



Designing the broadband universal service obligation

TalkTalk response to Ofcom's April 2016 call for inputs

30 June 2016

This is TalkTalk's response to Ofcom's call for inputs on designing the universal service obligation published on 7 April 2016.

1 Summary

We support the Government in its ambition to ensure that everyone in the UK is digitally connected. We believe that for the majority of the country this is best achieved by fostering an environment that supports commercial investment in ultrafast fibre networks combined with competition to deliver affordable, innovative services to customers. To create the right regulatory framework and market structure to achieve this, Ofcom must reform Openreach to make it fully independent from BT Retail and ensure effective infrastructure and retail competition across all broadband products. As we stated in our response to Ofcom's Digital Communications Review, we need to be bold in creating a world leading market which is fit for purpose for the next generation and beyond.

We note that the Government's objective for the universal service obligation (USO) for broadband is to ensure that everyone has the right to a decent broadband connection on request. Today, there are a range of reasons why some households and businesses do not have access to a broadband connection that delivers speeds greater than 10Mbit/s: availability of 10Mbit/s varies due to differing demand, and the performance and cost of different technologies in different geographies.

It is inevitable that some areas of the country will not be reached by the commercial or BDUK rollouts, and some form of Government intervention will be required to provide "decent" broadband. The challenge for Government is to identify what form of intervention best addresses this market failure, but minimises the risk of market distortion. A USO carries very significant risks, including:

- Repeating the mistakes of the BDUK programme by allowing BT to be the sole beneficiary of any intervention. At a time when Ofcom is seeking to drive greater competition in the market, it would be unacceptable if Government intervention weakened it. BT already accounts for 70% of superfast connections on the Openreach network. A USO that discriminated in favour of BT on non-superfast connections would only exacerbate competition concerns in the market.
- Distorting prices in the market. If a USO repeats the mistakes of the BDUK programme and enables a monopoly supplier (or different regional monopoly suppliers) to dominate the programme, they will have the commercial ability and incentive to artificially inflate rollout costs and retail prices. This will increase the overall cost of the USO and cause significant consumer harm.
- Crowding out private sector investment and transferring responsibility and cost onto Government. The proportion of the market currently without 10Mbit/s is continually shrinking, as the BDUK programme rolls out and

technological advances extend the reach of the commercial rollout. Satellite technology, for instance, continues to develop, offering the prospect that areas currently not reached by the commercial rollout may be viable shortly. A USO, however, risks crowding out this investment. Companies that could extend their commercial rollouts would have a very strong commercial incentive to claim they cannot, and instead seek USO funding to do it. That transfers the responsibility and cost of rollout from the private sector onto Government.

- Artificially raising customer expectations. Government and Ofcom have already conceded that a USO is unlikely to meet all need in the market and would not, in practice, be ‘universal’. Some areas will remain too expensive to reach. Given the degree of public frustration with the BDUK programme, and volume of complaints to local MPs in areas currently deprived of superfast broadband, there are significant political risks in artificially raising expectations by promising that services will be universal if that is not the case.

Rather than setting arbitrary national targets that will not be met universally, Government should instead consider funding more flexible interventions to address specific, local instances of market failure. For instance, in some cases, there may be marginal differences between the cost of providing a ‘safety net’ service of 10Mbit/s and a more advanced service, for instance through satellite services that provide higher speeds. In such a scenario, it may be rational to opt for a faster, more future-proofed service. In such a scenario, an arbitrary USO would constrain Government’s ability to select from the widest range of providers and technologies and find the right solution for different communities.

The Government’s desire to extend broadband infrastructure is only partly driven by economic concerns. It is also an instrument of social policy, designed to prevent entrenching digital divides and ensuring that all citizens can continue to access public services as they move to ‘digital by default’. TalkTalk therefore considers that it is appropriate for Government to finance any intervention directly including, where necessary, using some of the £8.5 billion the Government expects to save over the lifetime of this Parliament by moving government services online.¹

¹ <https://www.gov.uk/government/news/uk-to-be-the-g8s-most-digital-government-by-next-year-with-billions-of-savings-in-sight>

2 Comments on issues raised in the call for inputs

2.0 Specification and scope of the USO

How should the minimum technical performance of the USO be specified?

How should we ensure the USO is affordable?

If a USO were to be pursued, an important part of ensuring it is affordable is narrowly defining its scope to ensure it is a ‘safety net’ measure to support universal access to basic digital services, and is not co-opted as a means of delivering broader social objectives or future-proofing UK infrastructure. We maintain these broader objectives should be pursued through Ofcom’s strategy of encouraging greater infrastructure competition, investment in fibre and boosting retail competition in superfast. In areas where any USO was implemented as a ‘safety net’ measure, it should be fully contestable and designed to ensure competition at the wholesale and retail level.

Any Government intervention, including introducing a limited USO as a ‘safety net’ to ensure access to basic digital services, would have to take account of the following principles:

- Customers unaffected by the policy should not see their bills rise to pay for it
- The solution should seek to strengthen retail competition
- It should support, rather than undermine, infrastructure competition and investment
- It should be technology neutral
- It must recognise and leverage role of smaller/niche players
- Evidence base on which the policy is based should be formed with input from across industry, not just BT

The policy should be specified in such a way that it can be fulfilled by the maximum range of technologies including wireless. Any technical specification therefore should be set using a minimum set of criteria to allow the most appropriate technology to be used in light of local circumstances. An overly prescriptive technical specification would be unhelpful due to the range of factors affecting actual broadband performance. Other aspects of quality should be handled through existing regulation, local procurement, customer terms and conditions and efforts to raise awareness of the range of factors affecting broadband speeds and performance, rather than hardwired into any USO.

2.1 Social tariff

Should there be a social tariff for broadband services?

From TalkTalk's inception we have been committed to ensuring affordable access to telecommunications and making services which had previously been a privilege, a right for everyone. As the value player in the market, we are always keen to explore how we ensure broadband services are affordable to those on low incomes or those with special social needs. Ofcom and Government's first priority should be supporting a market structure which delivers affordable and accessible services. We do not think it appropriate to link any supply-side Government intervention on infrastructure to demand-side issues such as retail prices. The issues are separate and should be treated as such.

2.2 Demand for the USO

What might the potential demand for the USO be?

We do not have evidence of potential demand for the USO beyond the data reported in Ofcom's Connected Nations report and BDUK take-up statistics. We expect that households and businesses in a range of circumstances would be likely to make requests under a USO if it comes into force. While some customers will be outside the superfast broadband footprint, others may be covered by superfast but have chosen not to upgrade their connection or take superfast but suffer from degraded speeds under 10Mbit/s due to the distance from the cabinet to the premises. The design of any Government intervention, including a limited USO, would have to distinguish between these scenarios and ensure that existing network investments are not undermined.

Given that a USO risks significant market distortion, Ofcom must conduct early research to better understand the level of demand, the range of potential consumer requests, greater detail on the geographical distribution of likely demand and expected price elasticity. We would be reluctant to support Government intervention into the market that is not based on clear evidence and where all reasonable efforts have not been taken to minimise the risk of market distortion.

2.3 Cost, proportionality and efficiency of the USO

Cost evidence

Proportionality and definition of a 'reasonable request'

Ensuring efficiency

The most effective way of controlling the cost of a USO is to maximise the number of customers provided for commercially. This requires greater infrastructure competition to maximise the number of providers and technologies seeking to address coverage not spots. Ofcom's DCR was right to conclude that infrastructure competition requires a new Openreach model as well as the ability for rival operators to access BT's ducts and poles. It also requires greater clarity from BT about where it plans to build as part of the BDUK programme. Ambiguity about BT's rollout plans makes it difficult for alternative investors to assess unaddressed

demand or the size of the potential market. This is a barrier to alternative investors that might be able to provide commercial solutions. As discussed in the Summary, we are concerned that a USO would crowd out potential private sector investment and transfer the responsibility and cost of meeting existing demand from the private sector on to Government.

Some areas will not be provided for commercially, however, and will depend on some Government intervention to deliver access to “decent” broadband. Smaller providers may have niche solutions that are more cost effective in some areas than national solutions. Any intervention mechanism should be sufficiently flexible to support their involvement. This may require several local authorities to cooperate to aggregate demand in their areas, helping smaller providers reach the scale they require for investments to be viable.

If a USO was implemented, it would need to include a clear and explicit definition of a ‘reasonable request’ to ensure the intervention is proportionate and delivers on its objectives. In order to remove the risk of intervention undermining superfast and ultrafast investments, customers in premises that can receive speeds greater than 10Mbit/s using these networks should be explicitly excluded from any USO. If a USO is introduced, we envisage that a customer that meets the criteria of the USO would be expected to contribute to the cost of network installation if it exceeds a specified financial threshold. This threshold should take account of whether delivering broadband over 10Mbit/s requires completely new infrastructure or an upgrade to existing infrastructure.

2.4 The universal service provider or providers

How should the universal service provider be designated?

Given the range of reasons why consumers and businesses may not have access to broadband delivering speeds of at least 10Mbit/s and the range of possible solutions, if Government did pursue a USO, we consider that it is likely that Ofcom may need to designate different universal service providers in specific locations to most efficiently meet local needs. The process for selecting the universal service provider in any location must be fully contestable and USO providers must have an obligation to wholesale at a reasonable cost. We consider that this approach is likely to drive greater cost efficiencies and better ensure competition at the wholesale and retail level. It is paramount that the process is fully transparent, draws on input from across industry and does not unduly rely on BT when establishing the evidence base. As stated above, we consider that these criteria would be better met by designing a Government-funded rollout programme designed to address local circumstances than introducing a USO.

2.5 Funding of the USO and potential market distortions

Funding of the USO

How could any potential market distortions of competition be minimised?

The Government's proposed USO follows its BDUK rollout programme and seeks to ensure access to decent broadband for those not covered by the 95% rollout of superfast broadband networks, or by the expanding commercial investments in ultrafast networks under Ofcom's DCR strategy. In designing the BDUK programme, Government accepted that it was critical national infrastructure, essential not just to the country's economic future, but also as a means of delivering social policy objectives and public services. For instance, the Government expects to make significant savings by moving more services and operations online. Current Government forecasts suggest savings to the Exchequer could total over £8 billion over the course of this Parliament². As a direct beneficiary of the rollout, it was therefore appropriate for Government to invest in the superfast rollout to 95%.

The same principle applies to the USO. Where Government seeks to extend coverage, either to expand economic opportunities, as an instrument of social policy to avoid entrenched digital exclusion or to maximise the savings from digital government, it is appropriate for Government to finance the investment.

Direct government investment is also the most effective way of minimising market distortion. If providers were forced to finance the cost of the USO, this could only be achieved by reducing alternative network investment, such as the rollout of ultrafast infrastructure, or through increasing customer bills. The former will undermine Ofcom's stated desire for greater ultrafast investment and the second would risk distorting the retail market and pricing services beyond the means of low income households.

The energy industry provides a cautionary tale as to the risks of the alternative, seeking to finance government policy through a direct tax on customer bills. Consumers reacted angrily when 'green levies' artificially increased their bills to pay for government policies that customers had not consented to and had no control over. It is critical that the telecoms industry does not repeat the mistakes of the energy industry by imposing a broadband tax on consumers.

In designing any intervention, Ofcom and Government should seek to draw on the lessons of the BDUK programme to avoid market distortions. For instance, the Public Accounts Committee repeatedly raised concerns that the programme distorted the market. The Committee argued that a lack of transparency in the design of the programme created "conditions whereby alternative suppliers may be crowded out".³ It also concluded that "the lack of transparency on costs and BT's insistence on non-disclosure agreements are symptomatic of BT's exploiting its monopoly position to the detriment of the taxpayer, local authorities and those seeking to access high speed broadband in rural areas."⁴ The BDUK rollout to 95% will not be complete until the end of 2017. Before committing to a further multi-year market intervention, it is

² <https://www.gov.uk/government/news/uk-to-be-the-g8s-most-digital-government-by-next-year-with-billions-of-savings-in-sight>

³ Chair's comments – PAC report. <http://www.parliament.uk/business/committees/committees-a-z/commons-select/public-accounts-committee/news/rural-broadband-report-publication/>

⁴ Chair's comments – PAC report. <http://www.parliament.uk/business/committees/committees-a-z/commons-select/public-accounts-committee/news/rural-broadband-report-publication/>

critical there is a detailed assessment of the existing one. Where the design of the programme distorted the market and undermined competition, those lessons must be understood and avoided in any further intervention.

2.6 Review of the USO

When, and on what basis, should the USO be reviewed?

If introduced, the USO would need to evolve over time. Focus should remain on delivering a step change in national infrastructure through a strategy that supports investment and competition in fibre to ensure the greatest possible proportion of consumers and businesses benefit from future-proofed infrastructure, rather than incrementally increasing minimum standards. If this strategy is successful, any USO would be a backstop protection used in a tightly defined number of special circumstances rather than a larger intervention.

Nevertheless, we appreciate that the USO will need to be reviewed at some point if it was introduced. Given implementation is unlikely to begin until at least 2018, it seems appropriate that it would be reviewed at the mid-point in the 2020-2025 Parliament. That would provide sufficient time to meaningfully implement the USO, make informed assessments of its effectiveness and whether existing speed levels remain relevant for technology advances.