



SKY'S RESPONSE TO OFCOM'S CALL FOR INPUTS ON DESIGNING THE UNIVERSAL SERVICE OBLIGATION

SECTION 1: INTRODUCTION

- 1.1 Sky welcomes the opportunity to respond to Ofcom's call for inputs on designing the broadband universal service obligation ("the call for inputs").
- 1.2 Sky has strongly advocated for policymakers to display genuine ambition in their approach to digital infrastructure. Improving the access, speed and consistency of connectivity across the whole of the country is of vital importance to the UK's future. Digital communications infrastructure is a key technological enabler – an area where investment, availability and innovation can have multiplier effects across the whole economy.
- 1.3 There will always be geographical regions that are more difficult to provide for than others. Some areas may not be commercially viable, and may therefore require additional intervention in order to be served. Given this, Sky broadly supports the Government's commitment to the introduction of a universal service obligation for broadband to provide a basic broadband service to as much of the country as possible to ensure digital inclusion.
- 1.4 In the following sections we outline some key principles that Ofcom should seek to secure when making recommendations on the design of the USO, as well as identifying risks it should look to mitigate. We conclude by providing short specific comments on the areas Ofcom has requested inputs on.

SECTION 2: KEY PRINCIPLES OF A NEW BROADBAND UNIVERSAL SERVICE OBLIGATION

- 2.1 The introduction of a broadband USO should, like all policy interventions, be objectively justified, proportionate, cost-effective, technology neutral and targeted appropriately at areas where market provision is not forthcoming. It is crucial that Government and Ofcom seek to design a USO mechanism in line with this approach.
- 2.2 Consequently, Sky considers that there are a number of key principles against which Ofcom should evaluate potential USO delivery options. Failure to meet these principles would result in significant risks arising that could prove harmful to consumers and industry alike.

The broadband USO must not unduly distort the market

- 2.3 A central consideration in the design of the broadband USO should be what safeguards are included in order to prevent market distortion. Sky notes that the Universal Service Directive specifically requires that any USO measures "*seek to minimise market distortion*"¹.
- 2.4 The use of state-administered funding (regardless of whether this funding is provided for by general taxation or via an industry levy) to provide broadband services risks market distortion in a number of ways. These include:

¹ Universal service directive, recital clause (5)

- (i) The possibility that universal service providers (USPs) accessing this funding over-recover on their costs in instances where estimates are not transparent and/or independent assessment of these estimates is ineffective.
 - (ii) The risk that the availability of funding diminishes USPs' incentives to invest in areas which may in fact be commercially viable.
 - (iii) The potential for funding to be used by USPs to overbuild existing or planned networks from competitors that are not USPs.
 - (iv) The risk of vertically integrated operators being able to leverage any benefits that accrue at the wholesale level into downstream markets.
- 2.5 Each of these risks requires appropriate consideration and mitigation when designing the broadband USO. Sky considers that while it is within Ofcom's and Government's gift to address a number of these issues, others are more systemic concerns that will remain problematic given the current market structure.
- 2.6 The risk of over-recovery can be mitigated through robust scrutiny of cost estimates at the earliest opportunity. As the independent regulator, Ofcom should be responsible for evaluating the total cost of provisioning broadband to USO-eligible premises. It should establish this through a transparent and open consultation process, with full visibility of the estimates and methodology it is using. This estimate should also be independently reviewed by an independent auditor. These estimates will provide an upper bound for the total funding pot that needs to be made available for provision of the USO.
- 2.7 Similarly, the risk of network overbuild should be relatively straightforward to address. Ofcom's recommendations should include proposals with clearly defined eligibility criteria, including clear restrictions on the use of USO funding where networks exist or are planned.
- 2.8 However, Sky's concern is that any USO scheme established within the current market structure carries the risk of market distortion, given the likely central role of Openreach and the effect of BT's vertical integration. Any benefits that accrue at a wholesale level to Openreach could serve to give BT an advantage downstream at the retail level.
- 2.9 Relatedly, Sky is also of the view that BT's ownership of Openreach acts to hinder the level of fibre network investment and commercial roll-out in the UK. Without the prospect of network level competition (which is unviable at scale so long as BT Consumer only procures its services from Openreach), Openreach is only incentivised to adopt incremental upgrades to its copper network rather than more ambitious approaches. These upgrades may not deliver improved speeds on as wide a basis as may otherwise occur. While BT retains ownership of Openreach, the full potential of market provision is unlikely to be realised. This means that the broadband USO is likely to be deployed in areas that may otherwise be served commercially under a different market structure.
- 2.10 It is difficult to see how either of these issues can be mitigated through the design of the broadband USO. They are only likely to be addressed through significant structural remedies which Sky has previously advocated.
- 2.11 Risks to market distortion can arise not just from the use of USO funding, but also from its collection. Sky notes Government's "preference for an industry-funded scheme"², which

² DCMS letter to Ofcom, 22nd March 2016. Available at: http://stakeholders.ofcom.org.uk/binaries/consultations/broadband-USO-CFI/annexes/DCMS_Letter.pdf.

could conceivably take the form of an industry tax or levy. Depending on the scope of such a scheme, this could result in certain providers being competitively disadvantaged.

- 2.12 It is imperative that any levy be applied on a technologically neutral basis. The focus of the broadband USO is to ensure the provision of internet access to all consumers. This can clearly be delivered by a wide range of providers and delivery methods – fixed, cable, mobile, satellite and so on. Applying a levy only to a subset of these providers would risk distorting competition in favour of those operators that were not subject to the scheme.

Ofcom's recommendations should preserve fair and effective competition at the retail level

- 2.13 During the past ten years, consumers and businesses have benefited significantly from strong competition and rapid technological progress in relation to broadband and internet access. Entry by scale players such as Sky, TalkTalk, Orange and others produced a range of benefits, notably rapid rollout of new broadband technologies which increased speeds significantly, and innovative new approaches to pricing and packaging. The result was high levels of take-up of broadband services, falling charges, and impressive growth in broadband speeds delivered to consumers.
- 2.14 It is critical therefore that this level of retail competition is preserved – even in USO areas where there is currently no or limited provision of broadband. Sky further notes that Article 1 of the Universal Service Directive requires that provision of a minimum set of services should be undertaken “*without distorting competition*”³.
- 2.15 Sky notes two potential risks to retail competition that might arise through a broadband USO (notwithstanding our comments above in relation to BT's vertical integration).
- 2.16 Firstly, designation of USPs at the retail level risks restricting the choice available to those consumers living in the relevant USO area. Given the current market structure, it is unlikely that retail communications providers who are not vertically integrated network operators would seek to be designated USPs, given that in order to fulfil this regulatory obligation they would be reliant on a wholesale network access from a third party.
- 2.17 In order to alleviate this risk, in designing the USO, Ofcom should give consideration to designating USPs at the wholesale level instead. It is clear, for example, that Openreach's network infrastructure and scale would make it well placed to deliver a USO on a wholesale basis in the vast majority of cases. Were Openreach to be assigned the relevant obligation (i.e. be the party that accessed funds and faced regulatory sanctions if it did not deliver in line with its requirements), it would enable other providers to compete at the retail level in the USO areas, as occurs elsewhere.
- 2.18 In this case, communications providers such as Sky would continue to act as the point of contact for consumers wishing to take advantage of the USO. Providers would order new broadband lines in the same way as currently occurs, with Openreach notifying the provider where a request fell under the USO scheme and in such a case providing the cost of provisioning. Openreach could then on a periodic basis draw down funds from the USO pot, on the basis of the number of premises it had provided for in that period.
- 2.19 Secondly, there is a significant risk that certain delivery methods being considered by Ofcom for the USO could undermine existing retail competition based on LLU.
- 2.20 For example, Sky understands that Ofcom is considering the role that long-reach GEA might play in delivering a guaranteed 10Mbps broadband service to premises in GEA

³ Universal service directive, Article 1 clause 2.

enabled areas. Sky recognises the benefits of increasing the reach of broadband services by allowing cabinet-based DSLAMs to transmit signals in the ADSL2+ band. However, Sky also observes that injecting ADSL2+ frequencies at the cabinet will cause strong crosstalk interference into adjacent lines, many of which are likely to be carrying ADSL2+ signals from exchange based DSLAMs, and that such crosstalk is likely to cause severe degradation in the performance of the exchange lines. Since detailed knowledge about which lines run adjacent to each other is not available, the effect of permitting ADSL from a cabinet will be effectively to make exchange ADSL services running through the same cabinet unviable.

- 2.21 Roll-out of this product would therefore, in effect, prevent Sky and other LLU providers from being able to supply standard ADSL broadband to customers served by the same cabinet. Clearly this would have adverse effects on retail competition in areas already well served by a choice of providers.
- 2.22 To avoid this, Ofcom should not adopt any technological approach which will have consequential effects on retail competition from being used to deliver the USO.

Ofcom should propose a set of suitable technical characteristics required to deliver basic services

- 2.23 As Government noted in its consultation in March⁴, the rationale of a USO is to act as a 'safety net' where commercial providers do not deliver access to basic services (in this instance, internet access) for people in order to prevent social exclusion.
- 2.24 The term 'basic services' deserves careful evaluation. In its March consultation, Government referred to the need to ensure "*full participation in our digital society*", and listed a variety of activities that it considered contributed to this - "*watching video on demand, listening to internet radio or streamed music, using social media, accessing Government services, shopping online and working from home*".
- 2.25 Ofcom's task should be to evaluate the minimum set of technical characteristics needed to deliver these basic services. Doing so is crucial to ensure that the USO is an efficient mechanism, targeted at a limited number of households. Any alternative approach would risk being disproportionate. The USO is not the appropriate vehicle for Government to use in delivering any wider ambitions of improved connectivity.
- 2.26 Sky notes both Ofcom and Government's stated preference for a 10Mbps USO speed. Sky would highlight that speed is only one aspect of the customer experience of broadband services. Issues such as reliability, latency, simplicity and upload rates have become ever more important, and Ofcom should give consideration as to the minimum levels required for each of these in order for customers to access basic services.

Policymakers should ensure sufficient regulatory certainty and transparency of process

- 2.27 As noted, Sky welcomes the opportunity to provide our views to Ofcom at this stage of the policymaking process. But Ofcom and Government must ensure that they continue to engage with industry, both as the policy development process progresses, and once the specific USO mechanism has been decided on.
- 2.28 In the first instance, Ofcom should seek to consult on the recommendations it is minded to present to Government. The high level nature of the call for inputs means that

⁴ DCMS, "A new broadband universal service obligation". Available at: <https://www.gov.uk/government/consultations/broadband-universal-service-obligation>.

respondents will necessarily have to provide comments at a general level. Stakeholders should have an opportunity to examine in more detail the specific proposals which Ofcom makes.

- 2.29 Secondly, Ofcom should seek to ensure that the eventual implementation of the USO is equally transparent and open. In particular, and as highlighted above, the calculation of the USO footprint and any cost estimates should take place through a consultative process, with stakeholders having full sight of and the opportunity to comment on the methodology and values.
- 2.30 Finally, industry requires certainty over how future variations to the broadband USO might be made. Sky has already highlighted to DCMS that there must be a sufficiently high threshold for further future changes via secondary legislation - by, for example, stipulating that the Secretary of State (or, accordingly, Ofcom) must consult on any notice or order he/she issues in relation to future amendments to the USO such as a change in speed, affordability or other characteristic of the framework. Such an approach will be crucial in ensuring that, both now and in the future, industry has the opportunity to provide evidence and views on how the USO should operate and evolve.
- 2.31 In summary, Ofcom's recommendations to Government must clearly satisfy all four of these principles in order for the broadband USO to be an effective and proportionate intervention.

SECTION 3: COMMENTS ON OFCOM'S AREAS OF INPUT

- 3.1 In this section, we provide short comments on the six areas of the call for inputs. Our comments are framed by the principles we identified above

Specification and scope of the USO

- 3.2 As noted, Sky considers that it is crucial that a realistic minimum set of technical characteristics is alighted on in order for consumers to access basic services. We note Government's stated ambition of minimum speed of 10Mbps, but consider that Ofcom should explore other technical aspects such as reliability and upload speeds.
- 3.3 The call for inputs also asks how Ofcom can ensure the USO is made affordable, and whether there should be a social tariff for broadband services. If the broadband USO is defined as a safety net, setting a social tariff (for low-income groups for example) may be appropriate for a basic level of service.

Demand for the USO

- 3.4 Sky notes Ofcom's estimate of 2.4 million UK premises that were unable to receive broadband speeds above 10MBps in 2015⁵. Similarly, we note and concur with Government's assessment that the completion of the BDUK programme and continued commercial roll-out is likely to reduce this footprint significantly by the time the USO is introduced.

Cost, proportionality and efficiency of the USO

- 3.5 As highlighted, Sky considers that estimating the cost of the USO will be a critical area for Ofcom to focus on. There needs to be a clear independent assessment of the likely cost of provision, with Ofcom, industry and other sectoral experts able to scrutinise and input.

⁵ Ofcom "Connected Nations 2015".

Transparency and accuracy of cost estimates will be crucial in order to avoid the possibility of market distortion through over-recovery.

- 3.6 The call for inputs asks for views on what a 'reasonable request' might be defined as. In Sky's view, such a threshold can only be established once the likely cost profile and USO footprint has been established, and with due consideration to the level of funding that is appropriate. We note that the current telephony USO has a cap of £3,400, and would consider that this could provide a useful starting point.

The universal service provider

- 3.7 As noted, Sky considers that Ofcom should give due consideration to whether USPs should be designated at the wholesale level rather than the retail level, in order to preserve retail competition.
- 3.8 It is clear that Openreach's scale and ubiquity means it is well placed to deliver a broadband USO on a UK-wide basis. It may be that other wholesale providers, perhaps using particular delivery methods, have the ability to deliver in specific circumstances and as such should be USPs in specific regions or situations.

Funding of the USO

- 3.9 Where Government determines there is a substantial societal benefit only achievable through a USO-like intervention and requiring significant public funding, the most distortion-free approach to that funding is recognised to be general taxation. Sky supports this approach in principle.
- 3.10 We also note Government's stated preference for industry-led funding. We continue to believe that sector-specific funding obligations entail certain risks – most notably the potential to distort competition, as well as gaming of the resultant regulatory oversight.
- 3.11 As highlighted, it is crucial that if industry funding is pursued (via subscriber levy for example) it is technologically neutral and encompasses all broadband subscribers, whether by fixed line, mobile broadband or other methods.

Review of the USO

- 3.12 We highlight above the need for regulatory and investment certainty and transparency of process as part of any review of the USO. Ofcom also needs to future proof the USO to allow for future technological developments and to safeguard investment incentives. An important part of this assessment is the need for Ofcom to review the USO on a periodic basis (e.g. every 5 -10 years) in full consultation with industry.