



# SIMWOOD

STRAIGHT-TALKING, FORWARD-THINKING, TELECOMS

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Dear sirs,

## Consultation: Openreach proposed FTTP offer starting 1 October 2021

We note with interest and concern the Office of Communications' ("Ofcom's") consultation on Openreach's generous Equinox offer and your intention to allow it to proceed. We will set those concerns out here.

On the one hand, one could argue that British Telecommunications plc ("BT") is deftly playing the hand it has been dealt, operating within the rules of the game that were set some time ago, whether or not those rules would be considered fair by a neutral arbiter today. Further, as it relates to the pricing of a product that is not charge-controlled, set at above its demonstrable economic cost, regulatory economics would imply Ofcom should wave it through.

Considering the bigger picture however, reviewing multiple data-points outside of the specifics of this consultation, we do not subscribe to the view that Equinox should be permitted unmodified.

Simwood is not active in this market but has invested considerable time researching and planning within it, as Ofcom will be aware. We now have nothing directly to gain or lose from Equinox pricing succeeding or failing and therefore consider ourselves unbiased. This is because our plans have changed as a result of Ofcom's position and we feel that warrants explaining, not least because it evidences what Ofcom argues will not happen.

## Trust

We do not trust BT, as should be clear from our past responses to a range of consultations. Recent relevant Ofcom enforcement touches on reasons why, not least Ofcom finding BT contrived to harm a competitor's bid in Northern Ireland and compounded this by misleading the regulator in response to its statutorily-backed enquiries. Add to that mix other past conduct (not to mention their Italian accounting scandal), and this is not a company that should be allowed any claim on the moral high ground, or its surroundings.



Presuming Ofcom has a less cynical starting position to us where BT are concerned, allow us to pose a thought experiment. Had Openreach been sold to the People's Republic of China and was genuinely separate to other BT group companies, would Ofcom's view of Equinox change? Heck, would BT's view change? We suspect the answers are 'yes' and 'yes' and that being so, has this scheme been looked at through an appropriate lense we wonder? After all, the People's Republic of China does not have BT's enforcement record.

Ofcom appears to presume, despite evidence to the contrary, that BT can be trusted. Has the leopard changed its spots? Have BT's officers decided that altruism trumps their fiduciary responsibilities perhaps? We think not.

### Motivation

On the contrary, we suggest the very name of this scheme - 'Equinox' - gives hints to their true intent. Quite literally an equinox is the point at which dark and light are equalised, having been out of balance, before the balance proceeds to tip the other way.

They may see themselves as the light, others may see them as the dark, either way the implication of equalisation and tipping balance should be a concern, presuming they are not volunteering to tip the balance to the detriment of their own interests.

Looking at it another way, do they regard themselves as the sun, around which and dependent upon which, the rest of the industry should revolve? It is a long held view within the industry that BT's primary strategy is to engineer itself to be at the centre of everything - from our response to the recent Wholesale Voice Markets Review, we provided many examples of how BT's *permission* is required for any competitor to do anything. This paradigm is neither good for the consumer nor competition in our view.

### Our view

Through our reading of responses to the recent call for inputs, we find ourselves having sympathy for Ofcom's view, at least within the constraints of this Consultation - we absolutely disagree considering the big picture though. At one extreme, altnets find their business models altering as a result of regulatory risk, something we've had to contend with in voice for years, and neither they nor their investors will welcome that. At the other extreme, BT's resellers (whom to view as 'competitors' is frankly naive) support prices being discounted but think they should be cheaper still - to the extent this does not benefit consumers, this is dripping self-interest to such an extent as to



need disregarding. In so far as we are at neither extreme, we share some of Ofcom's perspectives.

Simwood has spent much of 2021 evaluating a network build in a very rural part of the country where BT has failed by any measure to deliver on past promises and state funding. Our experience is that despite the apparent untouched nature of the territory, BT has deployed Government underwritten fibre to do 'just enough'. It may not have delivered FTTP but it has laid a lot of fibre before, as far as residents are concerned, 'running out of funding'. BT appears to have cherry-picked communities to mop up taxpayer funding, leaving those premises which remain more undesirable and non-contiguous. Lastly, residents saw Openreach vans driving around a few years ago and anecdotal evidence suggests they are reluctant to switch to alternatives because they were promised at contract renewal that BT FTTP is coming 'soon'.

### Altnet economics

As a new altnet, viability depends on two metrics: cost per premises passed and penetration.

The cost per premises passed is unaffected by Equinox, although the precise mix of other Openreach products consumed will undoubtedly affect it. Ofcom are no doubt aware that Openreach has implemented surcharges on some products specifically where used by altnets, because they can. This is arguably the stick to accompany the carrot of the Equinox loyalty scheme.

Anticipated penetration should be quite high in an area where there is no existing FTTP, and indeed consumer demand for fibre is very high where there is no provision.

Both are assisted by any voucher schemes available. However, considering BT have, or may move to, mop up such vouchers, and have done half a job of laying fibre and convincing customers of its intent, that job is risky enough to start with. What we have in Equinox though is a further move, lowering prices to bring the marketing might of BT's pseudo<sup>1</sup>-competitors through a loyalty discount of up to 30% which tips this risk unacceptably against the altnet.

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<sup>1</sup> 'pseudo' in that their product offering already depends in the main on Openreach last-mile, exchange space and backhaul despite having the scale and resources to build network should they see a benefit in doing so.



## Competition failure

In our modelling therefore, Simwood is assuming a reduction in penetration of 50% and a 20% reduction in recurring revenue for those who do connect. This renders building in the most poorly starved outside-in priority areas as unviable, even though the headline focus of Equinox is the more populous areas we are not targeting. Thankfully, we have not invested anywhere near the extent of the altnets and therefore can take risk-avoiding decisions that only cost us opportunity. However, the decisions we are taking in actuality contradict what Ofcom says should happen in the Consultation.

Of course, to the extent we consume Openreach products as BT's pseudo-competitors do, we welcome a reduction in price, especially when combined with a loyalty scheme! That of course assumes the removal (or by any measure: reduction) of competition in the least competitive areas, motivates BT to do what it has so far failed to do there so there is actually a connection to resell. We suspect consumers in these areas will not see that connectivity delivered nearly as quickly as they would have done had an alternative operator been entering their market. Doubtless, the resulting absence of competition here will be cause for BT's begging bowl to come out in a few years when those areas remain unprovided for, because competition has failed as a result of the Ofcom-endorsed Equinox offer.

## FTTP costs

Next, we turn to the cost. BT voluntarily discounting a product is a new one on us, especially when conversations around fibre provision to date have cited the massive cost as a barrier.

Here is a company who is very quick to hold out the begging bowl for Government assistance, and one which benefits from the rest of the industry supporting its forays into other markets through an unfair Weighted Average Cost of Capital ("**WACC**") calculation (not to mention to gold-plated Crown Guarantee for its historically under-funded pension scheme).

In a massive exercise in double-think, BT have found the margin to offer a promotion to do what for years they've said they cannot afford to do without subsidy. Let us also not forget, whilst they will make significant marketing capital out of the £15bn they have committed, the industry is paying for this. Their credit rating is already sub-optimal and their share price has been in decline for over 5 years. Financing a further £15bn is only going to increase their WACC, and their WACC is of course an input into



those prices Ofcom does charge control. Just as with BT Sport, the cost will fall on industry whilst the benefit will be all BT's. It remains in Ofcom's gift to adopt the Irish regulator's position on the calculation of a WACC, a methodology we thoroughly endorse.

### Obsolete technology

BT's FTTP deployment is widely understood to be GPON, with a split ratio of 32:1. We would argue that sharing a 1.25Gbps connection, or even 2.5Gbps, between 32 premises is far from 'Gigabit capable' for all but one or two of them simultaneously. Regardless, it is short-sighted.

A cursory examination of altnets reveals that most are deploying XGS-PON or 10G-PON, themselves over a decade old as standards, which are an order of magnitude more performant than GPON. Many are also adopting a significantly lower split ratio too, such as 8:1. 10Gbps between 8 homes provides the same capability to each as BT is likely giving 32 to share in some cases. Other altnets are running the more expensive active ethernet option which scales potential far further as the last mile is not shared at all.

We do not wish to start a technical debate but one has to ask why there is this apparent disparity. We believe the answer has been given above already: GPON is just enough and it is cheap. BT could be said to have delivered the bare minimum for the maximum amount of subsidy so far.

Following the land-grab that an Ofcom-endorsed Equinix permits, we submit that in a few years GPON will be inadequate and require an upgrade. Perhaps the demand for such is a perfect justification for the begging bowl to come out again? Perhaps the altnets are planning ahead because they know *they* have no such prospect of taxpayer and industry subsidy in the future?

Lest this be an unwelcome observation, we'd highlight that Ofcom explored this topic back in 2009 in "Fibre capacity limitations in access networks"<sup>2</sup> which foresaw the need for BT to upgrade more elements in GPON to enable it to scale. 12 years ago the cost equation, technology and demands were rather different to today.

Before permitting BT to offer a loyalty scheme discounting prices up to 30%, Ofcom may wish to consider setting a minimum and future-proof technical standard to be

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<sup>2</sup> [https://www.ofcom.org.uk/data/assets/pdf\\_file/0023/27527/fibre.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0023/27527/fibre.pdf)



delivered, requiring BT to invest to an acceptable future-proof standard. We believe this would postpone consumer disappointment, and the need for both Ofcom intervention and more subsidy.

### FTTP demand

Let us also consider the claimed premise of this discount and loyalty scheme. The claimed justification is to encourage the take-up of FTTP over copper. This suggests that there is data suggesting that FTTP is not taken up when available. We would welcome being directed to such data as I'm sure would the very financially astute investors who have backed altnet builds.

Our experience is that the barrier to FTTP take-up is not the presence of copper, but rather availability of fibre. Lowering the economic return on building FTTP, and increasing the WACC for BT, do nothing to increase availability in and of themselves. Given different genesis, we suspect BT would run this argument themselves!

Aside from BT having benefited from billions in taxpayer-backing to do what it has done so far, we would like to pose a second thought experiment. What would BT's reaction be to Ofcom proposing to set charge controls on fibre products at the level of the Equinox offer? We would very much imagine a significant amount of bluster, threats that it would impede the roll out of fibre and jeopardise the Government's targets... along with a trip to the Competition Appeal Tribunal.

The potential for competition in availability by an altnet building spurs BT to finish building better than anything. Encouraging this instead of a BT loyalty scheme results in a win-win both for consumers who get something they otherwise won't, and the industry who will be funding BT's subsidy through WACC (and its Crown Guarantee through general taxation) whilst to differing extents benefitting from its infrastructure build.

### Favouring oligopolies

In the past few years, we have become increasingly fearful that Ofcom and Government policy alike is becoming a self-fulfilling prophecy - one which supports an oligopolistic telecommunications market in the UK. This contradicts the UK's prima-facie diverse and competitive market, with hundreds of network operators and thousands of independent entities providing services. At a global level, the UK *looks* like a case-study in how competition drives consumer outcomes, but increasingly isn't.



The Equinox offer adds grist to this mill; it is another step towards BT being re-entrenched as an infrastructure monopolist, just as the UK had the opportunity to shake itself loose of such a strangle-hold and make progress towards having legitimate alternatives.

Ofcom's behaviour suggests to us it may have priorities which require oligopolies in fixed and mobile infrastructure, which trump sections of the Communications Act. Conceivably there may be concerns around National Security and the distribution of Critical National Infrastructure into too many hands. We have no knowledge of this of course but are merely trying to rationalise Ofcom's apparent prioritisation as we see it. Ofcom would not be the first national Regulator we engage with who has adopted this position after all, but others are very unapologetic and open about it. Simwood, we're sure along with private capital, policy makers and consumers would welcome clarification on this such that capital and resources can be deployed more efficiently into other more open sectors.

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As always, we hope our views have been helpful and we remain very happy to assist wherever we can.

Yours faithfully,

Simon Woodhead FCSI  
CEO