly higher than

OFCOM projected (potentially above 60%). Altnets might highlight that, given the Equinox 2 offer will be in effect until 2031, OFCOM should have given more weight to the possibility of VMO2 and Nexfibre supplying FTTP to CPs in the future.

Unlike Equinox 1, altnets will also need to address the Failsafe Mechanism if they are to have any success in convincing OFCOM to reconsider its provisional conclusion. We expect the altnets will continue to highlight the practical challenges of CPs relying on the Failsafe Mechanism as a means of preserving their discounts under Equinox 2. For example:

- CPs that currently purchase only from Openreach are unlikely to want to put their discounts at risk by switching to an altnet and then submitting themselves to assessment by a third party, particularly if there will now be less financial incentive to switch to an altnet given the larger discounts available under Equinox 2.
- The cost and time involved for CPs in making a claim under the Failsafe Mechanism, as well as the risk that they may lose their discount while their claim is being processed, will further erode the financial benefits of switching to an altnet.
- CP's may be unwilling to share commercially sensitive information about their network with a third party appointed by Openreach, notwithstanding any non-disclosure obligations on the assessor. This further dis-incentivises CPs from relying on the Failsafe Mechanism.

Next steps

The consultation period in response to OFCOM's provisional conclusion on the competition impacts of Equinox 2 is currently underway, and will close on the 31st of March 2023. Altnets (and other interested stakeholders) will need to move quickly to gather any relevant evidence if they wish to present a case for OFCOM to re-consider its conclusion.

If you wish to discuss any of the above with us, please get in touch with a member of our Telecoms Sector Group.

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