

Response to Ofcom .. 'Approach to high excess costs under the broadband universal service' (B-USO). July 2021.

Mike Kiely – The Bit Commons

Response to Ofcom's consultation on the 'Approach to high excess costs under the broadband universal service' (B-USO).

1.Thanks for the opportunity to respond to the above consultation. It is good Ofcom have established BT's current approach to pricing requests for Broadband Universal Service obligation is 'significantly harmful' to the consumer. If Ofcom is providing BT time to implement mitigation measures for the harm it has caused to those applying for B-USO quotations, then the same mitigation measures should be applied more widely to all fibre requests since BT committed to make full fibre available as part of its commitment to BDUK on a national basis in 2014¹. Fibre on Demand was intended as a product to in-fill full fibre where the fibre cabinets could not support the >24Mbps requirement in rural areas. Fibre on Demand (FoD) includes all the components needed to meet the B-USO. A full commitment to in-filling using full fibre since 2014 and a commitment to be transparent and honest on the status of its capital contributions in BDUK activity would have reduced the probability of the B-USO being requested by Parliament. The significant consumer harm identified by Ofcom is likely to apply much of the BDUK activity where BT did not apply the direct Capital contributions expected in a gap funding model. Where BT failed to plan to use its own capital as part of planning rural upgrades it would mean BT was making the conscious decision to with-hold full fibre services and sup-optimally plan upgrades in rural areas. It is important Ofcom addresses all harm which has been inflicted on consumers as BT Group spent several years overcoming its reluctance to invest in full fibre. The latest finding by Ofcom is part of a continuum not an isolated incident. If the matter is dealt with in the manner outlined below, Ofcom can avoid the highly problematic matter of introducing an industry fund.

2.The solution being proposed by Ofcom, - the division of costs across 70% of the customers reached is a reasonable but 1) this is only one input to a much needed definition for a 'reasonable request' for a fibre service and 2) the 'reasonable request' rules needs to be applied at all subsidised works, all Fibre on Demand requests and all BT Community Broadband Partnership requests since 2014. Furthermore, the proposed B-USO mitigations measures needs to include a commitment to use existing BDUK contracts and resources be it change requests or other means that secures more and deeper rural Broadband coverage.

3.To deal with the history of BT Group's normalised deviancy² imbedded in the BDUK Framework, confirmed by the NAO in 2015 and some eight Parliamentary Select enquires throughout all the phases of the subsidised work Ofcom should demand the proposed BT mitigation measures are applied to all applicable full fibre activity in rural areas since 2014. The BT B-USO investment of £3,400 could in the wider application of Ofcom's finding could be tested in all subsidised works using

¹ Fibre on Demand available in all exchanges was announced by ex CEO of Openreach, in the presence of the current CEO of Openreach at the annual meeting for shareholders in Spring 2014. Record available.

² A term used by sociologists to describe a process in which deviance from correct or proper behaviour becomes normalized in a corporate culture or project. The deviance would have a long incubation period, with early warnings either misinterpreted, ignored or missed completely.

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a normalised BT contribution to direct costs³ of ~£70 per premise passed for FTTC and ~£350 for FTTP premises as means to check that significant consumer harm, where BT Group was planning of rural upgrades failed to include BT required capital expenditure at the planning stage. These numbers can be checked by extending the Fair Bet analysis conducted on Ofcom's behalf by Cartesian. Work on this specific matter was begun by Ofcom/Cartesian in 2017 WLA models and is evident in the published but incomplete WLA 2017 fair bet worksheets where one is labelled BDUK. The review should be done now as the monies which emerge could be used to mitigate against current and future B-USO costs.

4. For instance, the £84m being modelled as a risk appears small when compared with illegal use of subsidy to pass 1.1m Virginmedia⁴ customers. A nominal, or if you wish a 'fair bet' contribution of £70 per Virginmedia customer passed using BDUK subsidy would cover the entire risk. Merely checking that 'gap-funding' and 'profit share or clawback has been applied properly where BT planning excluded the opportunity for BT to make contribution to direct costs throughout much of phase 1 creates an ample means of financing the modelled risk.

5. The Bit Commons has been registering information with Ofcom under complaint number 00557595⁵, since at least 2016 having first raised concerns verbally and seeking help from Ofcom while still working at BDUK in May 2012, and then through subsequent submissions to industry and market review consultations, including those on regulatory financial reporting. The information submitted under complaint number 00557595 has also informed eight Parliamentary inquiries beginning in 2013 and the evidence has not been found wanting, but it has not all been acted upon. The normalised deviancy reported to BDUK in 2012 was simple. BT was pumping its bid prices high⁶, something denied by BT in their 2013 evidence to PAC and but which the NAO confirmed in 2015 by revealing BT had inflated its cost models for the BDUK Framework by 38%⁷ which is more than the direct capital contribution BT has contracted to make. While the subsequent eight Parliamentary enquiries and as many national audit functions (NAO, Audit Scotland, Audit Wales, NI Audit) have done much to unpick the normalised deviancy embedded in the BDUK Framework, the harm done to consumers particularly those denied an upgrade to service is yet to be fully reversed. This harm and the failure of our institutions to deal with the same harm Ofcom have now confirmed on a smaller group of customers led to what many considered a mis-informed request to create the B-USO which was out of date before it was implemented. This consultation can reduce the error by seeking greater alignment with rather than avoidance of BDUK activity. This proposed change is not difficult.

6. The Ofcom B-USO proposal is another piece in the jigsaw of work needed to unpick the wrongdoing protected by the mis-use of commercial confidentiality. The current Ofcom proposal wishes to act on a single piece of the jigsaw while avoiding the adjacent pieces in the jigsaw that are the

³ Allowable costs as defined by BDUK. It excludes all capitalised operational costs and excess application of overheads. The £70 for FTTC and £350 for FTTP are estimates of the direct incremental capital costs.

⁴ As measured and reported by Think Broadband in 2017.

⁵ Reference provided by OCC.

⁶ The scale of the excess was crude. Fujitsu was bidding the costs of a new full fibre network. To 'win' BT Group could price its overlay FTTC service at a little less than full fibre and still win, hence we see subsidy budgets of ~£300 per premise passed for FTTC which would require little or no investment from BT during phase 1 and much of phase 2. The matter remains unresolved.

⁷ See second NAO report on Broadband 2015. <https://www.nao.org.uk/wp-content/uploads/2015/01/The-Superfast-Rural-Broadband-Programme-update.pdf> No effort was made to re-set objectives so the excesses kept building. Excess costs were reported as savings. The BT capital – 'actuals' have never been reported on.

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outstanding BDUK upgrades to rural Broadband, and additional work that could be accommodated using the monies squirrelled away but yet to be publicly reported within the process⁸. The Government B-USO proposal originating in November 2015 was made without reference to the monies accumulating in the Capital Deferral first reported in BT's accounts in that year, three years after the excess inflation of costs in the BDUK Framework was reported by the author. If the excess costs now being requested would still be within the original budgets (subsidy and BT capital contribution) available if there was transparent reporting⁹. If the B-USO works were averaged across all customers benefitting from subsidy the £85m risk could be divided across some 7m¹⁰ subsidised customers adding no more than ~£11 per customer.

7.If Ofcom restrict its review to a selective number of B-USO orders, by avoiding a wider review, then it is endorsing the harm and the wrong-doing arising from the same malpractices identified by Public Accounts Committee and the NAO. Ofcom by choosing to take a narrow focus becomes complicit in a matter that still needs to be seen to be corrected, not avoided. The wider review impacting just more rural customers is justified by Ofcom's finding of significant harm. The suspension of this investigation points to the need for a wider investigation or a wider application of the mitigation measures BT is proposing.

8.It is perhaps better for Ofcom and the UK consumer if the proposed B-USO fix to recover costs from 70% of customers should be just one element of a fully defined 'reasonable request' for a fibre service. The other elements can be copied from the 'reasonable request' definitions for a PSTN line and can be outlined in the ruling. A fibre line overlayed on existing infrastructure will have a similar cost to provide, as evidenced by the £300-£400 unit cost being referenced by BT as the cost for the 6.2m area 3 premises it is now planning to do¹¹. The latter has been facilitated by subsidies of at least ~£1.3bn paying for some 38,000 fibre paths, the associated handover points and some 589k full fibre premises passed if the early subsidised work¹² in Cornwall is included. Some additional allowance may be needed where the 'innovation' of self-buried cable starts to be used to reach the most remote premises.

9.There are other changes that could be made to the B-USO process. Existing contracted works under BDUK for 'superfast'(>24Mbps) but yet to be delivered using full fibre will last until at least 2026 and if the Capital Deferral is re-applied from the unreported investment funds then work will go on longer. The 12 month Ofcom interaction clause between BDUK/B-USO could be extended to the duration of the BDUK contracts or a BT mitigation measure is to include B-USO premises using the contracted funds to reduce the excess costs to the consumer within the B-USO response time.

10.The most BDUK recent reporting highlights contracted works outstanding of 425,313 premises where these works are **only** delivering a reported 12,000 premises in the latest quarter (dec2020 to

⁸ Note BDUK and BT partially answering questions on the use of the Capital Deferral at EFRA Select Committee 2017. Oral evidence: Rural Tourism (including Broadband), HC 428 Wednesday 29 March 2017 see questions Q427, Q428 and Q429. Another attempt was made in 2019 with the same outcome.

⁹ Vodafone Annex 2 submission to Ofcom in 2017 WLA documents what could have been done.

https://www.ofcom.org.uk/data/assets/pdf_file/0021/105249/Vodafone-annex-2.pdf

¹⁰ 7m premise estimate = 5.7m contracted by BDUK, plus 1.1m overbuild of Virginmedia, early subsidised work in Northern Ireland (~350k premises) and Cornwall -(~85,000 premises).

¹¹ See BT press release <https://www.bt.com/bt-plc/assets/documents/investors/financial-reporting-and-news/quarterly-results/2021-22/bt-investor-relations-bulletin-news-and-events-during-q1-2021-22.pdf> page5.

¹² Cornwall work included some ~85,000 subsidised full fibre premises passed.

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mar 2021)¹³. This suggests works before all the clawback is re-applied will take **more than 8 years**. This means B-USO requests (66,500) could be easily incorporated and averaged within the outstanding works. It seems ridiculous Ofcom and BT model financial risks between £17m and £84m for 66,500 customers when there is a clawback provision of £825m¹⁴ and outstanding contract work worth hundreds of millions more. Taking the B-USO activity as an isolated activity is a victory for bureaucratic process over common sense. The mitigation measures BT is offering to compensate for the significant harm Ofcom has identified need to be checked for all rural upgrades as BDUK in nine years has yet to report on BT's actual capital contributions to allowable costs in their gap funding model. The significant harm Ofcom is witnessing is little more than a continuation of the same normalised deviancy first reported by me within BDUK in May 2012 and first flagged as an initial concern in Cumbria in January that year. It would be most peculiar of Ofcom continue to side step a matter, where it has now gathered evidence on a subset of the issue, which has been the cause of deep frustration in Parliament since 2013.

11. At a minimum therefore I would suggest a **third proposal**, which is to encourage BT/BDUK/LA to include in the first instance B-USO activity as change requests in the existing and outstanding BDUK contracts adjusted for an increased BT contribution. This is little more than BDUK/LA/BDUK had promised to do using the identified excesses which were latterly reported as operational savings across all BDUK projects. If the excess costs for 66,500 customers are averaged across all the intervention area of 5.7m premises (+1.1m overbuilt Virginmedia Premises) then higher incremental unit costs are easily absorbed without recourse to an industry fund. This proposal is consistent with the representations made by BDUK and BT to the 2013 Public Accounts Select Committee hearings. If fixing rural remains a priority then it is illogical for Ofcom not to extend the mitigation measures to check more rural work. Challenges at Efra Select Committee hearings on the re-use of monies owed in 2017 and 2019 have been ignored by officials and the matter avoided all together in the most recent consultations on proposed 'gigabit-capable' work.

12. This proposal reflects the reality that 12 months is not long enough for BDUK works to be concluded, while more time is needed to reduce the harm to customers arising from the normalised deviancy still present in BT's approach to BDUK rural contracts. This proposal allows Ofcom to do more for consumers using existing funds intended for this purpose. It also permits a further unpicking and corrections made to deal with the consequences of the normalised deviancy imposed by BT in the BDUK Frameworks. This will be most efficient in reducing the B-USO burden on BT and industry.

Consultations question.

Do you agree with our proposal to amend the treatment of excess costs in determining eligibility for a USO connection, where excess costs are above £5,000? Please set out your reasons and supporting evidence for your response.

13. Ofcom have outlined a quick fix on a very narrow scope and it looks like a private accommodation with BT Group has been agreed to overcome the 'significant consumer harm' which has been identified. What appears to be a private accommodation on this small group avoids the broader

¹³ If you compare the BDUK December Superfast report 2020, and the numbers reported in March 2021. March 2021 numbers available here <https://docs.google.com/spreadsheets/d/1Hs00bNsyRV1WoOt-fow3rsNXzpcKg26AsOWvk1bvJRk/edit#gid=1411146266>.

¹⁴ See notes from BT's accounts on page 7 of this submission.

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harms caused by longer term efforts to game a subsidy process, the latter contributing directly to the mis-timed B-USO.

14. Earlier in this response the need for Ofcom to define a 'reasonable request' for fibre is outlined. It is within this context that the B-USO proposal is then set.

15. In addition to the above the matter can be more comprehensively dealt with if Ofcom introduces in the form of an additional proposal which takes into account the work contracted and outstanding with BDUK (435k premises¹⁵) and the monies outstanding from 10 year programme of subsidies.

16. An additional third proposal would oblige BT and BDUK/LA to make all reasonable endeavours to include in the first instance B-USO requests within existing and outstanding contractual obligations (435k premises) which, if based on current progress (12k premises per quarter) will last another 8 years. The nature of the work and the solution is the same. The work is being conducted by the same people and those managing the finances will be aware of what is owed. This then removes the need for any proposed industry fund, while securing rather than avoiding additional fixes to the same harm that is likely to be tolerated and avoided by virtue of the work being conducted

17. The latter would require a modification added to A.7 schedule - Proposed modifications to the Conditions contained in Schedule 1 to the 2019 Notification.

It would read something like;

18. Where BDUK contracts for upgrades are outstanding and where B-USO requests can be accommodated using vouchers or utilising outstanding capital Deferral, BT and its BDUK and LA will endeavour (have agreed) to use these mechanisms and explain to the customer why these mechanisms have failed where an excess cost is deemed necessary.

19. Ofcom should separately use the fair bet analysis to confirm that BT has made the appropriate direct capital contributions to all subsidised works including the early work in Northern Ireland and Cornwall. Note the Northern Ireland audit office¹⁶ could not confirm 'value for money' for the subsidised broadband work. An Ofcom intervention at this time would be appropriate as neither the National Audit Office or the devolved audit functions have reported on 'actual' BT contributions to direct capital costs to BDUK. They have reported commitments and contracted but not actuals.

Other points to consider.

20. Ofcom can take the opportunity to adjust the B-USO to >24Mbps as a minimum. If B-USO is to be fixed using full fibre, there is no particular reason why the 10Mbps limit cannot be extended upwards.

21. The opportunity also needs to be taken to adjust the B-USO to support video calling and conferencing. This may need the planning rules for peak hour operations to be adjusted. The reliance on voice is out of date and this was clear during the DCMS consultations in 2017 and 2018.

¹⁵ 435k premises is the difference in premises BDUK is reporting as contracted and delivered available on the BDUK website for March 2021.

¹⁶ <https://www.niauditoffice.gov.uk/publications/broadband-investment-northern-ireland>

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22.Ofcom in reviewing the B-USO could also conclude that the need for an industry fund is unlikely and that is within BDUK's gift to use the monies outstanding in the Capital Deferral to uplift the B-USO to >24Mbps using full fibre services to do so.

23.Thank you for the opportunity to make this submission. Given the references to the £825m Capital Deferral in BT's accounts is beginning to dis-appear (see below) this may be one of the few opportunities to secure a final push on rural upgrades.

End.

Mike Kiely

24.Note: I was employed by BT for 22 years. I was subsequently employed by BDUK where I wrote most of the strategy and the technical requirements for 2012-2022 rural Broadband upgrades. I was asked to study and comply with the Nolan principals, the civil service equivalent of the BT Values and would expect principals and values to apply to the procurement. Unfortunately it failed to happen.

25.The BDUK specifications I wrote and budgets created to support BDUK requirements included substantial allowance for FTTP in-fill. You would not write a rural Broadband requirement to exclude those on long cooper loops. More than half of the original budget was for full fibre in-fill deep in rural areas, something seemingly forgotten in 2013 as BT Group withdrew most FTTP and attempted to portray FTTC as a panacea¹⁷. The mixed-economy solution as it was then known appeared to be forgotten about in 2013 and returned only in 2016-17 after the CMS Select Inquiry of 2016. This means there is still significant funding available to complete these works. This is now only partially recorded in the latest footnotes of BT published accounts. Outlined here is the very recent change in how BT has chosen to reduce the scale of the Capital Deferral reported.

BT Clawback – as per BT accounts 2020/21

BDUK Capital Deferral, intended to complete rural upgrades is referenced in the footnote number 1 in the KPI's – see 'Group-costs' tab on the BTplc results page.
£37m was added in 2021, which is great. This is equivalent to the entire BDUK allocation to Cumbria in 2012, a Cumbria which still has constituencies with less than 90% coverage.

There is no explanation on the workings of how this is converted into 'network capacity'. The accumulated total should now be **£825m but this is no longer visible**, as reference to the earlier years have been deleted and the only public record of the full amount no longer exists. Government, DCMS in 8 years have not reported the actual status of BT capital contributions or the clawback. It has been lied about several times, including Ministerial evidence to the 2016 CMS select committee inquiry. It has been blagged about in many other inquiries and responses to written Parliamentary Questions.

2019-20 BT KPI report provides a full record.

2 Gross BDUK grant funding deferral (clawback) included in capacity/network: 2014/15: £29m; 2015/16: £229m; 2016/17: £188m; 2017/18: £112m; 2018/19: £213m; 2019/20: £17m (Total - £788m)

2020-21 BT KPI report provides a partial record.

1 Gross BDUK grant funding deferral (clawback) included in capacity/network: 2018/19: £213m; 2019/20: £17m; 2020/21: £37m - No public record now exists of accumulated clawback which now be £825m. No public record exists of what has been paid back to whom, what is outstanding and what has been invested.

BDUK only needs to contract a further ~200k rural premises in England for Broadband upgrades using the existing contracts in order to achieve 99%+ Broadband coverage where 1m very rural premises have full fibre. **If completed it would amount to one of HMG's best ever procurements in terms of the outcome achieved versus cost to taxpayer. It will also, with the help of 8 Parliamentary inquiries have triggered the transition to full fibre from what has been a very reluctant BT Group who through this time have lost £2bn (source FT) on BT sport.**

¹⁷ As late 2016 Gavin Patterson then CEO was presenting copper bases solutions VDSL G.Fast as a panacea in BT press releases.

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26. I lost my position with BDUK as a contractor in 2012 after the work I produced showing the inflation of costs was leaked by parties unknown in 2012. BDUK as late as 2021 in WPQ 128953, despite the NAO finding in 2015 that BT had inflated its model costs by 38% stated BT was entitled to 'contingency'. This apparent indifference by officials is unfortunate and should be challenged, as after 9 years no public record yet exists of what and when BT made its Capital Contributions to the gap-funding model. There is only reference to 'committed', 'contracted', 'incurred', 'expected' but never actually paid¹⁸. This has a direct bearing on whether an industry fund is needed or not. I hope Ofcom can take the extra step to secure from BT the application of its mitigation proposals against the significant harm to any wrong-doing found throughout the rural works where subsidies were being gamed for FTTC and full fibre while BT capital was being effectively with-held. The references to the investment fund in many BDUK documents to complete rural upgrades has now disappeared as is the reference to the full Capital Deferral in BT's accounts. Neither is referenced in the 'gigabit-capable' consultations.

¹⁸ There is series of Written Parliament Questions (WPQ's) on this matter from 2015, and include WPQ's 13727, 13628, 20986, 47312, 206211. All used expressions to avoid confirming actual payments.