



Non-Confidential

ITS response to Ofcom’s Telecoms Access Review consultation

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ITS Main office address: 6600 Cinnabar Court, Daresbury Park, Warrington WA4 4GE



1 Executive summary

- 1 ITS is pleased to respond to Ofcom's Telecoms Access Review (TAR) consultation but is deeply concerned that Ofcom appears to have not recognised the significant network footprint and market impact ITS has had during the Wholesale Fixed Telecoms Market Review (WFTMR) period.
- 2 Despite proactive engagement with Ofcom, during the TAR data collection period, Ofcom appears to not have recognised ITS as a serious and growing competitor to BT in the leased lines market. ITS hopes this is an error, and that Ofcom will ensure this is corrected in advance of the TAR Final Statement.
- 3 ⌘ of ITS's existing footprint and ⌘ of planned future footprint are captured by Ofcom's proposed new LLA Area 3 market, in which Ofcom proposes to impose BOTH cost-based charge control on active leased lines of 1Gbps and below AND on dark fibre access (DFA).
- 4 ⌘ of ITS' existing and ⌘ of its planned Area 3 footprint will move to LLA Area 2 or the HNR markets under the TAR, but under Ofcom's transitional proposals, cost-based DFA lines will remain in place over the TAR period.
- 5 ITS currently prices its uncontended 1Gbps XGS-PON-based leased line products at ⌘ below the corresponding BT EADLA product. In order to gain market share, it is necessary for market entrants to price below the incumbent. To maintain this price differential under the proposed LLA Area 3 charge control, ITS would have to reduce its pricing by between ⌘ and ⌘. This is likely to make new network deployment in those areas uneconomical and may render existing deployments unviable.
- 6 Ofcom's proposal to continue to mandate cost-based DFA and the charge controls proposed for that product are further threatening the viability of existing and new competitive network deployments.
- 7 Ofcom's proposals threaten the viability of strong emerging competitors like ITS and is in direct contrast to Ofcom's promises of a 10-year period of stability to

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promote network competition (starting 2021) and to government policy to promote network competition across the country.

2 Introduction

- 8 ITS is among the largest wholesale providers of business connectivity services in the UK. Our network now covers more than 25% of business premises in the country (nearly 450,000 business premises) and has already connected over 300,000 business premises with broadband, leased line, or dark fibre connectivity products. Services are sold through a network of over 300 partners including Sky, Zen, PXC and also many large managed IT service providers.
- 9 ITS is already a significant competitor to BT and VMO2 and with an ambition to pass 1 million business premises in the next few years, ITS plans to become the largest business connectivity competitor to BT.
- 10 ITS is an INCA member and is actively supporting the range of papers submitted by INCA as part of the TAR process. However, as a business-only and wholesale-only provider, ITS has a specific perspective and specific concerns which are set out below.
- 11 ITS agrees with INCA's TAR response. This submission provides additional and confidential analysis of the impact on ITS of Ofcom's proposals and why ITS considers that Ofcom's proposed market definition and remedies for eth LLA Area 3 market are wrong and need to be amended before the final TAR Statement is issued in March next year.

3 ITS' business model and product portfolio

- 12 ITS builds new full-fibre networks and offers wholesale access to those networks to retail providers. Most of the retail providers using the ITS networks address the business market only, but some do a mixture of residential and business. ITS also

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has a small number of direct retail customers in both the residential and business markets.

- 13 In the business market, ITS offers three types of connections:
 - Ethernet connections
 - Uncontended XGS-PON connections, and
 - Contended XGS-PON connections.
- 14 ITS' product speeds vary between 100Mbps and 10Gbps. ITS has recently trialled a 50Gbps XGS-PON connection product.
- 15 ITS understands that Ofcom proposes to include the first two product categories in the leased lines access (LLA) market.
- 16 ITS sells approximately 3x uncontended connections and only a relatively small number of Ethernet connections.

4 Ofcom's proposed geographic market definition in the LLA

- 17 At present, the ITS networks cover approximately 450,000 business premises. In the WFTMR, Ofcom stated that it would promote investment across all fixed full-fibre networks and all products delivered across fixed full-fibre networks, ensuring the investor and operators had consistent investment signals across all the potential downstream markets that can be served by their new networks.
- 18 Although Ofcom defined approximately 1/3 of the UK premises (combined residential and business) as 'Area 3' where Ofcom considered it unlikely that material and sustainable competition to BT could be developed, it applied a pro-investment charge control of CPI-0% across the board. This gave market entrants like ITS the opportunity to enter the market and, in some locations, prove to Ofcom that material and sustainable competition is likely to occur even where Ofcom

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considered that it would not. ITS has, therefore, deployed across the current WFTMR Area 2 and Area 3 geographic markets.

- 19 ITS fully expected Ofcom to recognise its miscalculation (as it appears to have done in the WLA market), and to adjust the LLA Area 2 market to include the additional network competition. Thus, ITS expected the LLA Area 3 market to reduce substantially in size, not to expand to cover nearly half of the country.
- 20 In the TAR consultation, however, Ofcom is proposing to depart from its WFTMR approach both in how it defines the geographic markets and in what remedies it proposes to apply in the geographic sub-markets to the LLA product market. This applies particularly for the proposed LLA Area 3 market.
- 21 In the TAR, Ofcom proposes to expand the LLA Area 3 market to cover 46% (from approximately 30%) of postcode sectors and 38% of demand sites. Although Ofcom proposes to use a different approach to defining where material and sustainable competition to BT is likely to occur, the general measure and definitions for Areas 2 and 3 remain unchanged. ITS is deeply concerned that a simple change in methodology can result in such significant changes in the outcome.
- 22 ITS had the legitimate and reasonable expectation that, if material and sustainable competition to BT did in fact emerge, Ofcom would reduce the geographic scope of the Area 3 market and ensure that regulatory measures were supportive of further investment.
- 23 ITS finds Ofcom's proposed scope of the LLA Area 3 market even more surprising, given that ITS has expanded its footprint significantly since the analysis for the WFTMR was carried out, as have other operators, and has told Ofcom that it plans to expand that footprint further during the TAR period. Additionally, Ofcom has included 'leased lines equivalent' services in the LLA product market definition, which should, logically, increase the level of competition in that market.

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4.1 Recognition of ITS in Ofcom's market analysis

- 24 In the TAR consultation, Ofcom refers specifically to ITS, including where Ofcom discusses the increased use of XGS-PON-based networks for providing leased lines equivalent services¹ and where Ofcom discusses Altnets as market entrants.² Despite this, Ofcom is including both existing and planned ITS network coverage in the new proposed LLA Area 3 market, for which Ofcom expects to see no development of material and sustainable competition to BT.
- 25 In addition to responding to Ofcom's Section 135 information requests, ITS engaged with Ofcom on several occasions during the TAR data collection period and made a pre-consultation submission. It was ITS' understanding that Ofcom understood that ITS is a significant and serious network builder that is offering realistic alternatives to BT (and to providers using BT's network).
- 26 ITS partners with local authorities, including amongst others in Liverpool,³ the Local London partnership (sub-regional partnership of 9 boroughs in London),⁴ South Essex's Council,⁵ and Newcastle-under-Lyme.⁶ In these partnerships, ITS deploys metro networks for the local councils, and from that network presence ITS serves local businesses with competitive flexible connectivity. Further, as ITS is a wholesale business, it contributes significantly more to the development of competition in the leased lines market than would do a vertically integrated business.
- 27 These collaborations, and provision of critical connectivity to enable local economic growth, make ITS a significant market player and it is surprising that, having recognised that ITS is an important market entrant, Ofcom appears to have not taken into account ITS' network footprint when determining where Ofcom

¹ TAR V2 Paragraph 2.101.

² TAR V2 Paragraph 2.87.

³ <https://itsechnologygroup.com/news/its-to-lead-new-digital-infrastructure-across-liverpool-city-region/>

⁴ <https://itsechnologygroup.com/public-sector/cross-sector-collaboration-key-to-unlocking-local-londons-digital-potential/>

⁵ <https://itsechnologygroup.com/network-launches/south-essex-councils/>

⁶ <https://itsechnologygroup.com/news/newcastle-under-lyme/>

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expects material and sustainable competition to BT to develop. Ofcom's failure to do so will cause ITS's financial backers to question whether further network expansion is advisable.

- 28 ITS is extremely surprised at Ofcom's failure to recognise the value of network competition for the leased lines market in almost half of the country. ITS urges Ofcom to re-assess the level of existing and emerging competition across the country and to ensure that any remedies, that are a direct dis-incentive to network deployment (such as cost-based charge controls), are not applied or only applied where Ofcom can be certain that no material and sustainable competition can develop.
- 29 ITS believes that Ofcom's proposal for defining and regulating the LLA Area 3 market is a significant error (based on collecting the wrong data and fundamentally underestimating the current and planned network competition in the provision of conventional leased lines and leased lines equivalent services).⁷ Ofcom's proposals, if implemented, will increase the perceived risk of investment in the UK telecoms sector. For Ofcom to fundamentally change investment signals half-way through a 10-year 'regulatory stability' period, that was designed to promote investment in competing networks across the country, is in direct conflict with Ofcom's principles of transparency, predictability and accountability.
- 30 Ofcom's perplexing approach to geographic market definition, and the counter-intuitive results, would matter less to ITS if Ofcom was not also proposing to fundamentally change the way in which it regulates the LLA Area 3 market. Ofcom's proposal to extend the regulated cost-based dark fibre access (DFA) remedy to the enlarged LLA Area 3 market and to, additionally, introduce a cost-based charge control on active leased lines of 1Gbps and below, significantly reduces the business case for further investment and may render some existing investment uneconomical.

⁷ This is explained in further detail in the INCA TAR response.

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4.2 Ofcom's proposed price regulation in the LLA Area 3 market

- 31 In the expanded LLA Area 3 market, Ofcom is proposing to change the WFTMR CPI-0% pro-investment charge control for active connections to a cost-based charge control. Ofcom uses its TAR objective for that market to justify the change in regulatory approach.⁸
- 32 In the WFTMR, Ofcom's objective for Area 3 (for both WLA and LLA) was to promote investment by BT. This resulted in a pro-investment charge control of CPI-0%. but, in the TAR, Ofcom states that it's LLA Area 3 market objective is *"to promote competition based on access to Openreach's networks and protect consumers"*.⁹ This effectively means that no new network investment is promoted and this objective is used to justify the introduction of a cost-based charge control on active leased lines of 1Gbps and below alongside the cost-based charge control on dark fibre access (DFA).¹⁰
- 33 Ofcom argues that the DFA remedy is not an effective constraint on active leased lines pricing for 1Gbps speed and below, and that it is therefore necessary to impose the cost-based charge control on the active leased lines in that speed range.
- 34 Although Ofcom does not present any specific rationale for its change in regulatory objective for the LLA Area 3 market, ITS understands it is based on Ofcom's market analysis that suggests that there is little or no increase in competition to BT in this market (as defined in the TAR). However, as outlined above and set out in more detail in the INCA TAR response, Ofcom appears to have collected the wrong data

⁸ Although Ofcom does not explicitly explain the rationale for this radical change, it simply sets out a new and very different regulatory objective for the LLA Area 3 market and applies new regulatory remedies to meet that objective.

⁹ TAR V4 Paragraph 2.52.

¹⁰ In the LLA Area 3 market, there are effectively three cost-based charge controls applied at three different layers in the value chain: 1) for active leased lines at or below 1Gbps, 2) for DFA and 3) for PIA. Although PIA is applied in a different market (the PI market), it is directly applicable in the LLA Area 3 market.



for its market analysis and has materially underestimated existing and planned competition to BT in the LLA market overall.

5 How Ofcom’s proposals would impact ITS’ current and planned network footprint

35 The chart below shows the distribution of ITS’ existing network across the areas defined by the WFTMT and the TAR.

36 Figure 1: Current ITS network footprint



table redacted

37 At present the ITS networks cover 30 postcode sectors in the CLA, 30 postcode sectors in Area 2 and 30 postcode sectors in Area 3.

38 Under the TAR proposals, 30 of ITS’ postcode sectors in either CLA, HNR or Area 2 would move to the LLA Area 3 market, nearly doubling the ITS LLA Area 3 footprint.

39 Of ITS’ 30 postcode sectors currently in Area 3, under the TAR, 30 will move to Area 2 or the HNR, but existing DFA circuits will be allowed to remain in place under Ofcom’s transitional arrangements and will be subject to the TAR price control.

40 For the period up till 2031, ITS is planning further network expansion. Of that planned expansion, ITS have 30 planned network expansion and expects to grow beyond that level before the end of the TAR period.

41 The chart below shows the distribution of the planned expansion across the areas defined by the WFTMR and the TAR.

42 Figure 2: ITS planned network footprint



bar graph redacted

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- 43 Of the planned expansion ✂ postcode sectors would currently be in the CLA, ✂ in the HNR and ✂ in Area 2. Approximately ✂ of those postcode sectors would move into Area 3, if Ofcom's proposals are implemented. It is clear from the graph above that the TAR would substantially further increase ITS' LLA Area 3 market footprint.
- 44 ITS' plans include ✂ postcode sectors currently in Area 3 under the WFTMR. Of these, under the TAR, ✂ will move to Area 2 or the HNR, but existing DFA circuits will be allowed to remain in place under Ofcom's transitional arrangements.

6 How Ofcom's proposed charge controls would impact ITS

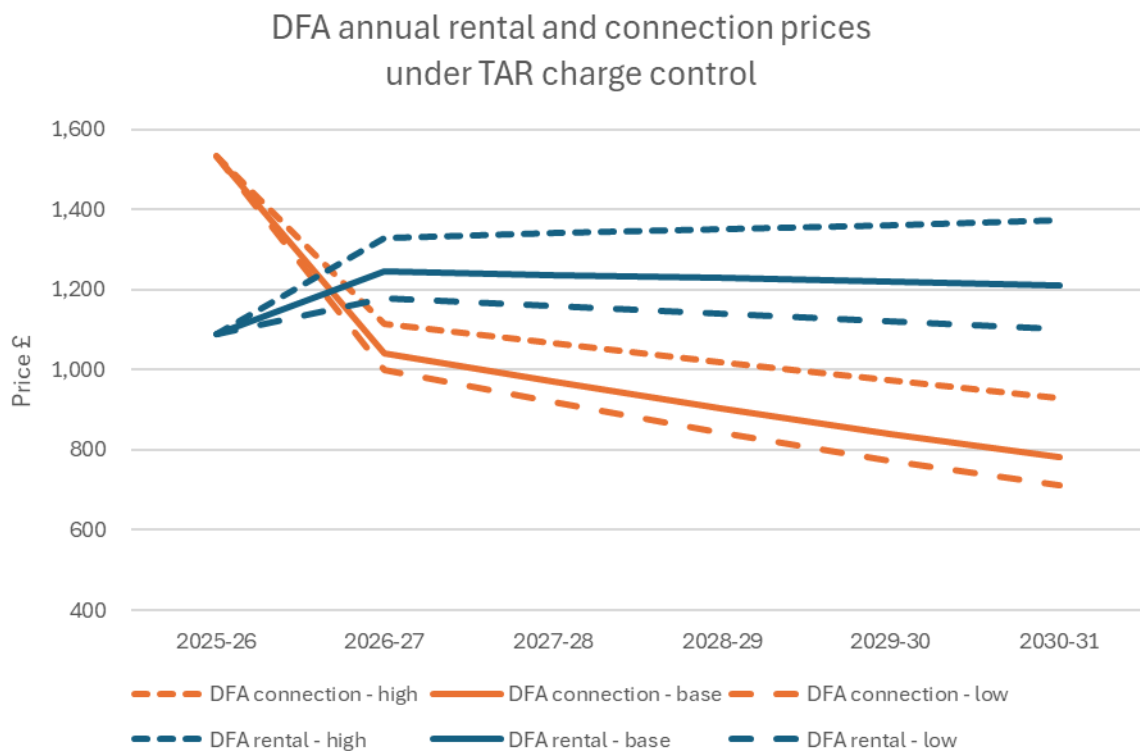
- 45 In the TAR, Ofcom is proposing to impose charge controls on BT's rental and connection products in LLA Area 3 as follows:
- For a basket of ethernet products with speeds ≤ 1 Gbps, a cost-based charge control with annual price reductions of between CPI-4.75% and CPI-8.5% (base case CPI-4.75%)
 - For ethernet speeds higher than 1Gbps, and charge control of CPI-0%
 - For dark fibre access (DFA) products, a cost-based charge control with a starting adjustment of +10% to +21% for rental products and -24% to -29% for connection. After the starting adjustment, annual price declines of between CPI-1.25% and CPI-3.75% would apply for rental products and between CPI-6.5% and CPI-10.25% for connection products.
- 46 BT's ethernet products comprise EAD, which provides an end-to-end connection and may be used in conjunction with a mainlink which extends the reach of the circuit, and EADLA which provides an access link from a single customer site to a network node. BT's DFA product is broadly comparable in structure to the EADLA active product.



- 47 The key change to pricing resulting from Ofcom's TAR proposals is in the ethernet <=1Gbps basket in LLA Area 3; this will be subject to real-terms price declines whereas under the WFTMR it was set as flat in real terms in both Areas 2 and 3.
- 48 In addition, there is a key change for postcode sectors which move into Area 3 under the TAR, as DFA is then applied as a remedy. This is priced significantly below the equivalent active EADLA product, and is also subject to a real-terms price decline over the TAR period and a one-off adjustment to reduce connection charges and increase rental charges. The proposed price changes to DFA are illustrated below.



Figure 3: Proposed DFA charge control



- 49 The continued downward pressure on the DFA pricing, combined with the significant one-off reduction in connection charges and increase in rental charges, makes competition against the BT regulated prices significantly harder for ITS.
- 50 The ITS leased line product range which most closely resembles BT's ethernet product set is the FibreBright range. These products are non-contended and comprise a single access circuit which is broadly equivalent to BT's EADLA product. ITS do not apply a connection charge for contract periods above 1 year.
- 51 The chart below shows a comparison of BT 1Gbps EADLA and DFA prices with ITS's 1Gbps FibreBright product, all on a 5-year contract basis.¹¹ For the BT products, the connection charge has been included at 20% of the tariff, such that it would be recovered evenly over the contract period. It is assumed that ITS's prices would increase in line with the same forecast inflation rates that are used in Ofcom's

¹¹ The 5-year contract period has been chosen as BT has a directly comparable price. ITS also offers a 3-year contract period, but there is no comparable BT price.



charge control model which is also the way Ofcom is expecting leased lines pricing in the LLA Area 2 market to change.

Figure 4 Comparison of BT and ITS prices over the TAR period, LLA Area 3

✂
graph redacted

- 52 Before the start of the TAR, ITS' price is ✂ below that of BT's equivalent EADLA product, but by the end of the TAR it is ✂ above BT's price. This suggests that by the end of the TAR, ITS would need to reduce its price by ✂ from the projected level if it were to retain a ✂ price discount against BT. This is a very material change from ITS' expectations under the WFTMR, where BT's ethernet pricing in both Area 2 and Area 3 was expected to remain flat in real terms.
- 53 Furthermore, BT's DFA price would be ✂ below ITS's FibreBright price by the end of the TAR; this would provide a strong price incentive for customers to choose BT DFA in situations where they are happy to provide their own active electronics. For ITS' existing and planned deployments in Area 2 under the WFTMR, but which are in Area 3 under the TAR, this represents a further material disadvantage for ITS compared to BT.
- 54 So as a result of Ofcom's reassignment of ✂ of ITS' existing network footprint, as well as more than ✂ of its currently planned future expansion, to Area 3, ITS would likely suffer a ✂ for its uncontended leased lines of 1Gbps and below.
- 55 This will result in greatly reduced returns in the existing footprint areas, which would reduce the likelihood of further expansion. It is likely that the currently planned expansion into Area 3 as defined by the TAR would become unviable, and this investment would therefore not be made.