
Compensating providers delivering universal services

Statement on the funding process and the making of
funding regulations under section 71 of the
Communications Act 2003

STATEMENT:

Publication date: 22 May 2020

Contents

Section

| | |
|--|----|
| 1. Overview | 1 |
| 2. Introduction | 3 |
| 3. Legal framework | 9 |
| 4. Reviewing and determining a request for funding | 20 |
| 5. Calculating and verifying a net cost | 37 |
| 6. Determining the extent of any unfair burden | 47 |
| 7. Establishing an industry fund | 55 |
| 8. Procedures for the collection and distribution of funds | 71 |
| 9. Calculation of a net cost for the broadband USO | 81 |

Annex

| | |
|---|-----|
| A1. Funding regulations | 99 |
| A2. Regulatory impact assessment | 100 |
| A3. Directions on financial reporting | 106 |
| A4. Guidance on calculating turnover | 107 |
| A5. Consultation responses: implementation of the broadband USO | 109 |
| A6. Glossary | 115 |

1. Overview

We want people across the whole of the UK to access better broadband and mobile phone services. The current coronavirus (Covid-19) crisis has highlighted the importance of communications services in everyone's lives, which are enabling them to stay connected with friends and family, continue to work and engage with businesses. So as set out in our Plan of Work for 2020/2021, we are continuing to encourage investment in faster, more reliable networks and make sure the coverage of networks extends as far as possible – even to the hardest-to-reach places.¹

In 2018, the UK Government introduced legislation for a broadband USO, to give homes and businesses the right to request a decent and affordable broadband connection. Ofcom is responsible for implementing the broadband USO, and in June 2019 we appointed BT and KCOM to deliver these connections. The broadband USO launched on 20 March 2020 and people can now make requests for these services.

As the 'Universal Service Providers', BT and KCOM are entitled to request compensation for any cost of delivering universal services that it would not be appropriate for them to cover themselves. Before assessing and verifying any request for compensation, we need to put in place the rules and procedures Ofcom and providers should follow.

This document explains our final decisions on the funding regulations for universal services and decisions on guidance as to how we will undertake any assessment. The funding regulations apply to the broadband USO and to any other universal service obligations for telecoms services.

What we have decided – in brief

- **A Universal Service Provider can request that Ofcom reviews their request for funding** for the cost of delivering the USO, minus any benefits associated with being the Universal Service Provider (net cost). We expect to review no more than one request for funding per year, and it is for Ofcom to decide on the scope of a review and when the review will begin.
- **A Universal Service Provider must submit appropriate information to support their request for funding.** We provide guidance on this information in the Statement. For the purposes of the broadband USO, we also separately require the provider to submit specific financial information, for example, capital costs incurred and forecasts of future revenues and costs.
- **When carrying out a review, Ofcom will need to determine the existence and level of any net cost.** We will review the information submitted by the provider and assess whether the costs incurred in delivering the USO were efficient. There will be a separate process to check our calculation including, if appropriate, by an independent party.
- **Once we determine a net cost, we will decide whether it would be unfair for the provider to bear some, or all, of that cost.** Our approach includes considering: the cost to Ofcom and industry of establishing and administering an industry fund; the impact on the provider of bearing these costs alone; the method of designating the Universal Service Providers; and the outcome of any previous determinations.

¹ Ofcom, April 2020. [Ofcom's Plan of Work 2020/21: Making communications work for everyone](#), page 22 .

- **If we find Universal Service Providers have incurred unfair costs, we may establish an industry fund to compensate them.** We will also determine who will contribute to the fund and how much they will contribute. This will include any threshold below which contributions will not be required.
- **Once we have established an industry fund, we will collect monies from industry and compensate the Universal Service Provider.** We will gather and check relevant information to calculate individual contributions. We will then invoice each provider required to contribute. When we start receiving the contributions, we will pay the Universal Service Provider on a monthly basis.

Our decision

- 1.1 We have considered comments received in response to our consultation and set out our decision on the funding regulations which can be found at Annex 1. We are providing greater clarity on how these regulations will apply when assessing a request for funding, including how these regulations apply generally to all USOs and how they will apply more specifically to the broadband USO.
- 1.2 In this document, we also:
 - a) make regulatory financial reporting directions for BT and KCOM. The directions will require the Universal Service Providers to supply information to support any request for a funding review;
 - b) set out our guidance on the calculation of net relevant turnover for the purposes of calculating the amount of any contributions that are due to an industry fund.

Next steps

- 1.3 We will make the Electronic Communications (Universal Service) (Costs) Regulations (2020) shortly. They will be available on the [legislation.gov.uk](https://www.legislation.gov.uk) website.
- 1.4 We will monitor BT and KCOM's delivery of the broadband USO. We will also continue to report on the number of premises that are unable to access decent broadband going forward, in our *Connected Nations* reports.

2. Introduction

- 2.1 In this statement we have decided to put in place The Electronic Communications (Universal Service) (Costs) Regulations 2020 (final) (“the funding regulations”) to establish a process to compensate Universal Service Providers for providing universal services. We anticipate that the first process to run under the funding regulations will relate to the broadband USO.
- 2.2 The broadband USO launched on 20 March 2020. Every home and business in the UK now has the legal right to request a decent, affordable broadband connection from BT, or KCOM in the Hull area.
- 2.3 The broadband USO acts as a ‘safety net’ for people who might otherwise get left behind and is one of the means by which we aim to secure decent broadband for consumers in the hardest-to-reach parts of the UK. The current coronavirus (Covid-19) crisis has highlighted the importance of communications services in everyone’s lives, which are enabling them to stay connected with friends and family, engage with businesses, study and work. Therefore, we continue with our plan of work priorities to encourage investment in improved networks and make sure the coverage of networks extends as far as possible – including to the hardest-to-reach places.
- 2.4 The Government introduced the legislation² for a broadband universal service obligation (“the broadband USO”) in March 2018 stating that affordable broadband connections and services must be provided throughout the UK with a download speed of at least 10 megabits per second (“Mbit/s”), an upload speed of 1 Mbit/s and other specified technical characteristics.³

Compensating providers delivering universal services

- 2.5 There is no automatic funding of the provision of universal services and compensation can only be paid to Universal Service Providers following an assessment by Ofcom.
- 2.6 In order for us to assess a net cost we need to put in place the funding regulations. These set out rules and procedures so that we are able to:
- a) determine whether a Universal Service Provider has incurred a net cost;
 - b) determine whether all or part of that net cost is unfair for the Universal Service Provider to bear; and if so,
 - c) establish an industry fund, including deciding who contributes to the fund.

² [The Electronic Communications \(Universal Service\) \(Broadband\) Order](#) came into force on 23 April 2018.

³ The technical specification of the broadband universal service in the 2018 Order includes a download sync speed of at least 10 megabits per second; an upload sync speed of at least one megabit per second; a contention ratio of no higher than 50:1; latency which is capable of allowing the end-user to make and receive voice calls over the connection effectively; and the capability to allow data usage of at least 100 gigabytes per month.

- 2.7 The funding regulations are not specific to the broadband USO. They will apply to costs incurred in connection with all universal service conditions currently in force⁴, as well as universal service conditions which may be imposed in the future. The underlying procedures we would follow to assess a net cost would be the same for all universal service obligations as they are underpinned by the same legislation.⁵ In our view, having a single set of rules and procedures will be more appropriate, straightforward and less burdensome than creating different sets of funding regulations for different universal service conditions.
- 2.8 The Government said that any compensation for the broadband USO would need to be met by an industry fund and through a cost sharing mechanism which will be established by Ofcom.⁶ As the Universal Service Providers, BT and KCOM can request funding for any unfair net cost incurred in the delivery of the broadband USO.

Purpose of this document

- 2.9 In *Compensating providers delivering universal services: Consultation on the funding process and notice of Ofcom's proposal to make funding regulations under section 71 of the Communications Act 2003* ("the November 2019 consultation"), we consulted on the rules and procedures the Universal Service Providers and Ofcom will follow should a request for funding be made.
- 2.10 In this statement we set out the decisions we have made on:
- a) the content of the funding regulations – the funding regulations will be made by way of statutory instrument and become law imposing legal and binding obligations. The funding regulations set out the rules and procedures we will follow when assessing any net costs of the provision of a universal service and where appropriate, compensating the Universal Service Provider for those costs. We intend to make funding regulations which will be substantively in the form contained in Annex 1. We plan to make them as soon as reasonably practicable after the publication of this statement after which they will come into force.⁷
 - b) Our approach to any request for funding under the funding regulations – the funding regulations will apply to costs incurred in connection with all present universal service conditions as well as universal service conditions which may be imposed in the future. The funding regulations have, therefore, been drafted with a broad application in mind.
 - c) Our approach to a request for funding specific to the broadband USO under the funding regulations – we outline how we envisage approaching the review of any net

⁴ The telephony USO which guarantees a decent level of home phone services has been in place since 2003.

⁵ The requirement to secure universal service in the UK currently derives from the Universal Service Directive which has been implemented into UK law through the Communications Act 2003 ("the Act") and secondary legislation.

⁶ DCMS, March 2018. [A new broadband Universal Service Obligation: Government's response to consultation on design](#), page 54.

⁷ The funding regulations will be available on the [legislation.gov.uk](https://www.legislation.gov.uk) website.

cost and compensating the Universal Service Provider for any unfair cost burden for the delivery of the broadband USO.

- 2.11 In addition, we also set out our decision on:
- a) regulatory obligations on financial reporting for BT and KCOM under the broadband universal service conditions F3.⁸ The obligations in the directions require the Universal Service Providers to supply certain information to us to support any request to review a net cost; and
 - b) guidance on the calculation of net relevant turnover for the purposes of calculating the amount of any contributions that are due to an industry fund.⁹

Background on the broadband USO

Designation of Universal Service Providers for the broadband USO

- 2.12 As part of our work to implement the broadband USO, we designated BT and KCOM as Universal Service Providers who will be responsible for taking requests for broadband USO connections. Following consultation, we set conditions that apply to them as they deliver broadband USO connections and services.
- 2.13 These cover the eligibility checks BT and KCOM should follow when they receive a request for a USO service; the delivery timeframes for providing these connections; requirements seeking to ensure that USO customers will receive the same quality of service as non-USO customers; pricing of USO services to ensure they are affordable so that customers will pay the same price for their USO service as equivalent services across the UK¹⁰; requirements for handling any complaints and dispute resolution; and a set of performance reporting requirements to help monitor compliance with these conditions.

Number of premises without access to decent broadband

- 2.14 As commercial and publicly-funded network rollout continues, the number of premises that cannot get decent broadband from a fixed network has continued to fall from 15% in 2014¹¹ to 4% in 2017¹² and 2% in 2019.¹³
- 2.15 There are around 610,000 homes and businesses that are still unable to receive a decent fixed line broadband service. Fixed Wireless Access (“FWA”) services have the capability to

⁸ See the June 2019 statement, [Annex 1 Legal instruments](#).

⁹ Please see Annex 4 of this document.

¹⁰ We also secured voluntary commitments from BT that the broadband USO services are priced no more than a safeguard level of £46.10 per month. The commitment was originally set at £45 per month in 2018 prices and has subsequently been uplifted by CPI. In general, we found that broadband prices in the UK are generally affordable and most service providers offer services comfortably below this price.

¹¹ Ofcom, December 2014. [Infrastructure Report 2014](#), page 2. This figure represents 15% of UK households cannot receive 10 Mbit/s.

¹² Ofcom, December 2017. [Connected Nations Report 2017](#), figure 2.

¹³ Ofcom, December 2019. [Connected Nations Report 2019](#), page 3.

connect a significant number of these premises. Taking account of predicted coverage of FWA services would leave around 189,000 premises unable to access decent broadband.¹⁴

Figure 1: Breakdown of the number of premises estimated to be unable to get decent broadband from fixed, WISP¹⁵ or mobile FWA connection

| Nation | No decent broadband from a fixed line | No decent broadband (no fixed, WISP or mobile) |
|------------------|---------------------------------------|--|
| UK | 610,000 | 189,000 |
| England | 412,00 | 111,000 |
| Northern Ireland | 50,000 | 20,000 |
| Scotland | 98,000 | 40,000 |
| Wales | 50,000 | 18,000 |

Source: *Connected Nations Report 2019*

- 2.16 The Government has set a limit of £3,400 for the cost of each connection. It is for BT and KCOM to determine whether the cost of a broadband USO connection is more than £3,400 as part of the eligibility checking process. As a significant number of these premises that cannot access decent broadband are in rural areas with challenging geographies, many will be over the reasonable cost threshold. Consumers have the option of contributing to the cost of connection over the £3,400 limit. Where that is not possible those premises will still be unable to get a decent, affordable service.

BT considers it will be able to connect 11-16k premises below the £3,400 reasonable cost threshold

- 2.17 The number of eligible premises has continued to fall due to several factors, including the expansion of FWA coverage and continued fibre rollout. BT now expects to connect 11-16k premises under the broadband USO.¹⁶
- 2.18 As the number of eligible premises continues to fall, so has the likely cost of delivering the broadband USO. At the time of our *Delivering the Broadband Universal Service: Designating Universal Service Providers and setting conditions* (“the June 2019 statement”) BT said a net cost for the broadband USO could be in the region of £50 to £80m based on connecting 40,000 premises.¹⁷ BT now estimates it would cost at least £30m to connect the

¹⁴ Ofcom, December 2019. *Connected Nations Report 2019*, page 2.

¹⁵ FWA services can be delivered on networks that only serve customers at a fixed location, by Wireless Internet Service Providers (“WISPs”). In the UK, these networks most commonly use licence exempt or light licensed spectrum such as the 5 GHz band. They can also be delivered on mobile networks, where the capacity of the network is shared with mobile users, using 4G and 5G technologies.

¹⁶ Ofcom meeting with BT on 6 April 2020.

¹⁷ BT response to the December 2018 consultation, page 6 and Section 3.

premises that fall under the £3,400 cost threshold.¹⁸ BT estimates that it could cost up to an additional £25m for i) any additional premises which on investigation prove unable to receive the minimum threshold speed and ii) premises above the cost threshold where the customer chooses to pay for the additional connection cost above the £3,400 threshold.¹⁹

KCOM considers there are no premises in the Hull area that will need a broadband USO connection

2.19 KCOM considers that there are no premises in the Hull area that will be eligible for the broadband USO and has said that all customers can order an affordable fibre or ADSL service which meets the technical specification of the broadband USO.²⁰ KCOM continues to extend its full fibre coverage in the Hull area.

Future work

2.20 Broadband is a vital part of many people's lives, enabling them to stay connected with friends and family, alongside engaging with businesses. These services have proved even more crucial in the current coronavirus crisis as people across the UK have had to adapt and change the way they live, work, learn and communicate.

2.21 It therefore is important that we continue work to address the remaining premises that will not be able to receive a decent broadband connection going forward. These premises are in the hardest-to-reach areas of the UK and are typically rural, remote and sparsely distributed. We are discussing with Government what options are available for improving these connections as well as looking to understand how people's needs for connectivity will evolve in future.

Next steps

2.22 We will closely monitor the delivery of the broadband USO and apply the rules and procedures set out in these regulations should a request for funding from BT and/or KCOM be submitted.

2.23 Through the universal service conditions, BT and KCOM are required to publicly report on connection supply times, complaints and on other parameters that we think are necessary to monitor how they are meeting the universal service conditions. We have also put in place additional annual reporting requirements so that BT and KCOM report to Ofcom on the specific timeframes within the obligations in respect of eligibility checking and delivery

¹⁸ Ofcom meeting with BT on 6 April 2020.

¹⁹ Where the cost of a connection is higher than £3,400 amount, eligible consumers and businesses will be able to receive a broadband USO connection and service if they pay (i) any costs over £3,400 (excluding VAT) and (ii) any VAT on the cost over £3,400.

²⁰ KCOM [webpage](#) on the broadband USO.

timeframes.²¹ Our annual *Connected Nations* report will provide updates on the progress of the broadband USO including the number, type and location of connections delivered.

Rest of this document

2.24 The rest of this document is structured as follows:

- **Section 3** sets out the legal framework for funding of the universal services;
- **Section 4** sets out our procedures for assessing a request for funding;
- **Section 5** sets out how we will calculate and verify a net cost;
- **Section 6** sets out how we will determine if a net cost is unfair;
- **Section 7** sets out the design of an industry fund and who contributes to it;
- **Section 8** sets out the procedures for the collection and distribution of contributions to an industry fund; and
- **Section 9** sets out the requirements in the separate regulatory financial reporting directions designed to support a net cost assessment in relation to the broadband USO and guidance setting out how to calculate net relevant turnover.

²¹ As BT is required to deliver 80% of connections within 12 months, 95% of connections within 18 months and 99% of connections within 24 months, it will need to report on how it has met the 12-month obligations by 20 June 2022 for the requests that were received between 20 March 2020 and 19 March 2021; and how it has met the 12-month, 18-month and 24-months obligations by 20 June for each subsequent year.

3. Legal framework

Introduction

- 3.1 In this section we set out the legal framework applicable to making funding regulations and subsequent decisions under those regulations in respect of a request for funding for any unfair financial burden arising from delivering a universal service.
- 3.2 Universal service means the provision of a defined minimum set of services of specified quality which is available to all consumers at an affordable price.²² The purpose of a universal service is to act as a safety net where market forces alone do not deliver affordable access to such minimum set of communications services.
- 3.3 The requirement to secure universal service in the UK currently derives from the Universal Service Directive which has been implemented into UK law through the Communications Act 2003 (“the Act”) and secondary legislation.²³ The scope of the universal service, specifying the minimum set of services that must be provided to secure compliance with the Universal Service Directive, is determined by the Secretary of State by making an order under section 65 of the Act. To date, the Secretary of State has made the following orders under section 65 of the Act.
- a) The Electronic Communications (Universal Service) Order 2003²⁴ (“the 2003 Order”) which set out that publicly available telephone services and other specified services (together “the telephony universal service”) must be provided, made available or supplied throughout the UK; and
 - b) The Electronic Communications (Universal Service) (Broadband) Order 2018²⁵ (“the 2018 Order”) which extended the universal service to broadband connections and services of specified quality (together “the broadband universal service”).²⁶
- 3.4 Ofcom’s role is to implement any order under section 65 of the Act to secure, as far as practicable, the universal service. In doing so, we must designate providers who will act as Universal Service Provider(s) and be subject to universal service conditions which set out how the provision of the universal service is to be achieved. We implemented the 2003 and 2018 Orders by designating KCOM and BT as the Universal Service Providers to deliver each of the telephony universal service and the broadband universal service in the Hull area and

²² See the definition of universal service contained in Article 2(j) of Directive 2002/21/EC of the European Parliament and of the Council of 7 March 2002 on a common regulatory framework for electronic communications networks and services as amended.

²³ The UK will continue to be required to comply with EU obligations including the Universal Service Directive until the end of the transition period (i.e. 31 December 2020).

²⁴ [The Electronic Communications \(Universal Service\) Order 2003](#)

²⁵ [The Electronic Communications \(Universal Service\) \(Broadband\) Order 2018](#)

²⁶ The technical specification of the broadband universal service in the 2018 Order includes a download sync speed of at least 10 megabits per second; an upload sync speed of at least one megabit per second; a contention ratio of no higher than 50:1; latency which is capable of allowing the end-user to make and receive voice calls over the connection effectively; and the capability to allow data usage of at least 100 gigabytes per month.

the rest of the UK respectively. We decided that it was appropriate to use a direct designation process in those cases rather than a competitive process.

- 3.5 Universal Service Providers may be compensated for the costs of delivering a universal service. The legislation provides that a net cost of providing a universal service can be compensated where it is established that such a net cost represents an unfair burden on a Universal Service Provider. In the UK, Ofcom is responsible for calculating the net cost of providing a particular universal service and determining whether and if so, to what extent, that net cost represents an unfair burden on a Universal Service Provider. Where an unfair burden is found, the Universal Service Provider must be compensated through one of the following mechanisms: (i) public funds; (ii) an industry fund established by Ofcom; or (iii) a combination of public and industry funding.
- 3.6 The legislation outlines the way in which the various steps of the funding process should be carried out. Ofcom is given discretion to decide how the funding process should operate in practice and what rules and procedures should apply to that process. The Act empowers Ofcom to make regulations which must specify the rules and procedures that Ofcom considers appropriate. Any subsequent funding assessment needs to be undertaken in accordance with those regulations.
- 3.7 The European Electronic Communications Code (“the Code”), which was adopted by the European Parliament and the Council of the European Union on 11 December 2018, replaces (among other things) the Universal Service Directive with effect from 21 December 2020.²⁷ The Government indicated in July 2019 that its intention was to implement the Code in full into the UK’s law by 21 December 2020, therefore retaining the universal service framework in the UK subject to the changes introduced by the Code.²⁸ The Code does not introduce many changes relevant to funding of the universal service²⁹ so the implementation of the Code is unlikely to affect materially this aspect of our work on the universal service.³⁰
- 3.8 The rest of this section sets out the legal framework applicable to both making funding regulations and subsequent decisions under those regulations in respect of a request for funding. When explaining Ofcom’s role in respect of funding of the universal service, we explain the following:
- a) the legislative provisions and the principles established by caselaw which are relevant to each stage of the funding process;
 - b) the duties to which Ofcom must have regard in fulfilling its role under the legislation in respect of the funding process;
 - c) the content and consultation requirements in respect of funding regulations;

²⁷ Article 125 of the Code.

²⁸ DCMS, July 2019. [Implementing the European Electronic Communications Code](#), page 5.

²⁹ Please note a change to the definition of Electronic Communications Service made by the Code which we explain in Section 7.

³⁰ The provisions of the Universal Service Directive relating to the universal service have been replaced in the Code by Articles 84 to 92 and Recitals 210 to 245.

- d) a summary of the obligations the legislation imposes on Ofcom with respect to reporting on the funding of the universal service; and
- e) Ofcom's duties in respect of the carrying out of impact assessments.

Legislative provisions and principles

3.9 The main stages of the funding process are set out below.

- a) Ofcom may calculate a net cost (if any) of complying with particular universal service conditions.
- b) Where Ofcom concludes that a net cost exists, Ofcom must determine whether it would be unfair for the Universal Service Provider to bear some or all of that net cost.
- c) The Universal Service Provider may apply to Ofcom for a determination that there should be an industry fund to compensate it for an unfair net cost burden.
- d) Where Ofcom receives such an application, it must determine whether there should be an industry fund having regard to whether public funds are to be used to compensate the Universal Service Provider for the whole or part of an unfair net cost burden.
- e) Where Ofcom has determined that an industry fund should be set up, Ofcom must determine who is liable to contribute to the fund.
- f) Ofcom, or the independent body Ofcom appoints to administer the fund, will proceed to collect and distribute the industry contributions.

Calculating a net cost of complying with universal service conditions

3.10 The legislation provides that a net cost of providing the universal service must be calculated using one of the following bases as applicable:

- a) where designation of Universal Service Providers is undertaken through a process which takes account of the net cost of complying with the universal service conditions to be imposed, the particular method of performing the calculation which has been used in the designation process must then be used when performing the calculation as part of the funding process³¹; and
- b) where such a process has not been used³², the net cost of providing the universal service must be calculated by subtracting market benefits accruing to a Universal Service Provider from the costs incurred in delivering the universal service.³³

³¹ Section 70(2) of the Act.

³² As explained above, Ofcom decided that it was appropriate to use a direct designation process when designating BT and KCOM to provide the telephony and broadband universal service.

³³ Section 70(3) of the Act.

- 3.11 The legislation sets out additional principles for calculating a net cost which the national regulatory authorities should have regard to (in addition to other principles they may identify as relevant).
- a) The net costs must be calculated as the difference between the net cost for a designated undertaking of operating with the universal service obligations and operating without the universal service obligations.³⁴
 - b) The calculation should take due account of costs and revenues, as well as the intangible benefits (such as an increase in brand value) resulting from providing the universal service but should not hinder the general aim of ensuring that pricing structures reflect costs.³⁵
 - c) In relation to costs, due attention is to be given to correctly assessing the costs that a Universal Service Provider would have chosen to avoid had there been no universal service.³⁶
 - d) In relation to intangible benefits, taking them into account means that an estimate in monetary terms, of the indirect benefits that an undertaking derives by virtue of its position as provider of universal service, should be deducted from the direct cost of the universal service in order to determine the overall cost burden.³⁷
 - e) The calculation should be based upon the costs attributable to: (i) elements of the identified services which can only be provided at a loss or provided under cost conditions falling outside normal commercial standards³⁸; (ii) specific end-users or groups of end-users who, taking into account the cost of providing the specified network and service, the revenue generated and any geographical averaging of prices imposed by the national regulatory authority, can only be served at a loss or under cost conditions falling outside normal commercial standards.³⁹
 - f) The calculation should be made separately and so as to avoid the double counting of any direct or indirect benefits and costs; the overall net cost of the universal service to any undertaking is to be calculated as the sum of the net costs arising from the specific components of universal service obligations, taking account of any intangible benefits.^{40, 41}

³⁴ Part A of Annex IV of the Universal Service Directive.

³⁵ Part A of Annex IV and Recital 19 of the Universal Service Directive.

³⁶ Part A of Annex IV of the Universal Service Directive.

³⁷ Recital 20 of the Universal Service Directive.

³⁸ This category may include service elements such as access to emergency telephone services, provision of certain public pay telephones, provision of certain services or equipment for disabled people as set out in Part A of Annex IV of the Universal Service Directive.

³⁹ This category includes those end-users or groups of end-users which would not be served by a commercial provider which did not have an obligation to provide universal service as set out in Part A of Annex IV of the Universal Service Directive.

⁴⁰ Part A of Annex IV of the Universal Service Directive.

⁴¹ The principles outlined in paragraphs 3.11(a) to 3.11(f) should be taken into consideration where designation of Universal Service Providers is undertaken through a process which does not take account of any net cost of providing the universal service.

- g) Any net cost of the universal service should be calculated on the basis of transparent procedures.⁴²

Auditing a net cost calculation

- 3.12 Any net cost calculation must be audited either by us or by a person who appears to us to be independent of the Universal Service Providers.⁴³ We are also required to ensure that a report of the audit is prepared and a summary of that report is published.⁴⁴

Assessing unfairness

- 3.13 Where we conclude that a net cost exists, we are required to consider whether it would be unfair for the Universal Service Provider to bear all or part of that net cost.
- 3.14 The Universal Service Directive provides that a compensation mechanism should, where necessary, be established where it is demonstrated that the universal service obligations can only be provided at a loss or at a net cost which falls outside normal commercial standards.⁴⁵ However, as observed by the European Court of Justice⁴⁶, in concluding that the net cost of the universal service does not necessarily represent an unfair burden for all the undertakings concerned, the Universal Service Directive intended to exclude the possibility that any net cost automatically gives rise to a right to compensation.⁴⁷
- 3.15 The legislation does not define the concept of unfair burden or specify how the national regulatory authorities should approach the unfairness assessment but some guidance has been given by the European Court of Justice.⁴⁸ It explained that the unfair burden is a burden which, for each undertaking concerned, is excessive in view of the undertaking's ability to bear it, account being taken of all the undertaking's own characteristics such as the quality of its equipment, its economic and financial situation and its market share.⁴⁹
- 3.16 The European Court of Justice emphasised that consideration of unfairness requires the national regulatory authority to carry out an individual assessment of the particular situation of the Universal Service Provider. That assessment must be conducted in light of the criteria laid down by the national regulatory authority, taking account of the Universal

⁴² Recital 19 of the Universal Service Directive.

⁴³ Section 70(4) of the Act.

⁴⁴ Section 70(6)(b) of the Act.

⁴⁵ Recital 18 of the Universal Service Directive.

⁴⁶ The judgments of the European Court of Justice (as it then was) in the following cases: (i) *European Commission v Kingdom of Belgium* C-222/08 (the [judgment](#) is available); and (ii) *Base NV and Others v Ministerraad* C-389/08 (the [judgment](#) is available). Both cases concerned the same legislation passed by the Belgian Parliament which acted as the national regulatory authority responsible for determining whether an unfair burden existed as a result of the universal service. The cases were considered by the same chamber of the European Court of Justice (the [judgment](#) is available).

⁴⁷ Paragraphs 48 and 49 of the judgments in cases C-222/08 and C-389/08.

⁴⁸ The judgments in case C-222/08 and C-389/08 referred to above.

⁴⁹ Paragraph 49 of the judgments in cases C-222/08 and C-389/08.

Service Provider's relevant characteristics and circumstances prevailing at the time of the assessment.⁵⁰

Compensating for an unfair burden

- 3.17 As set out above, where we determine that an unfair net cost burden exists, such burden must be compensated through one of the following mechanisms: (i) public funds⁵¹; (ii) an industry fund to which providers of Electronic Communications Networks ("ECN") and/or Electronic Communications Services ("ECS"⁵²) contribute⁵³; or (iii) a combination of public and industry funding.⁵⁴
- 3.18 We have the power to set up an industry fund where:
- a) we have determined that there is an unfair net cost burden; and
 - b) the Universal Service Provider has applied to us for a determination that contributions should be made by other communications providers.⁵⁵
- 3.19 The legislation gives us discretion to decide how the compensation process should operate in practice and what rules and procedures should apply to that process. The set of rules and procedures which we consider appropriate must be set out in regulations made by us. Once the funding regulations are made, each industry fund that is required will then be established and administered in accordance with the compensation mechanisms provided for in those regulations.⁵⁶
- 3.20 When making those regulations and subsequent decisions in individual cases under those regulations, we must seek to secure that the rules and procedures required to establish and administer an industry fund respect the principles of transparency, proportionality, no undue discrimination and least market distortion. In considering no undue discrimination, we need to ensure that the rules and procedures are carried out in a manner that we consider does not involve, or tend to give rise to, any undue discrimination against particular communications providers or particular Universal Service Providers, or against a particular description of them.⁵⁷
- 3.21 The principles of transparency, proportionality and no undue discrimination are general principles of the EU law. The principle of least market distortion does not have a similar status in EU law as the other principles. Instead, it is a principle which has been identified as particularly relevant to the framework for the universal service, as explained in the Universal Service Directive. There is no hierarchy between these four principles set out in

⁵⁰ Paragraph 50 of the judgments in cases C-222/08 and C-389/08.

⁵¹ Recital 22 of the Universal Service Directive states that public funds should be understood to comprise "funding from general government budgets including other public funding sources such as state lotteries."

⁵² ECN and ECS are defined in section 32 of the Act.

⁵³ Recital 21 to the Universal Service Directive refers to this as "recovering net costs from all users in a transparent fashion by means of levies on undertakings."

⁵⁴ Article 13(1) of the Universal Service Directive.

⁵⁵ Section 71(3) of the Act.

⁵⁶ Section 71(5) of the Act.

⁵⁷ Section 71(6) of the Act and Article 13(3) of the Universal Service Directive.

the legislation. In fulfilling our functions under the Act, we must therefore strike a balance, which we consider gives appropriate weight to each of those principles in light of particular circumstances of each case.

3.22 We explain how we understand each of those principles below.

Transparency

3.23 Transparency encompasses a number of features which focus on ensuring that sufficient information is provided, including explaining why a particular approach has been chosen and how competing considerations have been evaluated. We also consider that the complexity of a particular approach is relevant to securing transparency. For example, if an approach is so complicated that it cannot readily be understood, then it is unlikely to be transparent.

Proportionality

3.24 Proportionality requires that the means used to achieve a given end must be no more than that which is appropriate and necessary to achieve that end. It follows that ensuring a particular approach is proportionate involves considering potential alternatives.

No undue discrimination

3.25 The principle of no undue discrimination requires that similar situations must not be treated differently unless there is an objectively justifiable reason for doing so. In applying this principle, we think that it is necessary to decide whether persons are similarly situated such that a difference in treatment is discriminatory, and whether that difference in treatment can be justified.

Least market distortion

3.26 The Universal Service Directive requires us to secure that contributions are recovered in a way that as far as possible minimises the impact of the financial burden falling on end-users, for example by spreading contributions as widely as possible.⁵⁸

3.27 As explained above, we must have regard to the least market distortion principle alongside the remaining principles when deciding what rules and procedures we should include in the funding regulations and when making subsequent decisions in individual cases under those regulations. However, by placing a duty on us to 'minimise the impact' it is implicitly accepted that some market distortion may be an inevitable consequence of establishing a sharing mechanism under the funding regulations to compensate the Universal Service Provider for an unfair net cost burden.

⁵⁸ Recital 23 of the Universal Service Directive.

Other requirements applicable to compensating for an unfair burden

3.28 The principles of transparency, proportionality, no undue discrimination and least market distortion must be considered and respected at each stage of assessing, collecting and distributing contributions, namely choosing who should contribute to an industry fund and in what proportions. The legislation contains additional requirements in respect of each of those aspects as explained below.

Choosing who should contribute to an industry fund

- 3.29 We are tasked with deciding which providers should contribute to an industry fund in accordance with the following rules.
- a) Contributions may only be sought from undertakings who are subject to the general conditions⁵⁹, that is, those providing ECN and/or ECS, for example, providers of fixed and/or mobile networks.
 - b) Contributions cannot be sought from undertakings that are not providing services in the UK.⁶⁰
 - c) We may choose not to require contributions from undertakings whose national turnover is less than a set limit. For example, we may exempt new entrants which have not yet achieved any significant market presence.⁶¹

Deciding how much each contributor should pay

3.30 The legislation requires that contributions are collected in a transparent and neutral way which avoids the risk of the double imposition of contributions falling on both outputs and inputs of undertakings.^{62, 63} We are also required to ensure that any charges related to the sharing of the cost of the universal service must be unbundled and identified separately for each undertaking.⁶⁴

Collecting and distributing contributions

3.31 An industry fund must be administered either by the national regulatory authority or another body which is independent of the Universal Service Providers and other providers to whom general conditions apply.⁶⁵ The role of that body is to collect contributions and

⁵⁹ Section 71(3) of the Act.

⁶⁰ Article 13(4) of the Universal Service Directive provides that contributions shall not be sought from undertakings that are not providing services in the territory of the Member State that has established an industry fund.

⁶¹ Article 13(3) of the Universal Service Directive.

⁶² Annex IV of the Universal Service Directive.

⁶³ The double imposition of contributions might occur, for example, if a retailer purchases wholesale inputs from another undertaking (e.g. a network provider) on which contributions have already been collected, and contributions are collected again when the retailer sells those products to end-users.

⁶⁴ Article 13(4) of the Universal Service Directive.

⁶⁵ Sections 70(7) and 70(8) of the Act. It should be noted that if the scheme is to be administered other than by Ofcom, Ofcom must specify the person who will administer the scheme in the funding regulations.

oversee the transfer of all sums due to the Universal Service Providers that are entitled to receive payments from the fund.⁶⁶

Ofcom's duties

- 3.32 In addition to the statutory requirements set out above, in fulfilling its role under the legislation in respect of funding of the universal service, Ofcom must have regard to its duties under the Act. In particular, we must consider our principal duty to further the interests of citizens in relation to communications matters and the interests of consumers in relevant markets, where appropriate by promoting competition.⁶⁷
- 3.33 In performing those duties, Ofcom must have regard to objectives set out in section 3(4) of the Act as they appear relevant to Ofcom in the circumstances. We consider the following objectives to be relevant to fulfilling our role in relation to funding of the universal service:
- a) the desirability of promoting competition in relevant markets;
 - b) the desirability of encouraging investment and innovation in relevant markets; and
 - c) the desirability of encouraging the availability and use of high-speed data transfer services throughout the UK.
- 3.34 Ofcom must also act in accordance with the six Community requirements of which the following are particularly relevant:
- a) promoting competition;
 - b) promoting the interests of EU citizens; and
 - c) carrying out our functions in a manner which, as far as practicable, does not favour one form of network, communications service or associated facility; or one means of providing or making available such a network, service or facility.⁶⁸

Content and consultation requirements applicable to making funding regulations

- 3.35 The Act requires Ofcom to consult on proposed regulations with those who in Ofcom's opinion are likely to be affected by the funding regulations. The consultation period must be of at least one month.
- 3.36 We set out The Electronic Communications (Universal Service) (Costs) Regulations 2020 (draft) ("the draft funding regulations") that Ofcom proposed to make at Annex 5 of the November 2019 consultation. Having considered carefully the consultation responses, we have decided to make the funding regulations as set out at Annex 1. These regulations set the framework for the funding process including:

⁶⁶ Part B of Annex IV of the Universal Service Directive.

⁶⁷ Section 3(1) of the Act.

⁶⁸ Section 4 of the Act.

- a) the process Ofcom will follow before determining: the net cost of complying with the relevant universal service conditions; whether it would be unfair for a Universal Service Provider to bear the net cost of compliance; and, if there is to be an industry fund to compensate the Universal Service Provider, who should contribute to that fund;
 - b) how the contributions to an industry fund will be determined; and
 - c) how an industry fund will operate in practice (for example, how funds will be collected and distributed).
- 3.37 The general effect of the provisions of the funding regulations is described in Sections 4-8 of this statement.

Reporting on the compensation mechanism

- 3.38 The Act prescribes that, once funding regulations have come into force, Ofcom must publish a report which sets out for the period for which it covers:
- a) any determinations of net costs made;
 - b) the market benefits which have accrued to each Universal Service Provider as a result of being designated and subject to universal service conditions; and
 - c) details of the contributions made by each contributor to any industry fund.⁶⁹
- 3.39 The first report must cover the twelve-month period after the coming into force of the funding regulations. There must then be further reports to cover each subsequent twelve-month period.⁷⁰
- 3.40 Ofcom is required to prepare each report as soon as practicable after the end of the period to which it relates and must publish the report as soon as practicable after its preparation.⁷¹ Reports on compensation mechanisms are not required to contain any confidential information.⁷² In preparing and publishing those reports, Ofcom will have regard to its duties and powers in respect of disclosure under section 393 of the Act.

Impact assessment

- 3.41 Impact assessments provide a valuable way of assessing different options for regulation and showing why the preferred option was chosen. They form part of best practice policy-making. This is reflected in section 7 of the Act, which means that generally we have to carry out impact assessments where our proposals would be likely to have a significant effect on businesses or the general public, or when there is a major change in our

⁶⁹ Section 72(2) of the Act.

⁷⁰ Sections 72(3) and 72(4) of the Act.

⁷¹ Section 72(5) of the Act.

⁷² Section 72(6) of the Act. Confidential information is defined for these purposes in sections 72(7) and 72(8) of the Act.

activities. However, as a matter of policy, we are committed to carrying out impact assessments in relation to the great majority of our policy decisions.⁷³

- 3.42 We set out our impact assessment in the November 2019 consultation. In this statement, we have taken account of responses to that consultation and set out our conclusions on the impact of our decisions.

Equality impact assessment

- 3.43 Ofcom is separately required by statute to assess the potential impact of all our functions, policies, projects and practices on race, disability and gender equality. Equality Impact Assessments (“EIAs”) also assist us in making sure that we are meeting our principal duty of furthering the interests of citizens and consumers regardless of their background or identity.
- 3.44 It is not apparent to us that the decisions set out in this statement are likely to have any particular impact on race, disability and gender equality. Specifically, we do not envisage the impact of any outcome to be to the detriment of any group of society. Nor do we envisage any need to carry out separate EIAs in relation to race or gender equality or equality schemes under the Northern Ireland and Disability Equality Schemes. This is because our decisions contained in this statement set an appropriate framework for the funding process, including reviewing any request for funding submitted by the Universal Service Provider and compensating the Universal Service Provider for any unfair cost burden. This work therefore forms part of our duty to implement the universal service in order to ensure that all eligible consumers, irrespective of their race, disability, gender, income or the part of the UK they live in, can benefit from the universal service on reasonable request.

⁷³ For further information about our approach to impact assessments, see the guidelines: [Better policy-making: Ofcom’s approach to Impact Assessment](#).

4. Reviewing and determining a request for funding

- 4.1 In this section, we set out our decisions on the procedures for: a Universal Service Provider to request that Ofcom review a net cost of compliance; the making of an application for compensation for any unfair burden; and the determinations we may make when assessing a request for funding.

Requesting that Ofcom review a net cost of compliance

Our November 2019 consultation

- 4.2 We explained in our November 2019 consultation that the Universal Service Provider would be able to make a judgement about what point in the process of fulfilling its universal service conditions it should ask Ofcom to review a net cost of complying with those conditions.
- 4.3 We said that we would need to consider all relevant circumstances in deciding whether to undertake a review, including:
- a) if there is enough information to commence the calculation and verification of a net cost effectively and to carry out a proper assessment of the potential unfairness of the Universal Service Provider bearing a financial burden of complying with the universal service conditions; and
 - b) whether the potential size of a net cost is proportionate to the work involved in assessing the application and, potentially, setting up an industry fund.
- 4.4 We explained that we may accept the request to review a net cost, decline to commence a review, or to commence a review which is different in scope to that which the Universal Service Provider has proposed. We proposed to consider no more than one request for funding relating to the same universal service conditions per year. Any request submitted by the Universal Service Provider would need to be signed by a director of that company.

Responses to our November 2019 consultation

Requesting that Ofcom review a net cost of compliance with universal service obligations

- 4.5 BT agreed that it is a matter of discretion for the Universal Service Provider as to when and how frequently it submits claims in relation to a USO.⁷⁴ KCOM said that while the Act provides for Ofcom to commence a review of the extent, if any, of the financial burden of complying with one or more of the universal service conditions applied to a particular

⁷⁴ BT non-confidential response to the November 2019 consultation, page 7.

Universal Service Provider, it recognised that the Universal Service Provider is likely to make the request to Ofcom in advance of any active decision by Ofcom to do so.⁷⁵ Similarly, Virgin Media noted that there should be no obligation on Ofcom to commence a review.⁷⁶

- 4.6 BT suggested that when Universal Service Providers compile a net cost claim, it would be useful to know approximately how big a claim needs to be to trigger establishing a fund.⁷⁷
- 4.7 BT said it would be helpful for Universal Service Providers to have more detail and certainty on the further following areas in order to make an informed decision about when to submit a claim:
- a) efficiency and reasonableness in the establishment of the fund;
 - b) the expected approximate cost of establishing the fund;
 - c) an estimate of the amount of net cost below which it would be unlikely to meet the criteria for fund set-up; and
 - d) minimum threshold to identify providers that may have to pay into a fund.
- 4.8 Without this information, BT argued that Universal Service Providers may need to estimate the size of a net cost claim and would be incentivised to delay claims until they are sufficiently large. It said that this would not provide timely compensation and would in itself create costs.⁷⁸

Considerations when deciding whether to commence a review of a net cost

- 4.9 BT agreed that in deciding whether to start a review, Ofcom needs to be sure that the Universal Service Provider has provided enough information to be able to calculate and verify a net cost effectively.⁷⁹ Similarly, Virgin Media said that the onus should be on BT to submit a complete set of information and for Ofcom to assess whether it is worthwhile to commence a review.⁸⁰ KCOM agreed that a Universal Service Provider must submit enough information to support its claim for compensation.⁸¹
- 4.10 BT suggested that Ofcom should engage with the Universal Service Provider if Ofcom wishes to change the scope of the review, so the Universal Service Provider can withdraw or alter the submission if they wish to.⁸² Similarly, KCOM said that it would expect Ofcom to decide on the scope of a review and when the review will begin in consultation with the Universal Service Provider.⁸³

⁷⁵ KCOM non-confidential response to the November 2019 consultation, page 2.

⁷⁶ Virgin Media non-confidential response to the November 2019 consultation, page 4.

⁷⁷ BT non-confidential response to the November 2019 consultation, page 7.

⁷⁸ BT non-confidential response to the November 2019 consultation, page 7.

⁷⁹ BT non-confidential response to the November 2019 consultation, page 6.

⁸⁰ Virgin Media non-confidential response to the November 2019 consultation, page 4.

⁸¹ KCOM non-confidential response to the November 2019 consultation, page 2.

⁸² BT non-confidential response to the November 2019 consultation, page 6.

⁸³ KCOM non-confidential response to the November 2019 consultation, page 2.

- 4.11 On the potential scope of a review, KCOM agreed that the funding regulations should apply to costs incurred in connection with all present universal service conditions, as well as universal service conditions which may be imposed in the future. By extension, it suggested that a review of a net cost should include obligations under the telephony universal service obligation (“telephony USO”), for example public payphones. KCOM added that as Ofcom had indicated its intention to review these universal service obligations, it seemed appropriate to include these in the round as part of a net cost assessment. It also said this was only relevant to the extent that Ofcom considers the universal provision of such services makes sense per se.⁸⁴
- 4.12 Several stakeholders were concerned about ensuring the accuracy of information submitted by the Universal Service Provider as part of a request to review a net cost and that this had an impact on when it was appropriate to commence a review.
- 4.13 Three said that we should put greater weight on the following circumstances set out in the November 2019 consultation:
- a) A commencement of any review should be under the expectations of full actual information (rather than estimated).
 - b) In assessing the proportionality of any of Ofcom’s work, we should be mindful of BT’s potential share in any industry funding mechanism and its financial strength.
 - c) Noting the finality principle⁸⁵, the need to consider the possibility of more information being available in the future before deciding whether to commence a review.⁸⁶
- 4.14 Three said that any assessment for such a net cost burden should provide the best chance to take into account all of the actual and potential benefits as a result of providing the USO, and the best chance to actually measure take-up where it has been assumed. Three did not think that this would be possible after one year of BT providing the broadband USO, suggesting that the best evidence for indirect and other revenue benefits would be from assessing the take-up of USO customers for a period of time. It therefore disagreed that a net cost claim can be submitted annually and encouraged us to hold BT to account to assess the relevant benefits. Three estimated that in order to allow take-up to grow and the first contracts to expire, the first review of BT’s net cost should be no earlier than three years from the start of providing the broadband USO. In Three’s view, this would be enough time to assess the demand of the first year USO requestors as well as their end-of-contract behaviour in order to inform a robust estimation of direct and indirect benefits.⁸⁷
- 4.15 While Three acknowledged that we are trying to balance the proportionality of assessing net costs frequently against the time taken to compensate Universal Service Providers for

⁸⁴ KCOM non-confidential response to the November 2019 consultation, pages 1-2.

⁸⁵ The principle of finality is discussed further below. This refers to the principle we set out in the November 2019 consultation that we would not re-assess the scope of any net cost that is materially covered by an existing determination except in exceptional circumstances.

⁸⁶ Three non-confidential response to the November 2019 consultation, page 17.

⁸⁷ Three non-confidential response to the November 2019 consultation, page 14.

any net cost burden, it pointed to two other factors that it suggested would weigh the balance towards assessing net costs after a period of time to reflect:

- a) BT was designated as a Universal Service Provider because it is financially strong: this means that BT will have the ability to bear any net cost burden in the short-medium term; and
- b) Ofcom has set out its preference for ‘finality’ on net cost determinations: this means that any determination is unlikely to be revisited should factors turn out to be different from what was originally estimated.⁸⁸

4.16 Three noted that if we have a strong preference for the finality of net cost determinations, then we should ensure that any net cost burden assessment is as accurate as it can possibly be and therefore rely on a weight of actual data rather than predominantly on estimated data. It said that the only way to ensure this was to assess the net cost fully ex-post, rather than estimate the majority of benefits ex-ante.⁸⁹

4.17 Similarly, Virgin Media suggested that it is probably better for all concerned if BT is encouraged only to make a single claim from a fund once more is known, for example, about demand and the efficient cost of supply. It said that this would go a long way to minimise concerns on the part of claimants and contributors about under or over recovery of the net cost of the USO.⁹⁰

Frequency of commencing a review of a net cost

4.18 KCOM agreed that it is reasonable for Ofcom to expect to review no more than one net cost claim per year.⁹¹ TalkTalk⁹², Vodafone⁹³ and UKCTA⁹⁴ were also supportive of Universal Service Providers bringing no more than one request to review a net cost per year. TalkTalk noted that this will reduce administrative costs of the scheme⁹⁵, while Vodafone said that permitting increased claims would potentially reduce the scrutiny and depth of investigation on each claim by Ofcom.⁹⁶ The Federation of Communication Services (“FCS”) said that it agreed with the principle that claims should be made annually in arrears, supported by evidence specified and required by Ofcom.⁹⁷

4.19 BT said it anticipated that when and how frequently it submits claims in relation to a USO will be determined by the size of the USO, and in some cases BT may submit more than one claim per year for a USO.⁹⁸

⁸⁸ Three non-confidential response to the November 2019 consultation, pages 14-15.

⁸⁹ Three non-confidential response to the November 2019 consultation, page 15.

⁹⁰ Virgin Media non-confidential response to the November 2019 consultation, page 1.

⁹¹ KCOM non-confidential response to the November 2019 consultation, page 2.

⁹² TalkTalk non-confidential response to the November 2019 consultation, page 2.

⁹³ Vodafone non-confidential response to the November 2019 consultation, page 6.

⁹⁴ UKCTA non-confidential response to the November 2019 consultation, page 4.

⁹⁵ TalkTalk non-confidential response to the November 2019 consultation, page 2.

⁹⁶ Vodafone non-confidential response to the November 2019 consultation, page 6.

⁹⁷ FCS non-confidential response to the November 2019 consultation, page 1.

⁹⁸ BT non-confidential response to the November 2019 consultation, page 7.

Other responses

- 4.20 KCOM⁹⁹, Wansdyke Ltd¹⁰⁰ and Campaign to Retain Payphones¹⁰¹ agreed with our proposals. FCS said that the change to a USO based on broadband was likely to have a significant impact on demand and it was timely to review the cost implications.¹⁰²

Our decision

- 4.21 We have decided to set out the following guidance on the process for Universal Service Providers to request that Ofcom review a net cost.

Requesting that Ofcom review a net cost of compliance with universal service obligations

- 4.22 We remain of the view that the Universal Service Provider will be able to make a judgement about what point in the process of fulfilling its universal service conditions it should ask Ofcom to review a net cost of complying with those conditions. In particular, it will be able to consider when it has sufficient information to enable it to provide details of the costs incurred and explain why, in its view, these represent an unfair financial burden. It is, however, for Ofcom to decide whether it will commence a review, and the scope of that review, as set out in the Act.
- 4.23 In response to BT's request for more details for Universal Service Providers to make an informed decision about when to submit a request to review a net cost, we recognise BT's desire for more certainty about this and are open to engaging with Universal Service Providers to discuss the practicalities of making of a request. However, it is important to recognise that we cannot pre-determine issues such as the size of net cost that would trigger commencing a review and potentially establishing an industry fund.
- 4.24 It is for the Universal Service Provider to ensure its request to review a net cost contains the information required to enable Ofcom to undertake an assessment of a net cost.
- 4.25 The information and data submitted with a request to review a net cost would form a key part of our decisions. We and potential industry fund contributors need to be confident that the information submitted with the request is complete, has been prepared robustly, and has been subjected to appropriate checks and verification procedures.
- 4.26 To provide this confidence, we consider that it is important that a director within the Universal Service Provider's organisation should be accountable for the information submitted alongside a request to review a net cost. We therefore remain of the view that, any request to review a net cost should:
- a) contain a statement explaining the following in relation to the information submitted:

⁹⁹ KCOM non-confidential response to the November 2019 consultation, page 3.

¹⁰⁰ Wansdyke Ltd non-confidential response to the November 2019 consultation, page 1.

¹⁰¹ Campaign to Retain Payphones non-confidential response to the November 2019 consultation, page 1.

¹⁰² FCS non-confidential response to the November 2019 consultation, page 2.

- i) the information is accurate, fair and complete in explaining the methodology adopted and verification steps taken when calculating a net cost; and
 - ii) all reasonable steps have been taken to ensure that any estimates of a net cost and information serving as the basis of any calculations represent an accurate, fair and complete view; and
- b) be signed by a director.¹⁰³
- 4.27 While this requirement is not set out in the funding regulations, this is something we would expect Universal Service Providers to do for any request to review a net cost.

Considerations when deciding whether to commence a review of a net cost

- 4.28 We remain of the view that in deciding whether to undertake a review of a net cost, we would need to consider all the relevant circumstances, including:
- a) if there is enough information to commence the calculation and verification of a net cost effectively and to carry out an assessment of the potential unfairness of the Universal Service Provider bearing a financial burden of complying with the universal service conditions. This would include ensuring the Universal Service Provider has provided the required information set out in Section 5 and Section 9; and
 - b) whether the potential size of a net cost is proportionate to the work involved in assessing the application and, potentially, setting up an industry fund. We discuss this further in Section 6 where we cover the interaction between the potential size of an industry fund and our unfairness assessment.
- 4.29 Where we receive a request to review a net cost from the Universal Service Provider, we may accept the request to commence a review, decline to commence a review, or to commence a review which is different in scope to what the Universal Service Provider has proposed.
- 4.30 We take on board the points made by BT and KCOM and would engage with them ahead of making our final decision on whether to commence a review. We would notify the Universal Service Provider in writing of our decision on whether or not we have decided to commence a review, and where applicable, the scope of that review.
- 4.31 In response to KCOM's point about the scope of a review including all universal service obligations, as we explain in Section 2, the funding regulations will apply to costs incurred in connection with all universal service conditions currently in force (including the obligations under the telephony USO) as well as any conditions which may be imposed in the future. As set out above, we will consider what scope of a review may be appropriate once we know all the relevant circumstances. However, as a matter of principle, calculating

¹⁰³ We use the term 'director' within the meaning of section 250 of the Companies Act 2006, namely a person who is appointed as director, subject to the duties specified in the legislation and notified to the Companies House as director. It will be for the Universal Service Provider to decide which of its directors should sign off on the request to review a net cost and supporting evidence to be submitted to Ofcom. We would expect that in practice it is likely to be most appropriate for the Universal Service Provider's Finance Director (or equivalent) to be responsible for that.

a net cost and determining unfairness in respect of different universal service obligations together as part of the same assessment is likely to be more complex. In order to make the process of assessing a request for funding as efficient as possible, we would expect that when making a request for funding the Universal Service Provider would include a clear explanation of which specific set of universal service conditions are relevant to its request.¹⁰⁴

- 4.32 In making a decision on whether to commence a review, in the specific case of the broadband USO, we would look to see whether sufficient network has been built and if enough premises are receiving connections to ensure that adequate information on the following is available:
- a) the infrastructure necessary to deliver the broadband USO connections requested;
 - b) the capital expenditure incurred in making these connections; and
 - c) the products purchased by the premises that are receiving these connections.
- 4.33 At this stage, we remain of the view that this information is unlikely to be available until at least one year after the universal service conditions requiring the provision of broadband USO connections have come into force.¹⁰⁵ We consider Universal Service Providers being required to wait for at least one year before submitting a request to review a net cost to be a proportionate timeframe for the broadband USO.
- 4.34 We acknowledge the concerns expressed by stakeholders about the accuracy of the information submitted by the Universal Service Provider for a review of a net cost, and, in light of which, when it would be appropriate to commence a review.
- 4.35 In response to the points raised by Three, as noted above, in deciding whether to undertake a review of a net cost, we would consider all the relevant circumstances, including if there is enough information to commence the calculation and verification of a net cost effectively and to carry out an assessment of potential unfairness. In response to Three's suggestion that the first review of BT's net cost should be no earlier than three years from starting to provide the broadband USO, we would not commence a review of a net cost where we do not consider that we have enough information to do so.
- 4.36 Where we do decide to commence a review, we may still need to wait for further information to become available to make our decision if we feel that we cannot reasonably make a forecast based on the information we have. Given the delivery targets we have set for BT and KCOM to provide the broadband USO, we expect many of the connections to be delivered within the first 12 months. We therefore do not think setting a minimum three-year timescale for submitting a request to review a net cost would be appropriate.

¹⁰⁴ As KCOM noted in its response, we plan to review obligations under the telephony USO, as set out in our Plan of Work. See Ofcom, April 2020. [Ofcom's Plan of Work 2020/21: Making communications work for everyone](#), page 31.

¹⁰⁵ These conditions came into force on 20 March 2020.

- 4.37 We would have regard to characteristics such as the Universal Service Provider's economic and financial situation and its market share as part of our unfairness assessment, rather than at commencement of the review stage. This is set out further in Section 6.
- 4.38 We understand Three's concern that given our preference for finality of net cost determinations, any net cost assessment should be as accurate as possible. We also note Three's suggestion that a net cost is assessed fully ex-post rather than seek to estimate the majority of benefits ex-ante. As part of our assessment of whether to commence a review of a net cost, we would consider the likelihood of information becoming available in the future which may have a bearing on our assessment. We set out guidance in Section 9 on how we would expect to calculate a net cost specifically for the broadband USO, including how we would take into account forecasts of future costs and revenues.
- 4.39 We also acknowledge Virgin Media's suggestion that Universal Service Providers are encouraged to make a single request for funding once more is known about demand and the efficient cost of supply. We consider our approach strikes an appropriate balance between limiting how often we review a net cost, with the associated resource implications and cost, and ensuring that the Universal Service Provider is compensated in a timely manner.

Frequency of commencing a review of a net cost

- 4.40 We remain of the view that it is proportionate to review no more than one request to review a net cost relating to the same universal service conditions per year. Therefore, we do not intend to accept more than one request per year for the same USO. We consider this frequency strikes an appropriate balance between ensuring on the one hand that the Universal Service Provider is compensated for any unfair net cost burden in a timely manner and, on the other, that the work involved in assessing the application, and where relevant collecting and distributing funds, is proportionate.
- 4.41 We consider that reviewing more than one request per year would be inefficient. Furthermore, should we review more than one request for the same USO, this policy would help ensure we can make a decision on one request before reviewing another and avoid the scenario where decisions overlap, potentially slowing down our decision-making process.
- 4.42 In response to BT, it is for Ofcom to decide whether or not to commence a review of a net cost. Should BT choose to submit more than one request per year for the same USO, we may well reject one or potentially all of these requests.
- 4.43 We expect that once a Universal Service Provider has made a request relating to particular universal service conditions, irrespective of whether Ofcom chooses to commence that review or not by taking account of the considerations we have set out above, it would be appropriate for the Universal Service Provider to wait for a period of at least one year before making a subsequent request.

Making an application requesting compensation for any unfair burden

Our November 2019 consultation

- 4.44 In our November 2019 consultation, we explained that we can only determine that an industry fund should be set up if the Universal Service Provider has made a specific application requesting that Ofcom determine that other communications providers make contributions towards meeting that burden.
- 4.45 We proposed that the funding regulations allow for the Universal Service Provider to submit an application for compensation no later than two months after we commence a review and that any application must be made in writing and signed by a director.

Responses to our November 2019 consultation

- 4.46 BT agreed with our proposed procedure for making an application for compensation, subject to confirmation that it is sufficiently flexible to allow for Universal Service Providers to submit the net cost claim together with the request to establish an industry fund, along with any other information required.¹⁰⁶
- 4.47 KCOM acknowledged that in accordance with s71(3) of the Act, Ofcom can only determine that an industry fund should be set up if the Universal Service Provider makes a specific application requesting that Ofcom determine that other providers make contributions towards meeting that burden.¹⁰⁷

Other responses

- 4.48 KCOM¹⁰⁸, FCS¹⁰⁹, Wansdyke Ltd¹¹⁰ and Campaign to Retain Payphones¹¹¹ agreed with our proposals.

Our decision

- 4.49 The Act specifies that Ofcom can only determine that an industry fund should be set up if the Universal Service Provider has made a specific application requesting that Ofcom determine that other communications providers make contributions towards meeting that burden.¹¹²

¹⁰⁶ BT non-confidential response to the November 2019 consultation, pages 6-7.

¹⁰⁷ KCOM non-confidential response to the November 2019 consultation, page 2.

¹⁰⁸ KCOM non-confidential response to the November 2019 consultation, pages 3-4.

¹⁰⁹ FCS non-confidential response to the November 2019 consultation, page 2.

¹¹⁰ Wansdyke Ltd non-confidential response to the November 2019 consultation, page 1.

¹¹¹ Campaign to Retain Payphones non-confidential response to the November 2019 consultation, page 1.

¹¹² Section 71(3) of the Act.

- 4.50 We remain of the view that the approach we set out in the November 2019 consultation is proportionate. As such, where we choose to commence a review of a net cost of complying with particular universal service conditions, and notify the Universal Service Provider of that decision, the funding regulations allow for the Universal Service Provider to submit an application for compensation no later than two months after the opening of the review.¹¹³ We expect the Universal Service Provider is likely to make this application as soon as it can after it receives notification that we are commencing a review.
- 4.51 In response to BT's request for confirmation that an application for compensation can be submitted together with a request to review a net cost, as explained above, the legislation sets out the steps we must undertake and we cannot oblige Universal Service Providers to combine any stages of the process. However, we understand why BT would want to do this and therefore we would accept an application for compensation alongside a request to review a net cost.¹¹⁴
- 4.52 A potential consequence flowing from the application for compensation is that contributions in respect of any unfair net cost burden which Ofcom finds to exist could be required from industry. Ofcom and potential contributors to an industry fund need to be satisfied that the Universal Service Provider has properly considered whether to seek such contributions. Therefore, the funding regulations specify that any application must be made in writing and signed by a director.¹¹⁵

Determinations Ofcom may make when assessing a request for funding

Our November 2019 consultation

- 4.53 We explained in our November 2019 consultation that where we have decided to commence a review of a potential net cost, we may need to make the following determinations:
- a) the existence and, if required, the level of any net cost incurred by the Universal Service Provider;
 - b) whether it would be unfair for the Universal Service Provider to bear some or all of this net cost; and
 - c) where the Universal Service Provider has made an application to be compensated for any unfair burden through an industry fund, we will need to determine whether there should be a sharing mechanism that will compensate the Universal Service Provider.

¹¹³ Funding regulation 6(a).

¹¹⁴ In the event that: (i) the Universal Service Provider makes an application for compensation alongside a request to review a net cost; and (ii) Ofcom decides to open a review of a net cost but decides that the scope of that review is to be different to that proposed by the Universal Service Provider, the Universal Service Provider will need to make a new application for compensation.

¹¹⁵ Funding regulation 6(b).

- 4.54 We proposed that the funding regulations enable these determinations to be made simultaneously should we decide that this is appropriate.

Finality

- 4.55 We proposed to not re-assess the scope of any net cost that is materially covered by an existing determination except in exceptional circumstances. We explained that circumstances are only likely to be deemed exceptional if we consider they were unforeseen and of such scale as to be outside of normal commercial risks.

Responses to our November 2019 consultation

End-to-end process when assessing a request for funding

- 4.56 BT considered that the end-to-end process we set out in our November 2019 consultation, while comprehensive, is complex and unnecessarily drawn out. BT said while it supports the aims of the proposed process, it has the potential to create opportunities to game the system and appeal decisions, and could result in a significant delay in Universal Service Providers being compensated for their efficiently incurred costs.¹¹⁶
- 4.57 BT said that a timely process was needed so that it is clearer at an earlier stage which costs will be recovered and what the ask will be for contributors – particularly as providers may need to make provisions for a future contribution to the fund. BT noted that delay is costly because it incurs a financing cost associated with funding the USO, as well as a delay in being compensated. BT said this means it incurs the financing cost for longer than is strictly necessary, and this unnecessary delay could render the mechanism for delivering the USO policy objective disproportionate.¹¹⁷
- 4.58 In its response BT made a number of specific proposals which it suggested would shorten the end-to-end process, making it more efficient and less resource intensive for the Universal Service Provider, Ofcom and the rest of industry.¹¹⁸ BT's suggestions are addressed at relevant points in this statement.

Procedures for determinations when assessing a request for funding

- 4.59 Vodafone said that it was wholly appropriate for Ofcom to consult on its proposals before making any determination on a net cost burden.¹¹⁹
- 4.60 BT said that we should carry out the consultations and notification of our determinations for all matters of the review at the same time to avoid the need for a series of determinations. It proposed that a single consultation and determination should cover: calculating and verifying a net cost, determining the extent of any unfair burden,

¹¹⁶ BT non-confidential response to the November 2019 consultation, page 5.

¹¹⁷ BT non-confidential response to the November 2019 consultation, page 5.

¹¹⁸ BT non-confidential response to the November 2019 consultation, pages 5-6.

¹¹⁹ Vodafone non-confidential response to the November 2019 consultation, page 6.

establishing an industry fund, and setting out contributors and contributions (where possible). BT said that to do these separately needlessly lengthens the process and undermines the principle that Universal Service Providers are compensated for any unfair net cost burden in a timely manner. It said for the broadband USO, we should clarify in our final statement our intention to do this.¹²⁰

- 4.61 BT also recommended that we should come to a final determination within nine months of receiving a claim, and the Universal Service Provider submitting its claim should receive compensation within 12 months. BT said that a streamlined process would avoid unnecessary delays caused by multiple appeals of various Ofcom determinations.¹²¹

Finality

- 4.62 BT supported our desire to limit the re-assessment of claims to exceptional circumstances, given what it regarded as an already lengthy process and because it suggested that there were other routes available for claiming overpayment and appealing our determinations. Nonetheless, BT said the principle of finality should not prevent Universal Service Providers from including previously rejected costs in subsequent claims, in particular where we have previously decided that such costs were not sufficiently large to justify assessing the application and/or setting up an industry fund. BT suggested a related amendment to draft funding regulation 5(2) with regard to our unfairness assessment, discussed in Section 6.¹²²
- 4.63 Virgin Media said that it was not entirely clear how rejected claims would be treated in any subsequent claims. It said in our considerations on unfairness, there seemed to be more scope for BT to count again previously rejected net costs in a subsequent claim from the fund, which would undermine the principle of finality for all parties and weaken the appropriate incentive for BT to submit a limited number of claims for compensation. Virgin Media suggested that we be definitive that a Universal Service Provider cannot resubmit a previously rejected claim aggregated into a subsequent claim. However, it said if Ofcom declines to commence a review (rather than rejects a claim), the Universal Service Provider should be allowed to roll-up its net costs into a future request for an assessment.¹²³
- 4.64 Vodafone¹²⁴ and UKCTA¹²⁵ had concerns regarding our approach to finality, noting that not re-assessing the scope of any cost burden risks the over-compensation of funding. Vodafone pointed to the clawback mechanism within BDUK's schemes which requires funding receivers to pay back funds where their initial forecasts proved to be inaccurate. Vodafone suggested that the scale of BDUK clawback validated the requirement for any funding scheme to include a clawback mechanism.¹²⁶

¹²⁰ BT non-confidential response to the November 2019 consultation, pages 4, 6 and 7-8.

¹²¹ BT non-confidential response to the November 2019 consultation, page 5.

¹²² BT non-confidential response to the November 2019 consultation, page 8.

¹²³ Virgin Media non-confidential response to the November 2019 consultation, pages 1 and 4.

¹²⁴ Vodafone non-confidential response to the November 2019 consultation, page 6.

¹²⁵ UKCTA non-confidential response to the November 2019 consultation, page 4.

¹²⁶ Vodafone non-confidential response to the November 2019 consultation, pages 6-7.

- 4.65 Similarly, TalkTalk was concerned about finality, suggesting that while it would be disproportionate for us to reopen a decision in the event of minor variations in actual costs, it would be appropriate to ensure a mechanism is in place to address significant variations, especially given the novelty of providing broadband connectivity under a USO and the consequent uncertainty over costs. TalkTalk said that we should consult on an appropriate percentage threshold range for variations in costs to warrant review. It noted that it is important that there is a method of review built into the scheme, which would help to avoid the need for any party to legally challenge a funding decision, with its associated costs and drain on Ofcom resources.¹²⁷
- 4.66 Three said it agreed with our approach to finality but that we should put significant weight on the need to consider the possibility of more information being available in the future before deciding whether to commence a review.¹²⁸ This is discussed earlier in this section.

Other responses

- 4.67 KCOM¹²⁹, FCS¹³⁰ and Wansdyke Ltd¹³¹ broadly agreed with our proposals.

Our decision

Procedures for determinations when assessing a request for funding

- 4.68 Once Ofcom has decided to commence a review of a potential net cost, we may need to make the following determinations as part of the funding process.
- a) Determine the existence and, if so, the level of any net cost incurred by the Universal Service Provider if we decide to open a review. We set out the approach we would take in Section 5.
 - b) Determine whether it would be unfair for the Universal Service Provider to bear some or all of this net cost if we determine the existence and level of a net cost. We explain how we would approach this in Section 6.
 - c) Determine whether there should be a sharing mechanism that will compensate the Universal Service Provider and, if so, the nature of that sharing mechanism where we have determined the existence of an unfair net cost, and where the Universal Service Provider has made an application for compensation. We explain how we would approach this in Sections 7 and 8.
- 4.69 For each of these determinations, we will engage with stakeholders by consulting on a draft determination and take account of representations made over the consultation

¹²⁷ TalkTalk non-confidential response to the November 2019 consultation, page 2.

¹²⁸ Three non-confidential response to the November 2019 consultation, page 17.

¹²⁹ KCOM non-confidential response to the November 2019 consultation, pages 2-4.

¹³⁰ FCS non-confidential response to the November 2019 consultation, page 2.

¹³¹ Wansdyke Ltd non-confidential response to the November 2019 consultation, page 1.

period when making a final determination. The consultation period will, as a minimum, be no less than one month from the day after the draft determination is published.¹³²

- 4.70 We acknowledge BT's suggestion that we carry out the consultations and notification of our determinations for the review at the same time. The funding regulations enable these determinations to be made simultaneously should we decide that this is appropriate, and we would aim to complete the process in a timely way.
- 4.71 We have clarified the structure and drafting of the funding regulations concerning the procedures for making all of the types of determinations as referred to above. In the consultation we proposed to include three separate provisions describing the process for making determinations.¹³³ To simplify the drafting, we have decided to set out this process once in funding regulation 12, given that we have decided to follow the same process for all the types of determinations. In light of this clarification, we have also considered that the funding regulations should now be clearer that all the types of determinations can be made simultaneously or separately so there is no need to include a declaratory provision to that effect as we proposed in draft funding regulation 15. In practice, as far as appropriate, we would seek to undertake the various determinations together.
- 4.72 We recognise BT's preference for us to make a final determination within nine months and for BT to be compensated within 12 months of Ofcom receiving a request for funding, however, we do not consider it appropriate to specify timings in the funding regulations. This is because the funding regulations are designed to apply to any USO so we need to ensure the process is sufficiently flexible to accommodate the nature and scale of any future USOs. For the broadband USO, where possible, we would aim to undertake the determinations within nine months.
- 4.73 We would also endeavour to complete the process of setting up a compensation mechanism in a timely way but have to be mindful of the practicalities of collecting and distributing any contributions. There is also the consideration of fairness to industry fund contributors; for example, time would be spent verifying data so that contributors can be confident that the information has been properly verified before they are invoiced, and that they have sufficient notice to prepare to make the contributions.

Finality

- 4.74 In fulfilling our role, we will aim to provide certainty to Universal Service Providers on the costs, if any, that it will be compensated for, and certainty for industry fund contributors on the level of contributions which they will be required to make.
- 4.75 Stakeholder responses on the principle of finality highlighted the need for further clarification on how we expect this to work in practice, which we set out below. However, we remain of the view that given our objective to provide certainty to both parties, we do not think it would be appropriate to re-assess:

¹³² Funding regulation 12(3).

¹³³ These provisions were contained in draft funding regulations 7, 13 and 15.

- a) a net cost relating to any specific USO connections that have already been covered by an existing determination; or
 - b) a determination of unfairness relating to a specific net cost.
- 4.76 A reassessment of a net cost could lead to a smaller or larger net cost, both of which cause practical difficulties and do not meet our objective to provide certainty.
- a) Should a re-assessment result in a smaller unfair financial burden, the legislation does not provide for a mechanism to recoup monies once payment to a Universal Service Provider has been made.¹³⁴
 - b) If an assessment was later found to result in a larger unfair financial burden, there would be a further administrative burden on Ofcom associated with collecting and distributing any residual amount of money. This would also result in industry fund contributors, who will have relied on the original determination to plan and budget for any fund contributions, having to find additional funds to pay for any additional unfair burden.
- 4.77 In practice, before commencing any review of a net cost we will consider the likelihood of information becoming available in the future which may have a bearing on our assessment, given the difficulties in re-assessing a claim for which a determination has been made. If we consider future information will have a bearing, we may choose not to commence a review at that stage. However, once we have decided to commence a review, we expect the information and assurances provided by the Universal Service Provider as part of the request to ensure that we have an appropriate basis upon which to make an accurate assessment.
- 4.78 We remain of the view that only in exceptional circumstances would we commence a review that materially covers the scope of one or more previous reviews. We may however take into consideration previous determinations as part of considering future net cost and determinations of unfairness. We discuss this further below and in Section 6.

Circumstances in which the finality principle does not apply

- 4.79 The principle of finality would not apply in the scenario where we reject a request to review a net cost of complying with particular universal service conditions, for example, on the basis that we do not have enough information to commence a review.
- 4.80 Here we would not have made a determination on these costs, and so the Universal Service Provider could ask Ofcom to assess these costs at a later date. This could be on a stand-alone basis (i.e. the Universal Service Provider could ask Ofcom to assess exactly the same costs at a later date) or as part of a larger request (i.e. these costs could be rolled into a subsequent larger sum which the Universal Service Provider could then request that Ofcom assess).

¹³⁴ Any attempt to recoup this money may be possible and pursued under general law.

4.81 Where we reject a request to review a net cost, the Universal Service Provider would have to wait for a period of at least one year before any future request is submitted.

Circumstances in which the finality principle applies

4.82 The principle of finality would apply in the scenario where we have accepted a request to review a net cost and made a determination.

4.83 For example, where we have determined the existence of a net cost but do not consider this unfair for the Universal Service Provider to bear, the Universal Service Provider could not ask Ofcom to re-assess this net cost again, either by re-submitting a review of the net cost or including it as part of a larger figure which it requests that Ofcom assess at a later date.

4.84 Our determination on the following matters would be final and could not be reviewed again unless there were exceptional circumstances:

- a) the amount of the net cost; and
- b) our determination that it would not be unfair for the Universal Service Provider to bear the net cost. In this scenario, Ofcom has decided that there is no unfair burden and so no compensation would be paid for this net cost.

4.85 Circumstances are only likely to be deemed exceptional if we consider they were not reasonably foreseeable and of such scale as to be outside of normal commercial risks. Examples might include information coming to light which was not reasonably foreseeable or beyond a Universal Service Provider's control, or a fundamental change in how a service is provided.

4.86 Should exceptional circumstances materialise, and should we decide to review a net cost that was materially covered by an existing determination, we envisage informing any parties that may be affected by this as soon as reasonably practicable. As part of this, we would explain the change of circumstances and why we considered it to be exceptional.

4.87 In response to BT and Virgin Media's comments about how the finality principle relates to our unfairness assessment, we explain in Section 6 how previous determinations would be considered as part of assessing unfairness of a later request.

Further comments on finality

4.88 Unlike a publicly-funded rollout scheme such as BDUK, any funding for the universal service is retrospective. A request for funding made by the Universal Service Provider would need to demonstrate that the costs have been incurred. Therefore, in response to points raised by Vodafone, UKCTA and TalkTalk, we do not expect there to be large variations in actual costs incurred. We would need to make a forecast for any revenues and forward-looking costs such as operational expenditure (which we explain in Section 5) but, as explained above, before we decide to commence a review, we would need to satisfy ourselves that we have sufficient information in order to commence an assessment of net cost. We therefore do not consider consulting on a percentage threshold range for variations in costs to warrant review, as suggested by TalkTalk, to be necessary.

Summary of funding regulations

- 4.89 In summary, the funding regulations on the procedures for a review of a net cost and on the submission of an application for compensation in respect of any unfair net cost are as follows:
- a) we would consult on our proposals before (i) making a determination of a net cost of compliance; (ii) whether it would be unfair for the Universal Service Provider to bear all or part of that net cost; and (iii), where applicable, who should contribute to any industry fund and in what proportion;
 - b) the Universal Service Provider will have a period of two months to make an application for compensation which will commence on the date that Ofcom announces a review of any net cost of compliance; and
 - c) any application for compensation must be made in writing to Ofcom and be signed by a director of the Universal Service Provider.

Summary of our guidance

- 4.90 We also provide guidance on our approach to the procedures for a review of a net cost to include:
- a) that a period of at least one year should elapse between each request to review a net cost which relates to the same universal service conditions;
 - b) any request to review a net cost must be made in writing to Ofcom with a signed statement by a director to confirm the information provided is accurate, fair and complete;
 - c) we would engage with the Universal Service Provider ahead of making our final decision on whether to commence a review of a net cost;
 - d) we would decide whether to commence the review, and what the scope of any review should be before notifying the Universal Service Provider of our decision; and
 - e) we would not re-assess the scope of any net cost that is materially covered by an existing determination except in exceptional circumstances.

5. Calculating and verifying a net cost

5.1 In this section, we first summarise the principles set out in the Universal Service Directive that relate to the calculation of any net cost of complying with the universal service conditions. We then explain the process to assess a request to review a net cost, including the approach to calculating, verifying and auditing a net cost and the information that is required for us to do this.

Principles for the calculation

Our November 2019 consultation

5.2 As we explained in the November 2019 consultation, the Universal Service Directive and the Act contain the principles for the calculation of a net cost. These principles informed: (i) what rules and procedures we proposed to include in the funding regulations; and (ii) how we proposed to approach determining in practice a request for funding under the funding regulations. In formulating our proposals, we considered appropriate incentives for Universal Service Providers to provide universal services cost-efficiently and the requirements to obtain an audit of the calculations.

Responses to our November 2019 consultation

5.3 We did not receive any responses which specifically commented on our explanation of the principles which inform the content of the funding regulations and our approach to the calculation of a net cost.

Our decision

5.4 As set out in Section 3, the Universal Service Directive and the Act contain principles for the calculation of a net cost. The Act states that the financial burden of complying with one or more universal service conditions “is to be taken to be the amount calculated by OFCOM to be the net cost of compliance after allowing for market benefits accruing to the designated universal service provider from—(a) his designation; and (b) the application to him of universal service conditions.”¹³⁵

5.5 The Universal Service Directive explains that a net cost is to be calculated:

- a) as the difference between operating with the USO and operating without the USO;
- b) taking due account of costs and revenues, as well as the indirect¹³⁶ benefits that the Universal Service Provider derives from being designated;

¹³⁵ Section 70 of the Act.

¹³⁶ ‘Indirect’ benefits are also referred to as ‘intangible’ benefits in the Universal Service Directive. For the avoidance of doubt, wherever we discuss ‘indirect’ benefits, we consider that the same applies for ‘intangible’ benefits.

- c) the calculation needs to ensure that any costs that the Universal Service Provider would have chosen to avoid had there been no USO are taken account of;
 - d) a net cost calculation should be based upon the costs attributed to elements of the services provided at a loss or not commercially¹³⁷; and
 - e) a net cost calculation should also avoid double counting any costs and benefits and should be performed on the basis of transparent procedures.
- 5.6 The Universal Service Directive also sets out that we are to consider all means to ensure appropriate incentives for undertakings (designated or not) to provide services cost efficiently.¹³⁸
- 5.7 We continue to consider that these principles should inform the content of the funding regulations and our approach to the calculation of a net cost. We have therefore decided to reflect them in the funding regulations by outlining the matters which should be taken into account as appropriate given the facts and circumstances of a particular case and by specifying the information which must be provided to us by the Universal Service Provider to enable us to calculate and verify a net cost. The relevant provisions in the funding regulations are set out below.

Calculating and verifying a net cost

Our November 2019 consultation

- 5.8 We explained the factors we will need to have regard to when verifying and calculating a net cost, which include ensuring costs have been efficiently incurred.

Responses to our November 2019 consultation

- 5.9 BT¹³⁹ and Wansdyke Ltd¹⁴⁰ broadly agreed with our approach to calculating, verifying and auditing a net cost. BT also noted that data collection and verification should be proportional to the size of the USO.¹⁴¹
- 5.10 The Advisory Committee for Northern Ireland (“ACNI”) agreed that Ofcom should be the arbiter of what constitutes a net cost.¹⁴²
- 5.11 Vodafone argued that we had failed to set out the specific calculations which must be completed. It also highlighted the BDUK funding programme as an example of how calculating costs and revenues is not straightforward.¹⁴³

¹³⁷ Including losses as a result of serving particular end-users or through geographical averaging of prices.

¹³⁸ Part A of Annex VI of the Universal Service Directive.

¹³⁹ BT non-confidential response to the November 2019 consultation, paragraph 5.3.

¹⁴⁰ Wansdyke Ltd non-confidential response to the November 2019 consultation, page 1.

¹⁴¹ BT non-confidential response to the November 2019 consultation, paragraph 5.4.

¹⁴² ACNI non-confidential response to the November 2019 consultation, page 2.

¹⁴³ Vodafone non-confidential response to the November 2019 consultation, pages 7-8.

- 5.12 UKCTA were concerned that our proposed approach did not lead to cost control or accountability as the Universal Service Provider could spend considerable amounts connecting customers believing it can re-charge these amounts to other industry players.¹⁴⁴

Our decision

- 5.13 The approach to performing a net cost calculation should be done on a case-by-case basis and will need to balance the need for accuracy with the need to ensure that the process is also proportionate in terms of the administrative burden on Ofcom and the industry. The nature of the exercise will therefore depend on the scale, scope and nature of the request being submitted. In light of this, we have not specified a detailed approach to calculating and verifying a net cost in the funding regulations. Instead, based on the principles set out above, we have decided to provide in the funding regulations that Ofcom will have regard to the following matters as appear to us appropriate in a particular case:
- a) the costs incurred in complying with the relevant universal service conditions;
 - b) the extent to which the costs of complying with the relevant universal service conditions were efficiently and necessarily incurred;
 - c) the revenues and any other direct benefits generated as a result of complying with the relevant universal service conditions¹⁴⁵;
 - d) any indirect benefits that the Universal Service Provider derives from designation as a provider of a universal service and the compliance with the relevant universal service conditions;
 - e) whether or not the Universal Service Provider has made a request for funding and the sufficiency of information which has been provided to Ofcom together with that request; and
 - f) any other matters identified as appropriate by Ofcom having regard to the facts and circumstances of the case.¹⁴⁶
- 5.14 We recognise Vodafone's concern that while the calculation, verification and audit of a net cost should be documented in detail, the funding regulations themselves do not specify a detailed approach. However, what is important is that once a Universal Service Provider has submitted a specific request for funding, we will scrutinise it in detail. Furthermore, we will consult on a draft determination of a net cost. This will include a full description of the steps we have taken to verify the potential net cost as well as the details of the calculations themselves.¹⁴⁷ This will give stakeholders the opportunity to comment on the net cost calculation and the information used for the purposes of that calculation and supply any

¹⁴⁴ UKCTA non-confidential response to the November 2019 consultation, paragraph 12.

¹⁴⁵ These are revenues and benefits that are incremental to those the Universal Service Provider was previously generating (i.e. revenues gained from the provision of USO services minus the revenues foregone from the provision of USO services).

¹⁴⁶ Funding regulation 3(2).

¹⁴⁷ We note that in presenting the details of a net cost calculation we will have to balance commercial confidentiality against the need for transparency.

further information which they consider to be relevant to the calculation. We will consider these responses and any further information before issuing a final determination.

- 5.15 We are also able to provide further guidance as to how we would expect to perform a net cost calculation for a specific USO. In Section 9, we provide guidance on our planned approach for the broadband USO. Alongside this, we set out our regulatory financial reporting directions, as set out at Annex 3, to require the Universal Service Providers to supply specific information to support a request to review a net cost of compliance with the broadband USO.¹⁴⁸
- 5.16 We have decided to make it clearer in the funding regulations that we will take into account whether the Universal Service Provider has provided the specified information to Ofcom and the content of that information as well as any other relevant information which may be obtained through the exercise of our information gathering powers.¹⁴⁹ For example, if we received information that allowed us to calculate a potential net cost, but we did not consider that the available information was sufficiently detailed, we may decide to take a more conservative approach to a net cost calculation than would have been the case had the data been sufficiently granular and precise. We think that by making clear in the funding regulations that this can be a matter Ofcom will have regard to if appropriate, a Universal Service Provider will have an incentive to submit the highest quality information it has available for a request to review a net cost.
- 5.17 We have also decided to make the funding regulations simpler and less duplicative by removing the reference to “any costs avoided” in funding regulation 3(2)(a).¹⁵⁰ We consider that the benefit of “any costs avoided” is already captured under “direct benefits” which is set out as a relevant matter in funding regulation 3(2)(c).
- 5.18 A net cost to an undertaking of being designated as the Universal Service Provider will depend, amongst other things, on what would have happened if the undertaking had not been designated for the USO in question i.e. the appropriate counterfactual. Considering the appropriate counterfactual allows us to identify the impact of being designated as the Universal Service Provider and complying with the associated universal service conditions. We can also distinguish those impacts from other factors that might affect the Universal Service Provider, which are not related to the USO. In Section 9, we consider the appropriate counterfactual for the broadband USO.

Efficiency

- 5.19 We would assess the efficient net cost of delivering the USO. To do so, we would consider submissions and evidence that the costs were efficiently and necessarily incurred to deliver the USO in question. If we concluded that this was not the case, we would make appropriate adjustments to the net cost. This should provide an incentive for the Universal

¹⁴⁸ This is in the form of a template appended to the regulatory financial reporting directions set out in Annex 3.

¹⁴⁹ Funding regulation 3(2)(e) and funding regulation 3(3).

¹⁵⁰ In the November 2019 consultation, paragraph 5.10 a) made reference to “the costs incurred and any costs avoided in complying with the relevant universal service conditions.”

Service Provider to deliver the USO efficiently, as it risks not being compensated for any inefficiently incurred costs in delivering USO connections.

- 5.20 There are a range of different ways in which we could assess efficiency. The methodologies we would consider appropriate would depend on the size and the scope of the USO that is being considered. For example, we may decide to carry out cross-checks which compare the costs of certain aspects of USO delivery with the costs of other similar network upgrades by the Universal Service Provider. For example, we could compare the direct labour costs or equipment costs for a specified amount of network rollout in non-USO rural areas and USO areas.

Information to be provided with a request for funding

Our November 2019 consultation

- 5.21 Our draft funding regulations specified that the Universal Service Provider must provide us with information to enable us to determine the existence of a net cost of complying with the universal service conditions.

Responses to our November 2019 consultation

- 5.22 BT¹⁵¹, KCOM¹⁵², Virgin Media¹⁵³, FCS¹⁵⁴ and Wansdyke Ltd¹⁵⁵ broadly agreed with our proposals on the information that the Universal Service Provider should supply.
- 5.23 BT also called for additional guidance on the types of information that could be requested under paragraph 5.7(g) of our November 2019 consultation – “any other information identified as appropriate by Ofcom” as well as clarification that the Universal Service Provider can submit additional information it considers relevant for Ofcom to make an informed decision.¹⁵⁶ BT also made an overarching point about ensuring that Ofcom’s approach is clear, simple and proportionate.¹⁵⁷
- 5.24 Vodafone stated that we had failed to set out clear, concise, detailed information requirements.¹⁵⁸ It also considered that the draft funding regulations we set out gave all of the power, control and scope to the Universal Service Provider to selectively provide the information and transparency that is most favourable to its claim.¹⁵⁹
- 5.25 Vodafone also noted that our proposals were different to the normal way in which Ofcom operates when calculating costs, revenues and Net Present Value (“NPV”) projections or

¹⁵¹ BT non-confidential response to the November 2019 consultation, paragraph 5.1.

¹⁵² KCOM non-confidential response to the November 2019 consultation, page 4.

¹⁵³ Virgin Media non-confidential response to the November 2019 consultation, page 4.

¹⁵⁴ FCS non-confidential response to the November 2019 consultation, page 2.

¹⁵⁵ Wansdyke Ltd non-confidential response to the November 2019 consultation, page 1.

¹⁵⁶ BT non-confidential response to the November 2019 consultation, paragraph 5.2.

¹⁵⁷ BT non-confidential response to the November 2019 consultation, paragraph 1.10.

¹⁵⁸ Vodafone non-confidential response to the November 2019 consultation, paragraph 3.4.

¹⁵⁹ Vodafone non-confidential response to the November 2019 consultation, paragraph 3.6.

other formal regulation where Ofcom uses its legal information gathering powers and requests specific information using the sections 135 or 136 information gathering process under the Act.¹⁶⁰

5.26 Broadway Partners [3<] ¹⁶¹

5.27 UKCTA called for real accountability and transparency around the money spent and ensuring the most cost-effective technology is used. It said funding of the USO should be subject to greater scrutiny than has been the case under BDUK.¹⁶²

Our decision

5.28 As we explain in Section 4, when requesting a review of a net cost of complying with the particular universal service conditions, the Universal Service Provider should ensure that the request contains the required information for us to commence a review. The nature and detail of information supplied alongside a request will be dependent on the nature and scale of the USO.

5.29 We consider that it is appropriate for the Universal Service Provider to ensure that it provides us with information to enable us to commence an assessment of the existence, and if required, the level, of a net cost. This includes any data, in addition to the information that will be required as set out below, that the Universal Service Provider considers relevant for Ofcom to make an informed decision. Ofcom will then decide if it has sufficient information to open a review.

5.30 As set out above, it is the efficient net cost of providing the USO that will be the focus of any net cost assessment.¹⁶³ We consider that efficiency includes (among other things) considering whether the Universal Service Provider has used the most efficient technology to deliver USO connections and incurred an efficient level of costs in delivering USO connections.

5.31 The Universal Service Provider will therefore have to submit information to explain how it has ensured efficiency, including why it considers its choice of technology and its approach to providing connections to be efficient. Depending on the nature and size of the USO, we may:

- a) obtain further information relating to how the Universal Service Provider has demonstrated its efficiency, including a justification of its technology choice; and/or
- b) investigate what procedures and controls the Universal Service Provider has used to minimise costs.¹⁶⁴

¹⁶⁰ Vodafone non-confidential response to the November 2019 consultation, paragraph 3.6.

¹⁶¹ Broadway Partners confidential response to the November 2019 consultation, page 3.

¹⁶² UKCTA non-confidential response to the November 2019 consultation, paragraph 14.

¹⁶³ Part A of Annex IV of the Universal Service Directive.

¹⁶⁴ In the context of the broadband USO, we explained in the June 2019 statement that we would expect the Universal Service Providers to supply, as part of our assessment of any unfair net cost claim, their explanation and evidence to justify claiming for any connections that exceed the reasonable cost threshold. We said that any excess costs which cannot be

- 5.32 We note that the requirements for the provision of information within the funding regulations must be flexible as they need to be applicable to all future USOs. We are therefore unable to set out the information requirements in more detail, as doing so could limit our ability to calculate and verify future net costs. Indeed, specifying that the Universal Service Provider must provide “any other information identified as appropriate by Ofcom having regard to the facts and circumstances of the case” allows us to be flexible in the types of information we can request for future USOs.
- 5.33 However, as noted above, for specific USOs we may be able to provide more detail on the type of information required. For example, Section 9 and Annex 3 of this statement detail the information we expect to be submitted for the broadband USO.
- 5.34 We disagree with Vodafone’s concern that the funding regulations give too much control to the Universal Service Provider submitting the claim. As noted, for a specific USO we may be able to be more prescriptive as to the nature and format of the information the Universal Service Provider will be required to collect and provide. We will then carefully scrutinise the information provided in each claim. As noted above, funding regulation 3(2)(e) also provides an incentive for the Universal Service Provider to submit the highest quality information it has available.
- 5.35 As outlined above, where we need certain additional information to be provided (including where we identify any specific gaps in the submission), we will use our section 135 powers to formally request this. Where we have concerns over the reliability of information provided by the Universal Service Provider, we will consider whether it would be appropriate to request this specifically using our powers under the Act. This approach should limit the Universal Service Provider’s ability to only submit information that is favourable to its request for funding and enable us to fulfil our role effectively.
- 5.36 As noted above, we will consult on a draft determination of a net cost. We will publish an appropriate level of information in order to allow stakeholders to provide informed responses as part of an accountable and transparent process.
- 5.37 We have therefore set requirements for the provision of information within the funding regulations, specifying that the Universal Service Provider must provide:
- a) its own estimate of the net cost of complying with the conditions;
 - b) the calculation used to arrive at that estimate;
 - c) an explanation of the methodology it has used when performing that calculation;
 - d) the accounts or other information which serve as the basis for the calculation of the net cost;
 - e) an explanation of the steps taken to verify the accounts and other information on which the calculation is based; and

reasonably explained by unforeseen circumstances would not be considered efficient. See paragraph 5.101 of the June 2019 statement.

f) the evidence that the net cost was efficiently and necessarily incurred.

5.38 In our November 2019 consultation, we also proposed to include a provision in the draft funding regulations requiring the Universal Service Provider to provide to us an explanation of why the Universal Service Provider considers the identified net cost to be an unfair financial burden alongside any supporting information to justify its explanation. We have considered this proposed requirement further in light of the consultation responses, in particular BT's comment about ensuring that our approach is clear, simple and proportionate.

5.39 We have concluded that it is not necessary to impose a legal obligation in the funding regulations to require the provision of such explanations and information because the Universal Service Providers will likely have strong incentives to explain to us why they consider any particular net cost to be unfair and to provide all supporting information. If such explanations and information are not provided, Ofcom will not be able to take them into consideration.

Auditing a net cost

Our November 2019 consultation

5.40 We explained that this net cost calculation will need to be audited in line with the Universal Service Directive and the Act.

Responses to our November 2019 consultation

5.41 KCOM¹⁶⁵, Sky¹⁶⁶, Vodafone¹⁶⁷, TalkTalk¹⁶⁸ and Virgin Media¹⁶⁹ said that where a net cost is calculated by Ofcom, the calculation should be independently audited.

5.42 TalkTalk said that the full details of the audit and subsequent changes to Ofcom's assessment should be included in the consultation on its assessment.¹⁷⁰ Virgin Media considered that the audit should be carried out at the Universal Service Provider's cost.¹⁷¹

5.43 Broadway Partners [~~redacted~~]¹⁷²

5.44 Gigaclear welcomed our proposal to consult prior to any determination on a net cost of compliance with the universal service conditions as this will be critical in ensuring that a Universal Service Provider does not give preference to its own network/s when delivering USO connections.¹⁷³

¹⁶⁵ KCOM non-confidential response to the November 2019 consultation, paragraph 1.6.

¹⁶⁶ Sky non-confidential response to the November 2019 consultation, page 4.

¹⁶⁷ Vodafone non-confidential response to the November 2019 consultation, paragraph 2.3.

¹⁶⁸ TalkTalk non-confidential response to the November 2019 consultation, page 3.

¹⁶⁹ Virgin Media non-confidential response to the November 2019 consultation, page 5.

¹⁷⁰ TalkTalk non-confidential response to the November 2019 consultation, page 3.

¹⁷¹ Virgin Media non-confidential response to the November 2019 consultation, page 5.

¹⁷² Broadway Partners confidential response to the November 2019 consultation, page 3.

¹⁷³ Gigaclear non-confidential response to the November 2019 consultation, page 2.

Our decision

- 5.45 We note that several stakeholders have said that our calculation of any net cost should be independently audited. Stakeholders also referred to the need for the auditor to have sufficient technical expertise and for the changes that follow the audit to be published.
- 5.46 We understand that stakeholders expect some assurance that any calculation of net cost complies with the principles set out in the legislation. Our proposals relating to the audit were intended to address only one aspect of the overall verification of any net cost; an arithmetic check of our net cost calculation.
- 5.47 As explained above, to fulfil our duties, we will carry out appropriate verification tests on costs provided by the Universal Service Provider to ensure that only costs efficiently and necessarily incurred in connection with complying with the universal service conditions are included in any net cost calculation. We will also satisfy ourselves that revenues and other benefits included in a net cost calculation are not understated. We will then consult on a draft determination of a net cost. This will include a full description of the steps we have taken to verify the net cost as well as the details of the calculations themselves. This will give stakeholders the opportunity to comment on the net cost calculation and the information used for the purposes of that calculation and supply any further information which they consider to be relevant before issuing a final determination. Together, we consider that these verification procedures should give stakeholders significant assurance that any net cost calculations comply with the principles set out in legislation and, to TalkTalk's point give some visibility of the changes made to the calculations.
- 5.48 Section 70(4) of the Act explains that, after carrying out these calculations, Ofcom must either (i) obtain an audit of those calculations by a person who appears independent of the Universal Service Provider; or (ii) audit those calculations themselves. Our proposals relating to the audit are in respect of this single requirement.
- 5.49 The scale of the audit will depend on the scale and complexity of the calculation. We therefore remain of the view that whether the audit of our net cost calculation is carried out by Ofcom or an independent party should be decided on a case-by-case-basis. In relation to the broadband USO, we would in principle be minded to arrange for an external audit of any net cost calculation.
- 5.50 Given the arithmetical nature of the audit, we would not expect an auditor to need significant practical experience of the latest technology and commercial models to carry out such an audit. As explained above, technical and commercial considerations would form part of our verification work and, if we consider it necessary, we will engage the necessary technical and commercial expertise at this stage of the process.
- 5.51 We note Virgin Media's comment that that the audit should be carried out at the Universal Service Provider's cost. We consider that given the principles and requirements specified in the legislation as to how a net cost must be calculated, it may not be appropriate to include audit costs as part of the calculation, in which case such costs may need to be

recovered through Ofcom's administrative costs ("administrative levy") process. In any event, we expect that the cost of any audit is likely to be relatively small.

Summary of funding regulations

- 5.52 In summary, we have decided to specify that in calculating a net cost, we should have regard to the following matters as appear to us appropriate in a particular case:
- a) the costs incurred in complying with the relevant universal service conditions;
 - b) the extent to which the costs of complying with the relevant universal service conditions were efficiently and necessarily incurred;
 - c) the revenues and any other direct benefits generated as a result of complying with the relevant universal service conditions;
 - d) any indirect benefits that the Universal Service Provider derives from designation as a provider of a universal service and the compliance with the relevant universal service conditions;
 - e) whether or not the Universal Service Provider has made a request for funding and the sufficiency of information which has been provided to Ofcom together with that request; and
 - f) any other matters we identify as appropriate having regard to the facts and circumstances of the case.
- 5.53 We also decided to make the following funding regulations on the information that must be provided to Ofcom if a Universal Service Provider requests that Ofcom make a determination that there is an unfair net cost:
- a) the Universal Service Provider's estimate of the financial burden of complying with the relevant universal service condition or conditions;
 - b) calculations performed by the Universal Service Provider in order to arrive at the estimate referred to in paragraph (a);
 - c) an explanation of the methodology adopted by the Universal Service Provider when performing the calculation referred to in paragraph (b);
 - d) the accounts or other information serving as the basis for the calculations referred to in paragraph (b);
 - e) the Universal Service Provider's explanation of the steps taken to verify the accounts and other information described in paragraph (d); and
 - f) the evidence that the costs of complying with the relevant universal service conditions were efficiently and necessarily incurred.

6. Determining the extent of any unfair burden

- 6.1 In this section, we set out our decision on the process we will follow to determine the amount of any unfair burden on the Universal Service Provider that results from a set of universal service obligations. We have decided to make this assessment based on criteria which we set out below.
- 6.2 Because this assessment depends on the specific facts that apply at the time of the assessment, it must be carried out on a case-by-case basis.
- 6.3 In Section 4, we have explained the procedures that we will follow. This includes setting out our proposed decision and our reasons for making that decision in a draft determination and consulting for a period of at least one month before publishing a final determination.

Our November 2019 consultation

- 6.4 In our November 2019 consultation, we explained that if Ofcom determines that complying with a set of universal service conditions results in a net cost on a Universal Service Provider, Ofcom must consider whether it would be unfair for the Universal Service Provider to bear all or part of that net cost. Compensation can only be provided if we decide that there is an unfair burden.
- 6.5 We set out the criteria we would have regard to in assessing unfairness. We also set out that we would take into account the explanation provided by the Universal Service Provider as to why it considers that compliance with the relevant set of universal service conditions represents an unfair burden for it.

Responses to our November 2019 consultation

- 6.6 BT¹⁷⁴, Sky¹⁷⁵, TalkTalk¹⁷⁶, FCS¹⁷⁷ and Wansdyke Ltd¹⁷⁸ agreed with our overall approach to the assessment of the extent of any unfair burden of the USO.
- 6.7 BT was concerned that the costs of setting up and administering an industry fund will be high, leading to a high threshold for proceeding with a claim. It said that Ofcom should use a light touch, efficient and timely process to ensure the establishment of an industry fund is not unduly burdensome and when considering the costs associated with an industry fund

¹⁷⁴ BT non-confidential response to the November 2019 consultation, page 10.

¹⁷⁵ Sky non-confidential response to the November 2019 consultation, page 4.

¹⁷⁶ TalkTalk non-confidential response to the November 2019 consultation, page 3.

¹⁷⁷ FCS non-confidential response to the November 2019 consultation, pages 2-3.

¹⁷⁸ Wansdyke Ltd non-confidential response to the November 2019 consultation, page 1.

as part of the unfairness assessment, Ofcom should only consider efficiently incurred costs.¹⁷⁹ In that regard BT suggested the following changes.

- a) BT said that Ofcom should set a minimum claim threshold above which the net cost is proportionate to the work involved in assessing and potentially setting up an industry fund.¹⁸⁰
- b) BT suggested that draft funding regulation 5(2)(d) should be amended so that only the “likely efficiently incurred costs to OFCOM and others associated with establishing and administering a fund under these Regulations” as opposed to “the likely costs to OFCOM and others associated with establishing and administering a fund under these Regulations” appeared in the list of matters Ofcom must have regard to, if appropriate, when making an unfairness determination.¹⁸¹

6.8 BT and Virgin Media asked for additional clarity on how our proposals will work:

- a) BT¹⁸² and Virgin Media¹⁸³ asked how previous determinations of the net cost and unfairness would be taken into account when assessing subsequent claims;
- b) BT¹⁸⁴ and Virgin Media¹⁸⁵ asked how Ofcom will assess the extent to which the Universal Service Provider is exposed to competition and constrained by regulation and in particular which parts of the Universal Service Provider’s business are relevant to that assessment; and
- c) BT said that Ofcom should make it clear that the net cost recovered by the Universal Service Provider can include a reasonable profit.¹⁸⁶

6.9 BT suggested adding wording to draft funding regulation 5(2) such that “any previous OFCOM determinations rejecting the universal service provider’s claims” would be a matter which Ofcom must, in appropriate cases, have regard to.¹⁸⁷

6.10 Virgin Media suggested that wording should be added to draft funding regulation 5(2) such that whether the burden on the Universal Service Provider associated with bearing the net cost would be “excessive in view of the undertaking’s ability to bear it, account being taken of all the undertakings own characteristics such as the quality of its equipment, its economic and financial situation and its market share” would be a further matter which Ofcom must, in appropriate cases, have regard to.¹⁸⁸

¹⁷⁹ BT non-confidential response to the November 2019 consultation, page 11.

¹⁸⁰ BT non-confidential response to the November 2019 consultation, page 11.

¹⁸¹ BT non-confidential response to the November 2019 consultation, page 11 and Annex 1, page 2.

¹⁸² BT non-confidential response to the November 2019 consultation, pages 11-12.

¹⁸³ Virgin Media non-confidential response to the November 2019 consultation, page 1.

¹⁸⁴ BT non-confidential response to the November 2019 consultation, page 12.

¹⁸⁵ Virgin Media non-confidential response to the November 2019 consultation, pages 5-6.

¹⁸⁶ BT non-confidential response to the November 2019 consultation, page 12.

¹⁸⁷ BT non-confidential response to the November 2019 consultation, page 8 and Annex 1, page 2.

¹⁸⁸ Virgin Media non-confidential response to November 2019 consultation, page 7. This wording comes from paragraph 49 of the judgments in cases C-222/08 and C-389/08 which we summarise in Section 3.

- 6.11 Virgin Media suggested a different process for the assessment of unfairness. The first stage would test the Universal Service Provider's ability to pay relative to its cash generating ability. Then a second stage would assess whether the Universal Service Provider enjoys sufficient market power to enable it to defray sufficiently the net cost incurred.¹⁸⁹
- 6.12 Vodafone said that the Wholesale Broadband Access charge controls had been set on the assumption that BT would invest in rural areas. However, instead of undertaking that investment, BT decided to make returns in excess of their regulated cost of capital. Vodafone said that these excessive returns should be the source of funding for a net cost burden in the first instance.¹⁹⁰
- 6.13 A member of the public said that Ofcom should consider the extent to which the burden would distort prices in the absence of funding arrangements.¹⁹¹
- 6.14 UKCTA¹⁹², Telefónica¹⁹³ and Vodafone¹⁹⁴ said that it was too early to consult on funding regulations and that Ofcom should first establish that there is an unfair net cost.

Our decision

- 6.15 We address stakeholder comments about the administrative burden of an industry fund, clarifications on our approach and comments on the structure and timing of the funding regulations below. We then set out our reasoning and decision on the approach we will take to determining the extent of an unfair cost burden.

Responses to stakeholder comments

Assessment of administrative burdens

- 6.16 In practical terms, if an industry fund is needed, we will seek to establish the industry fund in such a way as to minimise the administrative burden on Ofcom and industry.¹⁹⁵ However, in the event that we set up an industry fund it is important that we also ensure that the level of verification is sufficient. This is a judgement we will need to make on a case-by-case basis as the amount of verification that is needed will vary with the size and scope of the fund.
- 6.17 Given that the amount of verification and the associated administrative burden will vary depending on the size of an industry fund; we cannot be definitive at this stage about the threshold above which a net cost is proportionate to the work involved in assessing and setting up an industry fund. In any event, a threshold would add limited clarity for

¹⁸⁹ Virgin Media non-confidential response to the November 2019 consultation, pages 5-6.

¹⁹⁰ Vodafone non-confidential response to the November 2019 consultation, pages 9-10.

¹⁹¹ S. Carter non-confidential response to the November 2019 consultation, page 5.

¹⁹² UKCTA non-confidential response to the November 2019 consultation, paragraph 3.

¹⁹³ Telefónica non-confidential response to the November 2019 consultation, page 3.

¹⁹⁴ Vodafone non-confidential response to the November 2019 consultation, page 3.

¹⁹⁵ Proportionality is one of the factors we must take into account when establishing a fund collecting and distributing funds.

Universal Service Providers because the administrative cost is only one criterion we would consider when determining unfairness.

- 6.18 We note that this part of the assessment would be limited to considering the cost to Ofcom and industry of establishing and administering an industry fund as set out in Sections 7 and 8.

Clarification of how our funding regulations will work

- 6.19 The relevance of a previous determination to the assessment of unfairness will depend on the context.
- a) If Ofcom has made a previous determination of unfairness and compensation has been provided to the Universal Service Provider then we would not expect the existence of that burden to have a bearing on subsequent determinations because that burden has been resolved.¹⁹⁶
 - b) If Ofcom has made a determination of a net cost but determined that all or part of the burden was fair, we will recognise that the new net cost is a further burden on the Universal Service Provider, as part of any subsequent determination i.e. when making a subsequent unfairness assessment we will have regard to the fact that the Universal Service Provider has already borne a certain net cost. In that circumstance, we may be more likely to find that further burden unfair and/or find that a bigger proportion of the further burden is unfair.
 - c) We will not re-open the question of funding for the burden that has previously been determined fair; unless there are exceptional circumstances (see Section 4).
- 6.20 The assessment of the extent to which the Universal Service Provider is exposed to competition and constrained by regulation will depend on the obligations placed upon it. We would not normally consider that exposure to competition and/or regulation in an entirely unrelated activity or market would be relevant to the assessment.
- 6.21 We agree with BT that the caselaw does not preclude a reasonable profit being included when calculating the net cost of a particular USO. For example, for the broadband USO, we plan to use the cost of capital to discount future cash flows when calculating the net cost in complying with the universal service conditions.
- 6.22 We do not agree with Virgin Media that there should be a two-stage process looking first at the cash generating ability of the Universal Service Provider and then at the degree of its market power. The cash generating ability of a firm tells us about whether the Universal Service Provider could bear the cost out of short term cashflow but that does not tell us whether it is fair for them to bear the burden. One of our criteria when assessing unfairness is the extent to which the Universal Service Provider is subject to competition in

¹⁹⁶ The approach we have taken to the prior burden may have some bearing on the approach we take in subsequent assessments.

relevant markets so Virgin Media's proposed second stage (the amount of market power) already forms part of our assessment framework.

- 6.23 In response to Vodafone, we have previously set out our general approach to returns in regulated telecoms markets.¹⁹⁷ Our approach to wholesale regulation is designed to maintain a balance between, on the one-hand, incentivising BT and others to invest in new technology (and become more cost efficient through time) and, on the other hand, ensuring fair prices for retail competitors and their customers. We recognise that BT's accounting returns in the wholesale broadband market referred to by Vodafone (i.e. the regulated "Market A" – which typically comprises rural exchange areas) have historically been above the cost of capital. However, as we explained in the 2018 WBA statement, we do not consider that these accounting returns represent an accurate picture of the economic returns in this market.¹⁹⁸ Even where past returns have been above the cost of capital, we do not consider it conducive to regulatory predictability and future investment incentives to clawback such returns through separate regulation – such as an assessment of USO net costs (if such net cost were found unfair).
- 6.24 We agree with a member of the public that the assessment of unfairness should include consideration of the extent to which the burden of a USO may be passed through to end-user prices. We have included the extent to which the Universal Service Provider is constrained by competition and regulation as part of our criteria for the assessment of whether a burden is unfair. Given that these criteria already form part of our assessment we do not see a need for a further criterion.

Timing of funding regulations

- 6.25 We remain of the view that it is appropriate to lay out the funding regulations in advance. Ofcom is required to put in place regulations setting out the procedures and principles in order to be able to make any of the determinations on net cost, unfairness and compensation mechanism in the event of a request for funding. Setting out those regulations in advance will ensure that the process of making those determinations is efficient. Stakeholders will have an opportunity to comment in due course, as we will consult on any specific determinations we propose to make.

Relevant criteria for determining the extent of an unfair cost burden

- 6.26 The relevant legislation does not provide detailed guidance on what circumstances might give rise to an unfair burden. As explained in Section 3, there is a piece of relevant caselaw in which one thing which is said is that an unfair burden is a burden which, for each undertaking concerned, is excessive in view of the undertaking's ability to bear it, having taken account of the undertaking's own characteristics.
- 6.27 The caselaw also says that it falls to the national regulatory authorities (in this case Ofcom) to lay down criteria which make it possible to determine thresholds beyond which a

¹⁹⁷ See for instance Ofcom, [Statement regarding BT's regulatory accounts for 2017/18](#).

¹⁹⁸ See paragraph 5.26 to 5.27 of Ofcom, Wholesale Broadband Access Market Review: final statement, July 2018.

burden may be regarded as unfair. Each individual assessment of a particular net cost must then be carried out by Ofcom against those criteria, taking account of the Universal Service Provider's relevant characteristics and circumstances prevailing at the time of the assessment. As explained in Section 3, in carrying out this role, we must have regard to our duties, including our principal duty to further the interests of citizens in relation to communications matters and the interests of consumers in relevant markets, where appropriate by promoting competition.

Criteria that we will apply to considering unfairness in this context

- 6.28 The calculation and verification of a net cost provides an important first step in the assessment of whether there is an unfair net cost burden. A verified net cost will show the existence and, if relevant, the level of the financial burden placed upon the Universal Service Provider as a result of being designated. If a net cost exists, this also demonstrates that there are elements of the identified services which can only be provided at a loss or provided under cost conditions falling outside normal commercial expectations. As explained in Section 5, only costs efficiently and necessarily incurred in connection with complying with the universal service conditions would be included in a net cost calculation.
- 6.29 We will consider the impact on the Universal Service Provider of bearing any net cost, having regard to its specific characteristics and circumstances prevailing at the time. When considering the relevant characteristics at the time of our assessment, we would have regard to the characteristics referred to by the European Court of Justice, namely the quality of the Universal Service Provider's equipment, its economic and financial situation and its market share.¹⁹⁹ In particular, we have decided that our assessment of unfairness should take into account the following factors:
- a) the degree to which the Universal Service Provider is exposed to competition (since firms with greater market power are less likely to suffer a competitive disadvantage or other adverse effects from bearing a net cost); and
 - b) the extent to which the Universal Service Provider is constrained by regulation in the market in question or a closely related market (which could limit the ability of a firm with market power to set prices and so will limit its ability to bear a net cost).
- 6.30 We consider that the method of designation is also relevant to the question of whether a verified net cost might constitute an unfair burden. Where a provider is directly designated (i.e. not through a competitive procedure) and has relatively limited control over the universal service conditions it faces, we are more likely to find the associated burden unfair, other things being equal.
- 6.31 Our assessment will compare the size of any net cost with administrative burdens associated with triggering a compensation mechanism for funding the universal service as envisaged by the legislation. In particular, we would consider the cost to Ofcom and industry of establishing and administering an industry fund. We would be unlikely to

¹⁹⁹ Paragraph 49 of the judgments in cases C-222/08 and C-389/08.

consider it unfair for a Universal Service Provider to bear a net cost if the cost of setting up and administering an industry fund was disproportionately large, compared to the likely amount of any prospective compensation.

- 6.32 We do not consider that it would be appropriate or necessary to make the change to the drafting of the funding regulations suggested by Virgin Media i.e. to stipulate that a factor which Ofcom must have regard to is whether the unfair net cost is “excessive in view of the undertaking’s ability to bear it, account being taken on all the undertakings own characteristics such as the quality of its equipment, its economic and financial situation and its market share.” We agree with Virgin Media that these factors, as set out in the caselaw of the European Court of Justice, are relevant and we will have regard to them when making a determination of unfairness of a particular net cost, alongside any other relevant, judicial guidance which may be available at the time of our decisions. In light of that, we do not think that it would be either appropriate or necessary to codify these factors in the funding regulations.
- 6.33 As set out in Section 4, there may be several determinations of a net cost. While we have not adopted the precise wording suggested by BT, we have added a new sub-paragraph to funding regulation 5(2), which sets out the matters Ofcom must have regard to, in appropriate cases, when assessing unfairness. That sub-paragraph states that the matter to which regard must be had is “any previous determinations under section 71(2) of the Act relating to the burden of complying with universal service conditions relating to the same universal service.”
- 6.34 In making each determination of unfairness we will consider whether there are any further criteria which may be relevant in addition to those outlined above.
- 6.35 In making our determination of unfairness, we will also consider any explanation provided by the Universal Service Provider as to why it considers that compliance with the relevant set of universal service conditions represents an unfair burden for it.²⁰⁰

Summary of funding regulations

- 6.36 In light of the consultation responses, we have decided to make an amendment to the version of the draft funding regulations on which we consulted. That is, we have added a new sub-paragraph to regulation 5(2), which sets out the matters Ofcom must have regard to, in appropriate cases, when assessing unfairness. That sub-paragraph states that the matter to which regard must be had is “any previous determinations under section 71(2) of the Act relating to the burden of complying with universal service conditions relating to the same universal service.” We have also made some other minor changes.
- 6.37 A summary of the relevant provisions of the funding regulations is set out below.
- 6.38 If Ofcom determines that complying with the universal service conditions results in a net cost on a Universal Service Provider, Ofcom must consider whether it would be unfair for

²⁰⁰ Funding regulation 5(3).

the Universal Service Provider to bear all or part of that net cost. Compensation can only be provided if we decide that there is an unfair burden.

- 6.39 We will have regard to the following criteria when assessing unfairness:
- a) the extent to which the Universal Service Provider is subject to competition in relevant markets;
 - b) the extent to which the Universal Service Provider is constrained by regulation in relevant markets;
 - c) the type and nature of the particular designation procedure which has been used for the designation of that Universal Service Provider, including whether or not a competitive procedure has been used;
 - d) the likely costs associated with establishing and administering an industry fund;
 - e) any previous determinations of unfairness relating to the burden of complying with universal service conditions relating to the same universal service; and
 - f) any other matters identified by Ofcom as appropriate having regard to the facts and circumstances of the case.
- 6.40 We will also consider any explanation provided by the Universal Service Provider as to why it considers that compliance with the relevant set of universal service conditions represents an unfair burden for it.

7. Establishing an industry fund

- 7.1 In this section, we set out the rules and procedures for establishing an industry fund, should Ofcom find that there is an unfair net cost burden. This includes:
- a) determining whether an industry fund should be set up;
 - b) determining the contributors to an industry fund; and
 - c) determining the level of contributions to an industry fund.
- 7.2 We will follow the rules and procedures set out in this section in order to make these determinations. As set out in Section 4, if we come to make any determinations regarding funding, we will consult and take stakeholder comments into account before issuing a final determination.

Determining whether an industry fund should be set up

Our November 2019 consultation

- 7.3 We explained in our November 2019 consultation that where Ofcom has determined that an unfair net cost burden exists and the Universal Service Provider has made an application for compensation:
- a) an industry fund will be set up to compensate the Universal Service Provider for an unfair net cost in full where there are no public funds committed to compensating the Universal Service Provider;
 - b) conversely, if the Universal Service Provider will be compensated in full from public funds, no industry fund will be established by Ofcom; and
 - c) if public funds are committed to compensate the Universal Service Provider for only part of an unfair net cost, then an industry fund will be set up to pay the remainder.
- 7.4 We also proposed a provision which would allow the Universal Service Provider to waive its right to all or part of the compensation, exercisable at any time.

Responses to our November 2019 consultation

- 7.5 Several stakeholders (KCOM²⁰¹, TalkTalk²⁰² and Wansdyke Ltd²⁰³) agreed with our proposals. BT, Virgin Media, Three, UKCTA, Sky, FCS and Vodafone raised some concerns regarding our proposals.

²⁰¹ KCOM non-confidential response to the November 2019 consultation, page 4.

²⁰² TalkTalk non-confidential response to the November 2019 consultation, page 3.

²⁰³ Wansdyke Ltd non-confidential response to the November 2019 consultation, page 2.

Concerns over postponement of compensation

- 7.6 BT was concerned that our approach to the issue of public funds may delay the timing and administration of compensation. In particular, BT made the following points.
- a) Our proposed draft funding regulation 9(3) would result in indefinite postponement of compensation where there are potential public funds. BT said that any consideration of central funds should be limited to firm commitments by Government and a short discretionary postponement, and Ofcom should have discretion (rather than be obliged) to postpone compensation.²⁰⁴
 - b) Ofcom should confirm in our final statement that there has been no clear commitment of central funds from Government for the broadband USO.²⁰⁵
 - c) Ofcom should clarify that the proposal to “open a separate fund to compensate each amount...” is intended to separate the administering of various claims and will not incur additional cost or burden.²⁰⁶

Concerns BT may be overcompensated

- 7.7 Three and Vodafone said that BT may be overcompensated from an industry fund. Three said that, where public funds are used and calculation of contributions from an industry fund postponed, there is a risk that BT is compensated twice: once by the industry for the USO and then again by the state for an alternative funding programme. Its preference would be for Government to at least part-fund the USO.²⁰⁷ Similarly, Vodafone said we should be mindful not to require providers to fund extensions of rival networks – as any funding provided will be money that a provider cannot spend on its own investment priorities. It said that given BT’s dominance in many markets, asking providers with far smaller market shares to contribute to BT’s network upgrade is especially concerning.²⁰⁸
- 7.8 Virgin Media said that a shortcoming of the USO arrangements is that state aid schemes will effectively be ignored if their delivery date for the customer is more than 12 months after a request for a USO connection. It said that the capital costs of such lines should be removed from the net cost calculation and that an industry fund must not be used to reduce the amount of state aid funding.²⁰⁹
- 7.9 UKCTA said that the imminent withdrawal of Wholesale Line Rental and copper retirement could end up leaving customers who currently enjoy a reliable telephone service without a line. It said that under no circumstances should replacing these lines be charged back to an industry fund.²¹⁰

²⁰⁴ BT non-confidential response to the November 2019 consultation, pages 12-13.

²⁰⁵ BT non-confidential response to the November 2019 consultation, paragraph 7.6.

²⁰⁶ BT non-confidential response to the November 2019 consultation, paragraph 7.7.

²⁰⁷ Three non-confidential response to the November 2019 consultation, page 9.

²⁰⁸ Vodafone non-confidential response to the November 2019 consultation, paragraph 5.2.

²⁰⁹ Virgin Media non-confidential response to the November 2019 consultation, pages 4-5.

²¹⁰ UKCTA non-confidential response to the November 2019 consultation, paragraph 13.

- 7.10 Sky said that given the wide range of potential costs of the broadband USO, which is largely dependent on the scope and scale of BT's commercial FWA deployment, there is a risk that we could set perverse incentives on BT to reduce the scale of its FWA or commercial plans and instead rely on the broadband USO. It said that universal service provision needs to be used only as a last resort when all other commercial solutions have failed.²¹¹

Concerns over uncertainty

- 7.11 Sky and FCS were concerned about the uncertainty of eligibility and demand for USO services. Sky said that we should consult again once we have a better understanding about the scale of premises that will be eligible for the broadband USO before deciding whether to introduce an industry fund.²¹² FCS proposed that no industry fund should be created until longer term demand, over a number of years, has been assessed and that the creation of an industry fund should be a "last resort," as it is likely to be the least efficient way of reimbursing the USO providers.²¹³
- 7.12 Vodafone said that it was unable to comment on our consultation questions relating to setting up an industry fund due to the lack of detail in our consultation.²¹⁴

Our decision

Concerns over postponement of compensation

- 7.13 In the event that public funds are to be committed to compensate the Universal Service Provider for only part of an unfair net cost, then an industry fund will be set up to pay the remainder. Therefore, it would be necessary to ensure that no payment from an industry fund takes place until the full extent of the public funds that are committed is clear, so that we can accurately determine the size of the industry fund. In practice, we would need a clear and unequivocal commitment that Government will fund all or part of a USO to delay setting up an industry fund. This commitment would need to be for funding which is specific to the USO in question. Other forms of state support, such as state aid schemes to subsidise rollout of further telecoms networks, are not a reason to delay payments from an industry fund.
- 7.14 While we have decided not to adopt all of the suggestions made by BT relating to draft funding regulation 9(3), we have clarified that it is only where it appears to us that public funds are committed to compensating the Universal Service Provider for a particular net cost, that we must postpone the determination of the amount to be collected from an

²¹¹ Sky non-confidential response to the November 2019 consultation, page 3.

²¹² Sky non-confidential response to the November 2019 consultation, pages 2-3.

²¹³ FCS non-confidential response to the November 2019 consultation, pages 1 and 3. FCS stated that we have not considered the impact of "front loading" of demand and suggested that we should strongly resist creating such a fund based on the level of cost incurred by providers in the initial years of operation of the new broadband USO.

²¹⁴ Vodafone non-confidential response to the November 2019 consultation, paragraph 5.1.

industry fund until such time as the amount to be compensated from public funds is known.

- 7.15 We can confirm that, at present, no Government funding has been committed to the broadband USO. In this particular instance, the Government stated that “the USO should be funded by the industry” when it published the Order setting up the broadband USO.²¹⁵
- 7.16 From an administrative perspective, we think it is appropriate and transparent to deal with the different amounts relating to each request for funding separately (rather than having a ‘running total’ which increases and decreases as we find unfair net costs and receive contributions). Administering the requests for funding separately is simpler and is not likely to lead to a disproportionate increase in costs.

Concerns BT may be overcompensated

- 7.17 In response to Three, Virgin Media and Vodafone, we consider it unlikely that the Universal Service Provider will be over compensated or compensated twice.
- a) In the case of a mixed funding model in which there is Government funding and industry funding for a USO, the Government funding is considered first, and the industry pays the remainder.
 - b) An overlap between a USO and state aid can be avoided through the design of the eligibility criteria for the USO. For example, in the case of the broadband USO, premises that will be connected through a publicly-funded rollout scheme within 12 months will not be eligible.²¹⁶
 - c) It is for the Government to avoid an overlap between a USO and state aid schemes. It can do this by excluding premises that will receive a USO service from the intervention areas specified in any future subsidised rollout.
 - d) In the unlikely event that there are premises that have been supplied with a service under the USO, and for which the Universal Service Provider has also received state aid, we would take account of that in our calculation of any net cost of complying with the USO (e.g. by removing those premises from our calculation).
- 7.18 In response to UKCTA, the withdrawal of Wholesale Line Rental will mean that voice customers will have their voice service provided over a broadband connection instead of a dedicated voice network. Copper retirement will see older equipment used to deliver copper services discontinued once fibre is in place. Our expectation is that in almost all cases a replacement broadband line will be available before the copper is retired and that this will be provided outside of the broadband USO.
- 7.19 We recognise that if an industry fund is set up then this will involve a transfer of funds from the contributors to the Universal Service Provider. It is only in cases where we have

²¹⁵ DCMS, March 2018. [*A new broadband Universal Service Obligation: Government’s response to consultation on design*](#), page 54.

²¹⁶ Ofcom, June 2019. [*Delivering the Broadband Universal Service Statement: Designating Universal Service Providers and setting conditions, Annex 1*](#) Condition A.3(b)(ii).

determined that the Universal Service Provider suffers an unfair burden that it will be compensated. The extent to which the Universal Service Provider is able to bear the cost because it has market power is part of the unfairness assessment (see Section 6). If funding is provided, the Universal Service Provider can only be compensated for the amount of the unfair burden.

- 7.20 We do not agree that the prospect of an industry fund would cause a Universal Service Provider to delay or drop plans for the rollout of commercial services. Funding will only be available if it can be demonstrated that compliance with the universal service conditions results in an unfair burden on the Universal Service Provider. Where an upgrade to a premises is already commercially viable, the revenues earned from that premises would be expected to exceed the costs of building the connection and so there will be no net cost associated with building that connection. Including that premises within a request under the broadband USO will not increase the overall net cost of the broadband USO and so will not cause an increase in the funding requirement.²¹⁷ The Universal Service Provider would therefore gain no advantage by delaying rollout to these premises in order to include them within the broadband USO footprint.
- 7.21 We note that BT's approach has been to roll out its FWA product in advance of the broadband USO launch date and expects that this will significantly reduce the number of premises that cannot access decent broadband.

Concerns over uncertainty

- 7.22 In response to Sky and FCS's concerns over uncertainty, as explained in Section 4, we note that if there is a request for funding, we will consult on our draft determination before setting up an industry fund.
- 7.23 In response to FCS's concerns about the availability of information on demand for the broadband USO, we note in Section 4 that the timing of a review of any net cost is a decision for Ofcom and one of the factors that we will consider when making that decision will be whether we have sufficient information available at that time.

Summary of our decision

- 7.24 We have decided to adopt the approach to determining whether an industry fund should be set up that we proposed in our November 2019 consultation. Where Ofcom has determined that there is an unfair net cost burden and the Universal Service Provider has made an application for compensation:
- a) an industry fund will be set up compensating the Universal Service Provider for an unfair net cost in full where there are no public funds committed to compensating the Universal Service Provider;

²¹⁷ In principle, we might expect the inclusion of commercially viable premises to reduce the amount of a net cost overall as the revenues would exceed the costs.

- b) conversely, if the Universal Service Provider will be compensated in full from public funds, no industry fund will be established by Ofcom; and
- c) if public funds are committed to compensate the Universal Service Provider for only part of an unfair net cost, then an industry fund will be set up to pay the remainder.

7.25 We have also decided to adopt our consultation proposal which would allow the Universal Service Provider to waive its right to all or part of the compensation, exercisable at any time, as we explain in Section 8.

Contributors to an industry fund

Our November 2019 consultation

- 7.26 The legislation allows for costs to be recovered from providers of ECN and/or ECS within the UK, or from a subset of those providers. If we consider this to be appropriate, we have the power to require only particular providers or a particular subset of providers to contribute, including requiring contributions only from undertakings whose national turnover is more than a set limit.
- 7.27 In our November 2019 consultation, we explained that we would use the principles of transparency, no undue discrimination, proportionality and least market distortion when considering which ECN and/or ECS providers should be required to contribute to an industry fund.

Responses to our November 2019 consultation

Providers that should contribute to an industry fund

- 7.28 KCOM agreed with our proposed approach to determining which providers should contribute to an industry fund.²¹⁸ Most of the other comments focused on whether the pool of contributors should encompass a narrow or wide subset of ECN and/or ECS providers and were focused on the broadband USO in particular.

The pool of contributors should be as wide as possible

- 7.29 BT²¹⁹, Sky²²⁰, TalkTalk²²¹ and Virgin Media²²² said that the pool of contributors should be as wide as possible, including mobile and communication services provided over the internet, to spread the burden of the net cost and avoid market distortion. Virgin Media said that there should not be any undue discrimination against providers, and that benefits from

²¹⁸ KCOM non-confidential response to the November 2019 consultation, page 4.

²¹⁹ BT non-confidential response to the November 2019 consultation, page 13.

²²⁰ Sky non-confidential response to the November 2019 consultation, page 5.

²²¹ TalkTalk non-confidential response to the November 2019 consultation, page 3.

²²² Virgin Media non-confidential response to the November 2019 consultation, page 6.

additional USO connections via network effects should be similar for fixed, mobile and those providing “over-the-top” (OTT) services.²²³

- 7.30 Virgin Media²²⁴ and Broadway Partners²²⁵ requested clarity on whether BT’s retail divisions and Openreach will be a contributor to an industry fund.

The pool of contributors should be limited to certain providers

- 7.31 Three²²⁶ and Telefónica²²⁷ said that any proposed funding mechanism should be limited to operators providing fixed services.
- 7.32 Three and Telefónica said that market distortions may not be minimised if we choose a wider set of contributors to an industry fund. Telefónica said that a wide pool would create distortion and would be discriminatory.²²⁸ Three said that fixed broadband and mobile broadband are not substitutable services, as set out in Ofcom’s Wholesale Local Access market review. Therefore, excluding mobile will not cause a competitive distortion in the fixed market.²²⁹
- 7.33 Three said that requiring mobile operators to contribute to an industry fund that fixed operators will benefit from in the medium to long term (given that some can supply USO lines after the initial term) and from which mobile will never benefit would be discriminatory.²³⁰
- 7.34 Furthermore, Three²³¹ and Telefónica²³² said that including mobile operators would be disproportionate, given the mobile industry’s work in funding initiatives with similar objectives, such as the Shared Rural Network.
- 7.35 FCS said that it agreed with the criteria being considered but that the pool of contributors should be minimised to reduce administrative costs.²³³

Large business providers and Universal Service Provider’s competitors should be exempt

- 7.36 UKCTA said that providers who serve other sectors, such as large business providers, whose customers are outside the scope of the USO should be excluded.²³⁴
- 7.37 Broadway Partners said that it should be exempt from contributing to the fund as it is already contributing to reducing USO costs by competing with BT in its USO areas.²³⁵

²²³ Virgin Media non-confidential response to the November 2019 consultation, page 2.

²²⁴ Virgin Media non-confidential response to the November 2019 consultation, page 6.

²²⁵ Broadway Partners non-confidential response to the November 2019 consultation, pages 2-3.

²²⁶ Three non-confidential response to the November 2019 consultation, page 8.

²²⁷ Telefónica non-confidential response to the November 2019 consultation, page 3.

²²⁸ Telefónica non-confidential response to the November 2019 consultation, page 4.

²²⁹ Three non-confidential response to the November 2019 consultation, pages 9-10.

²³⁰ Three non-confidential response to the November 2019 consultation, page 8.

²³¹ Three non-confidential response to the November 2019 consultation, pages 6-7.

²³² Telefónica non-confidential response to the November 2019 consultation, pages 2-4.

²³³ FCS non-confidential response to the November 2019 consultation, page 3.

²³⁴ UKCTA non-confidential response to the November 2019 consultation, paragraph 11.

²³⁵ Broadway Partners non-confidential response to the November 2019 consultation, page 2.

Case-by-case approach leads to uncertainty

7.38 Vodafone, UKCTA²³⁶ and Three²³⁷ said that keeping potential contributors unknown creates uncertainty. In particular, Vodafone was concerned that our case-by-case approach to determining an industry fund implies that we will make decisions at the time without providing clear guidance on any formal steps, which could introduce inconsistency.²³⁸

Turnover threshold

7.39 BT, FCS²³⁹, Wansdyke Ltd²⁴⁰ and The Independent Networks Cooperative Association (“INCA”²⁴¹) agreed with our proposal to apply a minimum relevant turnover threshold, but BT said that we should provide a preliminary indication of this threshold to provide more certainty to potential contributors.²⁴²

Our decision

7.40 The purpose of an industry fund is to compensate the Universal Service Provider for the unfair net cost burden Ofcom determines by sharing that burden with the wider industry. Under the legislation, our objective is to design a sharing mechanism that is transparent, proportionate, non-discriminatory and which results in the minimum distortion to competition and to user demand. The mechanism must also be workable in practice.

7.41 The majority of the responses to our November 2019 consultation, which related to the pool of contributors to an industry fund, were focused on the decisions that will be made in due course under the funding regulations. As set out in Section 4, we will consult on our draft determination before concluding on the pool of contributors.

7.42 We received no substantive comments on the funding regulations themselves and there was broad agreement that the principles of transparency, non-discrimination, proportionality and least market distortion should be used to make those decisions. We have therefore decided to adopt our proposals set out in our November 2019 consultation.

Providers that should contribute to an industry fund

7.43 We consider each of the relevant four principles (transparency, no undue discrimination, proportionality and least market distortion) in the context of how we will decide which ECN and/or ECS providers should be required to contribute to an industry fund. In doing so, we explain how these principles affect both the rules and procedures we have decided to include in the funding regulations and the framework for making subsequent decisions

²³⁶ UKCTA non-confidential response to the November 2019 consultation, paragraph 10.

²³⁷ Three non-confidential response to the November 2019 consultation, page 5.

²³⁸ Vodafone non-confidential response to the November 2019 consultation, paragraph 5.4.

²³⁹ FCS non-confidential response to the November 2019 consultation, page 2.

²⁴⁰ Wansdyke Ltd non-confidential response to the November 2019 consultation, page 2.

²⁴¹ INCA non-confidential response to the November 2019 consultation, page 4.

²⁴² BT non-confidential response to the November 2019 consultation, paragraph 7.8.

under those regulations in respect of a particular request for funding. We then make some additional points in response to stakeholder comments.

- 7.44 We note that the definition of ECS has been revised in the Code, bringing certain ‘over the top’ services into scope of the revised definition. These services are referred to in the Code as Number-Independent Interpersonal Communications Services (“NIICS”). As noted in Section 3, the Government indicated in July 2019 that its intention was to implement the Code in full into the UK’s law by 21 December 2020. If the UK’s legislation is amended to reflect that, suppliers of NIICS will, in the same way as all other ECS, fall within the description of providers Ofcom may require to contribute to an industry fund for a USO. Depending on when a request for funding may be made, and assuming an unfair net cost burden is found, we will determine appropriate providers or an appropriate description of providers in light of the definition of ECS that is in force at the time.

Transparency

- 7.45 Transparency encompasses a number of features which focus on ensuring that sufficient information relating to the sharing mechanism is provided, including our justification for the chosen approach and the evaluation of competing considerations.
- 7.46 Transparency will also require us to ensure that a sharing mechanism is easily understandable. This may point against adopting a particular approach which could result in a complex system of deciding which providers should be included or excluded from an obligation to contribute.

No undue discrimination

- 7.47 When determining who should contribute to an industry fund, we need to be mindful of the need to avoid undue discrimination towards a contributor or a description of contributors.
- 7.48 This will require us to consider whether potential contributors, or potential categories of contributors, are similarly situated. If we find, having identified the relevant factors to consider, that certain contributors or certain categories of contributors are in a similar situation, we will need to ensure that they are treated equally unless there are circumstances which objectively justify a difference in treatment. Equally, if potential contributors or potential descriptions of contributors are not in a similar situation, we will need to take account of those differences when making our decisions.
- 7.49 When assessing whether potential contributors are similarly situated, it may be necessary for us to consider whether and, if so, the extent to which they are in competition with one another. We discuss this in more detail under the ‘least market distortion’ heading.
- 7.50 However, there may be other relevant dimensions which we may need to consider when deciding which providers should contribute to an industry fund. For example, we note that the purpose of the USO framework is to ensure that all consumers have access to the minimum set of communications services to enable their full social and economic participation in society. Such interventions are therefore likely to bring benefits to the wider economy and to society as a whole. However, there may be particular types of USO

interventions which could stand to deliver additional benefits to certain providers, certain categories of providers, or their customers. In such cases, it may be appropriate to consider whether the type and/or scale of those benefits may mean that those providers, or those categories of providers, are in different situations to other providers.

- 7.51 These considerations will vary depending on the specifics of the USO intervention, the benefits that the USO delivers and on the market context. This part of the analysis therefore needs to be carried out on a case-by-case basis.

Proportionality

- 7.52 Proportionality requires that the means used to achieve a given end must be no more than that which is appropriate and necessary to achieve that end. This means that our chosen approach should be fully justified and involve a consideration of potential options.
- 7.53 In considering the proportionality of our decisions in a particular case, it will be important for us to explain what our objectives are in setting up an industry fund so that the proportionality of our proposals can be assessed against those objectives. In identifying relevant objectives in a particular case, we will always have regard to the overarching purpose of the universal service obligations which is to act as a safety net for the benefit of consumers, in order to prevent social and economic disadvantage. When establishing an industry fund, our starting point is that we will always seek to create a practical and fair system for meeting an unfair net cost burden, taking into account the administrative burden of establishing and operating an industry fund for Ofcom and the industry. There may be additional considerations which affect our overall objective in particular cases.

Least market distortion

- 7.54 As a sharing mechanism involves financial transfers between contributors and the Universal Service Provider, it has the potential to distort competition and user demand. The provisions of the Universal Service Directive require us to seek to minimise those distortions as far as possible.²⁴³

Avoiding distortion of competition

- 7.55 If the USO results in an unfair net cost burden, this means that the direct and indirect benefits to the Universal Service Provider are not sufficient to cover the costs of providing the USO. This shortfall would, if left uncompensated, potentially risk putting the Universal Service Provider at a competitive disadvantage, while offering an advantage to the Universal Service Provider's competitors. It is therefore an important function of any industry fund to share an unfair burden of the USO with the Universal Service Provider's competitors.
- 7.56 In addition, when deciding on the set of contributors, it may be appropriate and relevant to consider whether, and if so the extent to which, an industry fund may create a

²⁴³ See Part B of Annex IV of the [Universal Service Directive](#) which says: "Because such a compensation involves financial transfers, Member States are to ensure that these are undertaken in an objective, transparent, non-discriminatory and proportionate manner. This means that the transfers result in the least distortion to competition and to user demand."

competitive distortion. For example, this could be the case if one or more of the contributors to an industry fund is in competition with a provider that does not contribute to the fund. Such risks of competitive distortion will depend in any particular case on the size of an unfair net cost burden, the pool of contributors (and any non-contributors) and the extent of competition between them. All other things being equal, the risks of competitive distortion are likely to be more significant where the unfair net cost is a larger sum, since the burden on individual contributors would be greater. Assuming the same level of unfair net cost burden, the risks are likely to diminish where the pool of contributors is wider, since each individual contributor would bear a smaller share of the overall net cost burden. Again, for a given level of unfair net cost burden, the risks of a competitive distortion will also diminish when the pool of contributors faces more limited competition from non-contributors.

- 7.57 The extent to which the USO and an industry fund may create competitive distortions depends in large part on the size, scope and design of the USO and on the size of any unfair net cost burden that results. It will also depend on the extent and nature of competition between the Universal Service Provider and other firms over the expected duration of an industry fund, recognising that competition between firms can occur in a variety of different ways and can change over time. This part of the analysis therefore needs to be conducted on a case-by-case basis for each prospective industry fund.

Avoiding distortion of user demand

- 7.58 The legislation provides that the least market distortion principle means that contributions should be recovered in a way that, as far as possible, minimises the impact of the financial burden falling on end-users, for example by spreading contributions as widely as possible.
- 7.59 It is possible that the requirement to make contributions may cause contributors to increase their prices.²⁴⁴ Price increases may cause a distortion in user demand if, in response, consumers purchase smaller amounts of the products subject to a price rise. The scale of this distortion would depend on the size of any price increase, the products subject to a price increase and how sensitive consumers' decisions are to changes in price for those products. The risk of a price impact and of the associated distortion in user demand will be greater, all other things being equal, where the amount of funding to be collected by an industry fund is larger.
- 7.60 In principle, the risk of these distortions may be reduced if we choose a wider set of contributors. A wider set of contributors increases the number of providers affected, but each provider bears a smaller burden, leading to a smaller potential for distortion in the prices of their services.
- 7.61 The above factors may therefore point towards a wider pool of contributors providing a wider set of services to spread the burden of an unfair net cost, although the extent to which there is a risk of a distortion in user demand will vary from case to case.

²⁴⁴ Whether they do so in practice is difficult to predict and will depend on the specifics of the sharing mechanism and the markets in which contributors operate.

Summary of our approach to the choice of contributors

- 7.62 We received a range of comments from stakeholders pointing to the importance of both specific factors and particular principles within the framework to argue for a wide or a narrow pool of contributors respectively.
- 7.63 There is no hierarchy between the four principles of transparency, no undue discrimination, proportionality and least market distortion. In some cases, they might point in different directions or have overlapping considerations. When making decisions we must therefore look at all the principles and how they interrelate, giving such weight as we consider appropriate to each of the relevant factors. Determining the weight that should be given to each principle will therefore need to be carried out on a case-by-case basis, taking into consideration the factors that apply at the time and given the specific characteristics of the USO in question.
- 7.64 In light of this, we do not think that it would be appropriate for us to specify a particular set of contributors now in the funding regulations.

Further clarifications in response to points made by stakeholders

- 7.65 In response to Virgin Media and Broadway Partners, both BT (including Openreach) and KCOM as Universal Service Providers are suppliers of ECN and ECS and so are in scope as potential contributors in the same way as any other supplier of ECN and ECS. Our determination of who would contribute will be driven by the four principles set out above. We note that, if their competitors are required to make contributions, exempting the Universal Service Providers from contributions is likely to cause a competitive distortion.
- 7.66 We note Three's suggestion that we should consider the mobile industry's work in funding initiatives such as the Shared Rural Network. In principle, if there are pre-existing distortions in a market, then this could be a factor that is relevant to our assessment of least market distortion. We will consider whether any such distortion exists and the implications this has for the design of an industry fund, and weigh this against other principles, at the time a determination is made.
- 7.67 We note UKCTA's suggestion that large business providers, whose customers it claims are outside the scope of the broadband USO, should be excluded. We note that the eligibility criteria for the broadband USO do not exclude premises based on the type of occupant; so large businesses are not out of scope for the broadband USO. As set out above, we will use the four principles of transparency, non-discrimination, proportionality and least market distortion to determine who should contribute to an industry fund.
- 7.68 We disagree with Broadway Partners that it should be exempt from contributing to an industry fund because it is contributing to reducing broadband USO costs by competing with BT in its broadband USO areas. Many different providers, including BT and KCOM, have made and continue to make commercial deployments which will reduce the number of premises that cannot access a decent broadband service. The purpose of an industry fund is to compensate the Universal Service Provider for the unfair burden of providing

connections that have not been connected commercially or via state aid. We will determine contributors based on the four principles set out above.

- 7.69 We acknowledge the concerns that some stakeholders had regarding uncertainty. By setting out the procedures and principles that will apply in the event of a request for funding in these funding regulations we are providing as much clarity as is possible at this stage. When more is known about the broadband USO and any other future USO, we will engage with, and consult, stakeholders about establishing any industry fund at an appropriate time.
- 7.70 In any event, in relation to the broadband USO specifically, we expect that the overall burden on the Universal Service Providers will be relatively small (see Section 2) which will limit the extent of financial uncertainty for prospective contributors.

Turnover threshold

- 7.71 We agree with INCA's analysis that requiring contributions from small new entrants may distort competition in the longer term.²⁴⁵ We also agree that the pool should be limited only to those with sufficient resources to contribute.
- 7.72 As above, financial uncertainty for prospective contributors to the broadband USO is limited given the potential size of this USO; an industry fund as a whole is likely to be relatively small.

Summary of our decision

- 7.73 We have decided to adopt the funding regulations set out in our November 2019 consultation. We will determine the communications providers who will contribute to any industry fund if, and only if, we find there to be an unfair net cost burden on the Universal Service Provider. We will determine the subset of providers that must contribute and can require contributions only from providers whose turnover is more than the limit we specify in our determination. In making those determinations, we must have regard to the principles of transparency, least market distortion, no undue discrimination and proportionality.

Calculation of contributions

Our November 2019 consultation

- 7.74 We explained in our November 2019 consultation that the legislation requires contributions to be collected in a transparent and neutral way which avoids the danger of double imposition of contributions falling on both the outputs and the inputs of undertakings.
- 7.75 We set out that if there was a need for an industry fund, we would determine the proportions in which particular contributors shall contribute to the fund. We said that

²⁴⁵ INCA non-confidential response to the November 2019 consultation, page 4.

contributions would be determined in one of the following ways: (i) they would be determined by the turnover of the contributor as a proportion of the sum of the turnover figures of all of the contributors; or (ii) they would be based on a formula which takes into account the category of that contributor and its turnover.

- 7.76 We proposed to use net relevant turnover as the basis for the calculation of the payments. This allows contributors to deduct the value of relevant inputs that they have bought from other suppliers, which avoids the possibility of contributions falling on both the outputs and the inputs of an undertaking.

Responses to our November 2019 consultation

- 7.77 Most respondents agreed with our proposed approach to use net relevant turnover as the basis for the calculation of payments or did not comment. In particular, Sky said that the proposed approach is transparent, neutral and avoids the risk of double counting.²⁴⁶
- 7.78 BT said that we should use the same approach that we use for calculating the administrative levy, using additional information (e.g. retail volumes or revenues) for all ECN and ECS. This could be sourced through follow up information requests. It argued that the 'net relevant turnover' approach is not consistent with proportionality as it would provide less clarity to contributors, it is not familiar to the industry, increases the burden on providers, and increases the likelihood of errors resulting from multiple submissions.²⁴⁷
- 7.79 Virgin Media requested confirmation that TV revenue should be excluded from the assessment of relevant turnover.²⁴⁸ It also said that providers should get a discount on their contribution if they can show that their own investment has reduced the scale of the USO.²⁴⁹
- 7.80 Three said that the approach is discriminatory. Fixed operators will have a lower net turnover because they can net off considerable Openreach/BT wholesale input costs, but mobile network operators cannot reduce net turnover in the same way. It proposed that a less distortionary and discriminatory approach would be to exclude mobile operators.²⁵⁰

Our decision

- 7.81 We have decided to adopt the approach to the calculation of contributions set out in the November 2019 consultation. If there is a need for an industry fund, we will determine the proportions in which particular communications providers, or a particular subset of them, must contribute to the fund.²⁵¹ Contributions would be determined in one of the following ways: (i) they would be determined by the turnover of the contributor as a proportion of

²⁴⁶ Sky non-confidential response to the November 2019 consultation, page 5.

²⁴⁷ BT non-confidential response to the November 2019 consultation, pages 14-15.

²⁴⁸ Virgin Media non-confidential response to the November 2019 consultation, page 6.

²⁴⁹ Virgin Media non-confidential response to the November 2019 consultation, page 3.

²⁵⁰ Three non-confidential response to the November 2019 consultation, page 18.

²⁵¹ Funding regulation 10.

the sum of the turnover figures of all of the contributors; or (ii) they would be based on a formula which takes into account the category of that contributor and its turnover.²⁵² We have not defined a specific approach to calculating turnover within the funding regulations.²⁵³ However, we have provided guidance on our preferred approach, using net relevant turnover, in Annex 4.

- 7.82 As stated in the November 2019 consultation, we consider that net relevant turnover avoids double imposition on both inputs (i.e. wholesale access services purchased from other contributors) and outputs (i.e. downstream sales of communication services, such as sales to residential or business customers). The requirement to avoid such double imposition is a legal obligation deriving from Part B of Annex IV to the Universal Service Directive.²⁵⁴
- 7.83 We do not agree with BT that the burden of calculating net relevant turnover is disproportionate. Net relevant turnover builds on the relevant turnover information used in the administrative levy which is well established, and we do not think that it should be unduly burdensome for providers to identify their wholesale purchases of ECN and ECS from any other industry fund contributors.
- 7.84 Three is correct that under a net relevant turnover approach some providers can net off costs where they purchase inputs from other contributors. This is because the revenue associated with those purchases already results in a contribution to an industry fund which is paid by the supplier. We consider this is the correct approach and avoids double imposition of contributions on the outputs and inputs of undertakings as required as part of the USO framework. We do not consider the net relevant turnover approach is discriminatory – any purchases which form the basis of another providers’ contribution to an industry fund may be deducted regardless of whether the provider is a fixed or mobile provider.
- 7.85 In response to Virgin Media’s request that TV revenue should be excluded, we will determine the services that qualify as ‘relevant’ on a case-by-case basis. We note that currently, TV transmission revenue is considered a ‘relevant activity’ in the Networks and Services administrative charges, while TV content revenue is captured separately in the TV licence fees.²⁵⁵ Given that under the USO framework contributions to an industry fund can only be required from providers of ECN and/or ECS or a subset of them²⁵⁶, insofar as pay-TV services in question are an ECN and/or ECS, then the associated revenues should be included in the net relevant turnover calculation.

²⁵² The relevant provisions are contained in funding regulation 10 of the funding regulations. We have made drafting changes to funding regulation 10 to improve its clarity.

²⁵³ We use the term “specific turnover” in the funding regulations.

²⁵⁴ Directive 2002/22/EC, [Universal Service Directive](#), March 2002, Annex IV, Part B: “In accordance with Article 13(3), a sharing mechanism based on a fund should use a transparent and neutral means for collecting contributions that avoids the danger of a double imposition of contributions falling on both outputs and inputs of undertakings.”

²⁵⁵ See our [Statement of Charging Principles](#) for more information.

²⁵⁶ This means that contributions cannot be required from providers of content services as defined in section 32(7) of the Act.

- 7.86 In summary, we have decided not to amend our guidance on calculating turnover and have decided to adopt the regulation that we proposed in the November 2019 consultation with some amendments to clarify the meaning.

Summary of funding regulations

- 7.87 In summary, the funding regulations set out the following procedures for establishing an industry fund.
- 7.88 We will establish an industry fund to compensate the Universal Service Provider if the following conditions are satisfied:
- a) we determine that there is an unfair net cost burden;
 - b) the Universal Service Provider makes an application for industry contributions;
 - c) the Universal Service Provider has not waived its right to all or part of the compensation; and
 - d) the unfair net cost burden will not be financed by public funds.
- 7.89 We will determine the communications providers who will contribute to an industry fund. We will determine which providers must contribute and can require contributions only from providers whose turnover is more than the limit we specify in our determination. In making those determinations, we must have regard to the principles of transparency, least market distortion, no undue discrimination and proportionality.
- 7.90 We will publish our proposals and will specify the period within which representations about our proposals may be made by those likely to be interested or affected by it. Any such period must be not shorter than one month.
- 7.91 Once we have considered these representations, we will publish our determination setting out the total amount to be compensated, identifying contributors to an industry fund and the proportions in which particular contributors, or particular categories of them, will be required to contribute.

8. Procedures for the collection and distribution of funds

- 8.1 In this section, we set out our decision on the process by which we would collect funds from industry and compensate the Universal Service Provider, if we find that there is an unfair net cost burden and have determined that there should be an industry fund.

Collecting contributions to an industry fund

Our November 2019 consultation

- 8.2 In our November 2019 consultation, we explained that in order to calculate communications providers' contributions to an industry fund, we would need to collect net relevant turnover information from providers. We issued draft guidance setting out a definition of net relevant turnover to help providers ensure that they submit the correct information. We explained how we would verify this information and ensure its accuracy.
- 8.3 We set out the process we proposed to follow when invoicing providers for contributions to an industry fund, including how we would inform fund contributors of the amount an unfair net cost would increase if there was any delay in payment beyond the date on which it was envisaged that payment would be made. We explained that we may permit a contributor to pay an invoice in instalments but the overall amount payable by that contributor would also increase if it chooses this payment method.

Responses to our November 2019 consultation

Collecting and verifying turnover data

- 8.4 As set out in Section 7, BT suggested that for simplicity, we should have a consistent approach between collecting contributions to an industry fund and our own administrative costs. It noted that in relation to the administrative levy, we receive submissions on turnover nine months after the previous year end and collect fees from debtors on a monthly basis in the financial year following the submission. BT proposed that where additional information may be necessary, we should use information already available to us (for example, the same approach that is used for the administrative levy) or request specific additional information from individual providers. BT noted that for the broadband USO, this would allow us to identify now which providers will contribute what proportion under the existing ECN and ECS definitions.²⁵⁷

²⁵⁷ BT non-confidential response to the November 2019 consultation, pages 4, 6 and 15.

Invoicing contributors

- 8.5 Virgin Media said it had assumed that BT would be required to contribute towards the net cost of providing the USO and therefore the relevant question was whether shouldering the whole cost would constitute an unfair burden. It thought that this appeared to jar with our statement at 8.10 of our November 2019 consultation where there seemed to be some discretion involved: “Where the Universal Service Provider is required to share a proportion of an unfair net cost burden, we would deduct the Universal Service Provider’s contribution from an unfair net cost...”. Virgin Media called for more clarity on this, asking under what circumstances the Universal Service Provider would not be required to share a proportion of the unfair burden, and how Ofcom would determine the proportion to be shared.²⁵⁸
- 8.6 BT said that we should confirm that we would recognise the time value of money (i.e. interest) for the period between BT incurring costs and repayments being made from the fund.²⁵⁹
- 8.7 BT considered payment in instalments into the industry fund to be reasonable so long as Universal Service Providers are compensated appropriately for any delay in receiving payments. BT said that this was not an issue if all unfair net costs are repaid within the year, however this was unlikely given the approach that we proposed.²⁶⁰
- 8.8 BT also noted that we proposed to set a relevant turnover threshold for contributors to the industry fund, as well as repayment by instalments, so all contributors should be able to pay relevant amounts without cashflow issues arising.²⁶¹

Other responses

- 8.9 Vodafone said that the level, timing and actual requirement of any funding was currently wholly uncertain. It noted that it was important that if Ofcom does deem that industry funding is required, that the request for funding to the funding providers is first consulted on and any deemed funding contributors are given the appropriate time to actually make the contributions.²⁶²
- 8.10 TalkTalk said that the terms for the collection and distribution of funds should be reasonable and fair and allow sufficient time for payment.²⁶³
- 8.11 KCOM²⁶⁴ and Wansdyke Ltd²⁶⁵ agreed with our proposals.

²⁵⁸ Virgin Media non-confidential response to the November 2019 consultation, pages 6-7.

²⁵⁹ BT non-confidential response to the November 2019 consultation, paragraph 1.10.

²⁶⁰ BT non-confidential response to the November 2019 consultation, page 15.

²⁶¹ BT non-confidential response to the November 2019 consultation, page 15.

²⁶² Vodafone non-confidential response to the November 2019 consultation, paragraph 6.1.

²⁶³ TalkTalk non-confidential response to the November 2019 consultation, page 3.

²⁶⁴ KCOM non-confidential response to the November 2019 consultation, page 5.

²⁶⁵ Wansdyke Ltd non-confidential response to the November 2019 consultation, page 2.

Our decision

Collecting and verifying turnover data

Collecting turnover data

- 8.12 As we explain in Section 7, we consider that net relevant turnover is likely to be the appropriate approach to determine individual contributions to an industry fund but we would set out our decision on this where we make a determination relating to an industry fund, on a case-by-case basis.
- 8.13 In response to BT's point that we should use information already available to us for calculating contributions to an industry fund, for example, by using the same approach that is used for the administrative levy, for the reasons we set out in Section 7, we consider that net relevant turnover would be the most relevant and appropriate approach. As we do not currently collect net relevant turnover information from providers, we would need to collect this information to enable us to calculate providers' respective contributions.
- 8.14 Nonetheless, where there is scope for us to use any information we already hold or rely on existing processes we would do so. For example, net relevant turnover is based on relevant turnover, which we already collect from providers as part of the administrative levy. Providers should therefore be able to use the relevant turnover information they already submit to Ofcom as the basis to calculate net relevant turnover.
- 8.15 We recognise that calculating net relevant turnover could impose an additional administrative burden on providers; we do not therefore think that it would be proportionate to collect this information annually alongside relevant turnover information collected for the administrative levy. We therefore envisage collecting net relevant turnover information only when we are assessing an application for compensation, at the point we require the information.
- 8.16 To help providers ensure that they submit the correct information, we have issued guidance setting out how to calculate net relevant turnover. Our guidance can be found in Annex 4. As we currently collect relevant turnover information for the administrative levy based on the calendar year, we plan to take the same approach for net relevant turnover to minimise the administrative burden on providers.

Verifying turnover data

- 8.17 As the net relevant turnover figures we collect from providers would inform our calculation of individual contributions, we would take steps to verify this information and ensure its accuracy. We consider that our proposed approach to verifying turnover information, as set out in the November 2019 consultation, remains a proportionate approach.
- 8.18 We plan to use relevant turnover information that we collect annually for the administrative levy as the basis for verifying net relevant turnover information. In respect of the administrative levy, we currently verify the relevant turnover information for certain communications providers each year, which involves the following checks.

- a) Requesting an extract from providers' internal records showing a reconciliation between the turnover reported in its statutory accounts and relevant turnover submitted to Ofcom.
 - b) Ensuring the income streams excluded as non-relevant are appropriate and in line with the Statement of Charging Principles.²⁶⁶
 - c) Asking providers to explain any material movement in their year-on-year relevant and non-relevant turnover.
- 8.19 We may carry out additional verification work on the net relevant turnover information as we find necessary and proportionate, considering the size of an unfair net cost burden. This may mean collecting additional information from providers and we would seek this as required.
- 8.20 Once we have established the group of contributors, we would calculate industry fund contributions with reference to the verified net relevant turnover information. Any errors in the net relevant turnover information submitted by providers could result in the need to re-calculate invoices, which would be complicated and would introduce uncertainty for industry fund contributors. It is therefore important that providers supply us with the correct information in the first instance. We would collect net relevant turnover information using our powers under section 135 of the Act, which enables us to take appropriate enforcement action against any provider submitting incorrect information.

Invoicing contributors

- 8.21 We remain of the view that our proposed process for invoicing providers for contributions to an industry fund, as set out in the November 2019 consultation, is proportionate and fair, balancing the interests of both the Universal Service Provider and industry fund contributors. We have therefore decided to adopt this approach in the funding regulations.
- 8.22 In response to Virgin Media regarding the circumstances in which a Universal Service Provider would not be required to contribute to an industry fund, as explained in Section 7, as suppliers of ECN and ECS, BT and KCOM are in scope as potential contributors to an industry fund. We expect that in most cases it would be appropriate for the Universal Service Provider to be required to contribute. Regarding Virgin Media's question of how Ofcom would determine the proportion to be shared, as also explained in Section 7, this would be undertaken on a case-by-case basis, taking account of the four principles specified in the legislation and using the net relevant turnover approach we have set out in this document.
- 8.23 Having established which providers would contribute to an industry fund and calculated the relevant amounts, the funding regulations specify that Ofcom would send an invoice to each entity required to contribute to an industry fund apart from the Universal Service Provider.²⁶⁷ To ensure a proportionate approach, where the Universal Service Provider is

²⁶⁶ Ofcom, February 2005. [Statement of Charging Principles](#).

²⁶⁷ Funding regulation 13(1).

required to share a proportion of an unfair net cost burden, we would deduct the Universal Service Provider's contribution from an unfair net cost and then invoice the other contributors to recover the residual amount. This is to avoid the Universal Service Provider paying money to Ofcom only for this to be paid back to the Universal Service Provider.

- 8.24 The invoice would explain when and how the sums due should be paid by a contributor. The funding regulations state that a contributor must pay the contribution in the manner specified and by the deadline set out in the invoice.²⁶⁸ We would issue invoices after publication of our determination and give sufficient notice to contributors on the specific amount they would be required to pay. Payment must be made within the time period specified in the invoice.
- 8.25 The funding regulations also provide that in setting out the proportion of an unfair net cost to be paid by a particular contributor in a determination, Ofcom should specify:
- a) on what date payment to the Universal Service Provider is envisaged to take place ("the relevant date"); and
 - b) the percentage by which that amount of an unfair net cost will increase after the relevant date; for example, if an instalment plan is offered by Ofcom and elected by a contributor, or where payment is late (i.e. payment is made after the relevant date which is set out in an invoice).²⁶⁹
- 8.26 A determination relating to an industry fund would involve a decision on the relevant period covered, which takes into account the date on which compensation is paid. To ensure that the Universal Service Provider is not disadvantaged for any significant period between that determination and the payment from an industry fund, we would specify the percentage by which the amount of an unfair net cost would increase if there was any delay in payment beyond the date on which it was envisaged that payment would be made. We would set out that percentage in each case in our determination.
- 8.27 The funding regulations also provide that Ofcom may permit a contributor to pay the invoice in instalments.²⁷⁰ We may allow for payment by instalments where this is appropriate in light of the amount charged and in line with the principle of proportionality. In such a case, the overall sum payable by that contributor would also increase if it chooses this payment method.
- 8.28 To ensure no undue discrimination between providers, this option would be available to all contributors where the amount due is over a specified level. We would set out whether payment by instalment would be an option, and the relevant terms, in our determination. Where we make this option available, contributors can either pay as a lump sum or choose to pay by instalments.
- 8.29 When deciding whether payment by instalments is appropriate, we would need to make a decision about the timeframe in which these payments would be made. This could be a

²⁶⁸ Funding regulation 13(2).

²⁶⁹ Funding regulation 12(6).

²⁷⁰ Funding regulation 13(3).

shorter or longer period depending on the size of an unfair net cost burden. In each case, we would ensure the Universal Service Provider is appropriately compensated for any delay in receiving payments.

Further comments

- 8.30 We acknowledge Vodafone's point that the level, timing and actual requirement for funding is currently uncertain. However, as the timing of any compensation will depend on when an application for compensation is made by the Universal Service Provider, we cannot be more prescriptive on timings at this point in time.
- 8.31 In response to Vodafone's comments that requests for industry funding should be consulted on, as explained in Section 4, we would consult on any sharing mechanism that would compensate the Universal Service Provider for no less than one month and take account of stakeholder representations when making a final determination.
- 8.32 In relation to comments from TalkTalk and Vodafone that the process for collecting and distributing funds should be fair and allow contributors appropriate time to make contributions, we consider that the process we have set out is reasonable, fair and allows sufficient time for contributors to make payments. As we would engage with stakeholders by consulting on each determination we make as part of the funding process, stakeholders would be on notice that they may be required to contribute to an industry fund, potentially for several months, before we would issue a determination. We would also allow a reasonable period for contributions to be paid in the invoices we issue to contributors.

Process by which we would compensate the Universal Service Provider

Our November 2019 consultation

- 8.33 In our November 2019 consultation, we proposed to transfer industry fund contributions to the Universal Service Provider once per month, unless, in our opinion, it would be inappropriate to do so. The amount paid would comprise of all the industry fund contributions we have received in the previous month and any additional amounts due and collected in respect of payment of contributions after the relevant date as we specify, for example, to reflect any delay in payment to the Universal Service Provider.
- 8.34 We explained that once we have taken reasonable steps to recover unpaid contributions, and after a period of at least six months from the deadline for payment has elapsed, the draft funding regulations include a 'backstop' option which enables us to re-distribute unpaid contributions in certain circumstances amongst the contributors, or a sub-set of them as we consider appropriate.
- 8.35 We said that the Universal Service Provider may also waive its right to receive sums it would otherwise be entitled to and set out the way in which this can be done.

8.36 Finally, we said that where we determine that it would not be appropriate to take further steps to collect and distribute contributions and publish a notification to that effect, the scheme set up to collect industry contributions towards a particular unfair burden would effectively be closed. At that point, while we may transfer any contributions we have received to the Universal Service Provider, we could not take further steps to secure the payment of those contributions and could not exercise the 'backstop' option referred to above.

Responses to our November 2019 consultation

- 8.37 BT was concerned that our proposed timescale for bad debt recovery is too long and said it should not take six months to trigger the bad debt process to recover civil debts.²⁷¹
- 8.38 BT also said that reallocating bad debt amongst other providers may lead to further delays and stressed the importance of having a framework in place that encourages providers to pay in a timely manner and discourages any tactical gaming of the system.²⁷²
- 8.39 Three said our proposed backstop for non-payment of any unpaid contributions by fund contributors risked distorting the finality of any determination. It considered this point, along with the fact that the Universal Service Provider was assessed to be financially strong enough to bear any net cost of the USO before any compensation is paid, meant that we should not pursue contributors (who have already correctly paid) for others' unpaid contributions.²⁷³
- 8.40 BT also said that any process for recovering bad debts should allow for the recovery of the cost of the debt.²⁷⁴

Other responses

- 8.41 BT agreed with our proposed payment process for Universal Service Providers, subject to its comments above on the potential for delays from the approach to recovering bad debts.²⁷⁵
- 8.42 KCOM²⁷⁶ and Wansdyke Ltd²⁷⁷ agreed with our approach.

Our decision

- 8.43 We remain of the view that where we are in receipt of industry fund contributions, we would transfer these contributions to the Universal Service Provider once per month, unless in our opinion, it would be inappropriate to do so.²⁷⁸ This approach would ensure

²⁷¹ BT non-confidential response to the November 2019 consultation, page 15.

²⁷² BT non-confidential response to the November 2019 consultation, page 15.

²⁷³ Three non-confidential response to the November 2019 consultation, page 18.

²⁷⁴ BT non-confidential response to the November 2019 consultation, page 15.

²⁷⁵ BT non-confidential response to the November 2019 consultation, page 15.

²⁷⁶ KCOM non-confidential response to the November 2019 consultation, page 5.

²⁷⁷ Wansdyke Ltd non-confidential response to the November 2019 consultation, page 2.

²⁷⁸ Funding regulation 14.

that a Universal Service Provider is compensated in a timely manner and avoids unnecessary delay, while permitting us to adopt a different approach if, in particular circumstances, this was appropriate.

- 8.44 Under the Universal Service Directive, Ofcom has a role in ensuring that a Universal Service Provider is compensated in full for the amount of a net cost which Ofcom has found to be unfair. We have adopted in the funding regulations the approach to dealing with any unpaid contributions that we proposed in the November 2019 consultation, on the basis that we consider that this is the most appropriate and fair approach.
- 8.45 As with all stakeholders regulated by Ofcom, we would expect contributors to an industry fund to meet their obligation to pay by the given deadline. If there is delay in payment, the provider in question must promptly explain the reasons for the delay. We have set out in the funding regulations that where an invoice remains unpaid after the deadline for payment specified in the invoice, Ofcom would be able to recover this as a civil debt.²⁷⁹ We intend to take reasonable and proportionate steps to recover unpaid contributions to ensure that the Universal Service Provider is fully compensated, which may include pursuing unpaid contributions through the Courts.
- 8.46 Having taken reasonable steps to recover unpaid contributions, the funding regulations include a 'backstop' option which enables us to re-distribute unpaid contributions in certain circumstances amongst the contributors, or a sub-set of them as we consider appropriate.²⁸⁰ The funding regulations provide for this option after a period of at least six months from when the deadline for payment has elapsed, which we consider would allow sufficient time for us to take steps to recover any unpaid contributions.
- 8.47 We acknowledge BT's concerns about our timescale for bad debt recovery. We would aim to conduct this expediently but need to be mindful that pursuing debts through the Courts can take some time. In response to BT's comment that it should not take six months to trigger the bad debt process to recover civil debts, the six-month timescale we have set out is for triggering the 'backstop' option of redistributing unpaid contributions in certain circumstances amongst contributors. We can and would envisage undertaking the bad debt recovery process before this point.
- 8.48 We consider that the 'backstop' option strikes the right balance between taking sufficient steps to recover monies from those who should pay them and ensuring that the Universal Service Provider is compensated fully and in a timely manner. While we understand the concerns expressed by BT and Three about reallocating bad debt amongst other providers, we consider this to be the most appropriate way of ensuring the Universal Service Providers are fully compensated for any unfair net cost as required by the Universal Service Directive. We have given ourselves a range of options to deal with unpaid contributions and would take a proportionate approach in the circumstances. We would not re-distribute

²⁷⁹ Funding regulation 13(4).

²⁸⁰ Funding regulation 15(2).

unpaid contributions amongst contributors without taking reasonable steps to recover funds first.

- 8.49 In response to Three’s comment that the ‘backstop’ option risks distorting the finality of any determination, we think that this approach is reasonable for the reasons set out in the paragraph above and would only expect to trigger this option in limited circumstances.
- 8.50 The funding regulations provide that the Universal Service Provider may waive its right to receive sums it would otherwise be entitled to and sets out the way in which this can be done.²⁸¹ It would be up to the Universal Service Provider to decide whether, in any given circumstances, it is prepared to do so.
- 8.51 The funding regulations also specify that where we determine that it would not be appropriate to take further steps to collect and distribute contributions, we will publish a notification to that effect and the scheme set up to collect industry contributions towards a particular unfair burden would effectively be closed. At this point the funding regulations specify that while Ofcom may transfer any contributions it receives to the Universal Service Provider, it cannot take further steps to secure the payment of contributions and cannot exercise the ‘backstop’ option referred to above. In our view, it is necessary, in the interests of certainty, that the funding regulations contain a mechanism for bringing a particular funding process to a close where in our view it would be appropriate to do so.²⁸²
- 8.52 Finally, in response to BT’s comment that any process for recovering bad debts should allow for the recovery of the cost of the debt, as explained earlier in this section, we would allow for the recovery of interest to account for delay in payment.

Industry fund annual report

Our November 2019 consultation

- 8.53 In our November 2019 consultation, we explained that where an industry fund is established, we are required to publish relevant information each year on the functioning of the fund.

Responses to our November 2019 consultation

- 8.54 We did not receive any comments from stakeholders on this issue.

Our decision

- 8.55 As we explain in Section 3, the Act²⁸³ requires Ofcom to prepare an annual report on the functioning of any industry fund. This must include details of any determination we make

²⁸¹ Funding regulation 16.

²⁸² Funding regulation 17.

²⁸³ Section 72(2) of the Act.

regarding the cost of providing the USO during the reporting period, as well as market benefits accrued by the Universal Service Provider and contributions to the fund.

- 8.56 Where an industry fund is established, we would publish relevant information each year to meet this requirement.

Summary of funding regulations

- 8.57 We have made some small drafting changes to the version of the draft funding regulations on which we consulted. We have not, however, changed the substance of the relevant provisions. The funding regulations are summarised below.

- a) When making determinations relating to an industry fund, we must have regard to the principles of transparency, least market distortion, no undue discrimination and proportionality.
- b) We shall send an invoice to each contributor save for the Universal Service Provider. Providers who receive this invoice shall pay the contribution prescribed in the invoice in the manner and by the deadline specified in the invoice.
- c) We would transfer the amounts received from contributors to the Universal Service Provider once per month unless, in our opinion, it would be inappropriate to do so.
- d) Contributors may be permitted to pay the invoice in instalments; we would specify the percentage by which the amount of an unfair net cost will increase if a contributor opts for this method of payment.
- e) The percentage by which the amount of an unfair net cost will also increase if payment of contributions occurs after the relevant date as specified by us (i.e. the deadline specified in the invoice, at the percentage specified in the invoice).
- f) If a contributor does not pay its contribution or an instalment of that contribution by the deadline for payment specified in the invoice, the unpaid amount and any additional amounts in respect of payment of contributions after the relevant date as specified by us shall be recoverable by us as if it were a debt due to us.
- g) If contributors have not paid their contribution by the deadline, a period of at least six months from the deadline for payment has elapsed, the Universal Service Provider has not waived the remaining amount due, and no public funds have been committed to compensating the Universal Service Provider for this sum, we may require additional contributions from the contributors, or such sub-set of them as we consider appropriate.
- h) The Universal Service Provider may waive its entitlement to all or part of the amount to be compensated by sending a notice to us.
- i) Where we determine that it would not be appropriate to take further steps to collect and distribute contributions, we will publish a notification to that effect and the scheme set up to collect industry contributions towards a particular unfair burden would effectively be closed.

9. Calculation of a net cost for the broadband USO

9.1 In this section we set out guidance on how we intend to assess a net cost for the broadband USO, should a request for funding be received. In doing so, we explain that our approach is to calculate a net cost using a Net Present Value (“NPV”) methodology. We would also assume that, for the purpose of the counterfactual of the Universal Service Provider operating without the broadband USO, there is no alternative provider of the broadband USO.

The counterfactual for the calculation

Our November 2019 consultation

9.2 We explained that the appropriate counterfactual affects the calculation of a net cost as it provides a baseline against which the incremental costs and benefits of the USO are measured.

9.3 In the specific context of the broadband USO, we considered that the appropriate counterfactual was that there is no alternative Universal Service Provider of the broadband USO, as BT and KCOM were the only providers to pass the second stage of the designation process.

Responses to our November 2019 consultation

9.4 BT²⁸⁴, KCOM²⁸⁵, Virgin Media²⁸⁶ and Wansdyke Ltd²⁸⁷ agreed with our counterfactual.

9.5 TalkTalk disagreed with the counterfactual. It considered that in the intervening time between Ofcom’s *Implementing the Broadband Universal Service Obligation: Requests for expressions of interest* (June 2018) and the launch of the broadband USO, a range of market developments (including changes in Physical Infrastructure Access, significant differences in funding arrangements for various market participants, and new entry) had occurred. This means that the results of the original designation process (i.e. no alternative provider) may no longer be accurate and so it would be appropriate to revisit the counterfactual.²⁸⁸

9.6 Three disagreed with the counterfactual, noting that the counterfactual would have developed over time absent the USO given the continued improvement and coverage of

²⁸⁴ BT non-confidential response to the November 2019 consultation, paragraph 9.1.

²⁸⁵ KCOM non-confidential response to the November 2019 consultation, page 5.

²⁸⁶ Virgin Media non-confidential response to the November 2019 consultation, page 7.

²⁸⁷ Wansdyke Ltd non-confidential response to the November 2019 consultation, page 3.

²⁸⁸ TalkTalk non-confidential response to the November 2019 consultation, page 3.

4G networks and growth of 4G home broadband and mobile-only networks. This would have resulted in a loss of margin to mobile providers in some USO areas.²⁸⁹

Our decision

9.7 As noted in Section 5, the choice of the appropriate counterfactual is an important element of a net cost calculation. The choice of the appropriate counterfactual affects the calculation of a net cost as follows.

- a) Where a Universal Service Provider was not operating in the USO area prior to designation, and was unlikely ever to do so commercially, the counterfactual is one of zero sales for the Universal Service Provider in that area. In this scenario all revenues earned over USO connections are incremental.
- b) Where a Universal Service Provider was operating in the USO area prior to the designation, there are two possibilities for the counterfactual:
 - i) if an alternative provider would have been designated to deliver the USO, the Universal Service Provider would lose revenues from existing connections to the alternative provider; or
 - ii) if there was no alternative provider that would have been designated to deliver the USO, then the incremental revenue that is relevant to a net cost calculation is the difference between the revenue earned over the new USO connection and the revenue earned over the pre-existing connection.

9.8 In the case of the broadband USO, both of the Universal Service Providers, BT and KCOM, were already active in their respective USO designation areas prior to being designated as the Universal Service Providers. We have therefore considered whether an alternative provider would likely have been designated as the provider of the broadband USO.

9.9 As set out in the June 2019 statement²⁹⁰, in June 2018 we invited expressions of interest to be designated as a Universal Service Provider and received eight responses. We applied a two-stage assessment to the applicants to assess whether they could deliver the broadband USO if designated.

9.10 At the first stage of the process, we found that in addition to BT and KCOM only one further provider, Hyperoptic, met our assessment criteria. The criteria included the requirement that: (i) the applicants had the proposed technology to deliver a service that would meet the technical specification of the broadband USO as set out in the 2018 Order; and (ii) the applicants had sufficient sources of funding in place to deliver the broadband USO if designated.

9.11 However, we felt that we did not have sufficient information to assess Hyperoptic at the second stage (where, amongst other things, we had to assess its operational ability to build

²⁸⁹ Three non-confidential response to the November 2019 consultation, pages 18-19.

²⁹⁰ Ofcom, June 2019. [*Delivering the Broadband Universal Service: Designating Universal Service Providers and setting conditions*](#), paragraphs 4.5 and 4.9-4.10.

the necessary infrastructure to provide the broadband USO connections and to deliver the required service quality). Hyperoptic subsequently withdrew its interest in being designated and as a result, we designated the only remaining providers, BT and KCOM, as the Universal Service Providers. Given this, we consider that for the purposes of the broadband USO it will be appropriate to assume that there was no alternative provider of the USO.

9.12 We disagree with TalkTalk's argument that we should reconsider the choice of counterfactual (i.e. whether any other provider would be able to provide the broadband USO in the absence of BT and KCOM being designated). As outlined above, the designation process was finalised relatively recently, i.e. in June 2019, and subsequent developments since this date are unlikely to mean that an alternative provider of the broadband USO is likely to be a credible provider (at scale) at the present time.

9.13 To calculate a net cost we must assess the difference between the factual and counterfactual scenarios over an extended period of time; reflecting the long life of some of the assets that will be deployed for the broadband USO. We recognise that both the factual and counterfactual scenarios may be affected by market developments. For example, as Three notes in its response, the Universal Service Provider(s) for the broadband USO could potentially over time lose market share in the counterfactual due to the growth of mobile broadband in rural areas. Future roll-out of services can be difficult to predict, however we would consider the potential for future loss of market share (from mobile and/or other networks) in the counterfactual when determining which costs and benefits are incremental. We would therefore expect the Universal Service Provider(s) to develop a counterfactual scenario that is realistic, based on sound assumptions and supported by evidence.

The use of NPV methodology in the calculation

Our November 2019 consultation

NPV methodology

9.14 We explained in the November 2019 consultation that our approach to calculating a net cost for the broadband USO was based on the NPV of the difference between the cashflows of the Universal Service Provider when operating with the broadband USO and operating without the broadband USO.

Expenditure to date

9.15 We explained that most of the costs incurred prior to the date of any claim will be in the form of capital expenditure.

Future cashflows

- 9.16 We explained that operating costs should only be included to the extent they are not offset by the avoidance of other operating costs and that revenues from additional services sold by the Universal Service Provider should be included in a net cost calculation.
- 9.17 We also noted that we did not expect indirect benefits to be significant for the broadband USO in light of the fact BT and KCOM are already designated as Universal Service Providers for the telephony USO.

The choice of discount rate

- 9.18 We proposed to discount future cash flows using an appropriate discount rate. Where available, we proposed to use the cost of capital from a regulatory decision applicable to the relevant line of business in question, at or around the time of main capital expenditure for the broadband USO.

Responses to our November 2019 consultation

NPV methodology

- 9.19 KCOM²⁹¹, TalkTalk²⁹², Broadway Partners²⁹³ and Wansdyke Ltd²⁹⁴ agreed with the NPV approach. BT²⁹⁵ and Virgin Media²⁹⁶ also agreed with the NPV approach highlighting that it avoids the need for multiple calculations over the lifetime of the assets.
- 9.20 BT also recognised that an NPV calculation which involves a 20-year forecast can lead to some issues, but that these issues can be addressed using a reasonable set of assumptions. These assumptions consisted of: service margins and a cost of capital which remain constant; benefits based on a margin per line (scaled by forecast volumes); recognition of customer churn over time; and recognition of the time between expenditure by the Universal Service Provider and repayment from the fund.²⁹⁷
- 9.21 Vodafone and UKCTA²⁹⁸ were concerned that the NPV calculation is set up in such a way to weigh towards the broadband USO provider over-recovering its initial network costs rather than under-recovering. Vodafone noted that that is because the costs incurred in providing the service are largely fixed, up front and relatively certain (i.e. capped at £3,400) while the revenues are subject to high uncertainty and are very sensitive to small assumption changes.²⁹⁹

²⁹¹ KCOM non-confidential response to the November 2019 consultation, page 5.

²⁹² TalkTalk non-confidential response to the November 2019 consultation, page 3.

²⁹³ Broadway Partners non-confidential response to the November 2019 consultation, page 4.

²⁹⁴ Wansdyke Ltd non-confidential response to the November 2019 consultation, page 3.

²⁹⁵ BT non-confidential response to the November 2019 consultation, paragraph 9.2.

²⁹⁶ Virgin Media non-confidential response to the November 2019 consultation, page 7.

²⁹⁷ BT non-confidential response to the November 2019 consultation, paragraph 9.3.

²⁹⁸ UKCTA non-confidential response to the November 2019 consultation, paragraph 15.

²⁹⁹ Vodafone non-confidential response to the November 2019 consultation, paragraphs 2.4-2.6.

- 9.22 Three also disagreed that using a NPV methodology reduced the risk of material forecasting errors as revenues and customer behaviour would be almost entirely estimated as well as any future efficiencies gained from operating services for the USO.³⁰⁰ Vodafone also highlighted the fact that the calculation relies heavily on uncertain future predictions.³⁰¹
- 9.23 BT asked us to confirm that we will recognise the time value of money (i.e. interest) for the period between BT incurring costs and repayments being made from the fund.³⁰²
- 9.24 A member of the public stated that the details we set out at consultation were deficient and would not allow for the calculation of an unambiguous value of the NPV of the USO. They suggested an alternative approach to calculating net cost based on modern equivalent asset costs for assets that existed prior to the Universal Service Provider being designated, including operating costs that existed prior to designation.³⁰³

Expenditure to date

- 9.25 TalkTalk noted that we would have to make decisions about the attribution of joint and common costs between the delivery of the broadband USO and other products, for example: the reinstatement of collapsed ducts or where infrastructure has additional uses beyond the broadband USO (e.g. 5G).³⁰⁴

Future cashflows

- 9.26 BT agreed with our position that we did not expect intangible benefits to be significant in the context of the broadband USO specifically. It argued the broadband USO would have no positive impact on its brand, and the increase in the ubiquity of service (even were this to be shown to be a source of benefit) would be limited as the extra number of customers is very small in proportion to BT's existing base. It also considered that there could be an intangible disbenefit if societal expectations around what the USO should provide (and how quickly) do not match the reality of consumer expectations.³⁰⁵
- 9.27 Given this, BT considered the requirement to provide an estimate in monetary terms of intangible benefits is disproportionate and asked for clarity that it would not be required to submit any further evidence on intangible benefits.³⁰⁶
- 9.28 KCOM noted that it would expect to look closely at the benefit calculations (e.g. value enhancement to the brand resulting from being designated as the Universal Service Provider), particularly in relation to legacy USO obligations.³⁰⁷

³⁰⁰ Three non-confidential response to the November 2019 consultation, page 19.

³⁰¹ Vodafone non-confidential response to the November 2019 consultation, paragraphs 7.1-7.3.

³⁰² BT non-confidential response to the November 2019 consultation, paragraph 1.10.

³⁰³ S. Carter non-confidential response to the November 2019 consultation, page 4.

³⁰⁴ TalkTalk non-confidential response to the November 2019 consultation, page 3.

³⁰⁵ BT non-confidential response to the November 2019 consultation, page 10.

³⁰⁶ BT non-confidential response to the November 2019 consultation, page 10.

³⁰⁷ KCOM non-confidential response to the November 2019 consultation, page 4.

- 9.29 TalkTalk considered that any claim must reflect direct and indirect benefits.³⁰⁸ Sky³⁰⁹ and Virgin Media³¹⁰ noted that we should not underestimate the intangible benefits. Three³¹¹ and Vodafone³¹² stated that they expect similar intangible benefits as those calculated for Ofcom's 2006 USO analysis. FCS was pleased that intangible benefits were to be balanced against direct financial costs.³¹³
- 9.30 Three also noted that the template proposes an alternative schedule for the entry of indirect benefits. It noted that this puts the initiative on BT to estimate its own indirect benefits and provides an incentive for it to reduce the level of indirect benefits to the lowest level or omit potential benefits.³¹⁴
- 9.31 Three further considered it necessary for Ofcom to set out in greater detail the areas of indirect benefits for which BT should collect information.³¹⁵ Virgin Media noted it would be beneficial for BT to understand how Ofcom would calculate the level of indirect benefits.³¹⁶
- 9.32 Three said that we should consider incremental revenues from BT Mobile, EE and BT TV in our net cost assessment given the distortion that BT creates from potentially upselling these services to USO customers.³¹⁷
- 9.33 TalkTalk noted that as there is limited comparative or time series data to use as a reference point, the review of a net cost will require a review of the technical structure of the network and consideration of gold-plating and whether decisions taken on network design and components are inefficient.³¹⁸ Virgin Media was also concerned about efficiency, noting that BT may gold-plate its USO investments to be consistent with its 'full-fibre' ambitions.³¹⁹
- 9.34 Virgin Media³²⁰, UKCTA³²¹ and a member of the public³²² asked for reassurance that the most efficient technology has been used to meet the USO obligation.
- 9.35 INCA stated that the inclusion of the costing of the use of third-party infrastructure where available on a commercial basis would help meet the efficiency necessity tests and reduce the potential for market distortion. It argued that if BT decided not to use cheaper alternative infrastructure, the amount of any claim for the broadband USO could be

³⁰⁸ TalkTalk non-confidential response to the November 2019 consultation, page 2.

³⁰⁹ Sky non-confidential response to the November 2019 consultation, pages 3-4.

³¹⁰ Virgin Media non-confidential response to the November 2019 consultation, pages 1-2.

³¹¹ Three non-confidential response to the November 2019 consultation, pages 11-14.

³¹² Vodafone non-confidential response to the November 2019 consultation, paragraphs 6.2-6.3.

³¹³ FCS non-confidential response to the November 2019 consultation, page 1.

³¹⁴ Three non-confidential response to the November 2019 consultation, page 14.

³¹⁵ Three non-confidential response to the November 2019 consultation, page 14.

³¹⁶ Virgin Media non-confidential response to the November 2019 consultation, page 2.

³¹⁷ Three non-confidential response to the November 2019 consultation, pages 11-13.

³¹⁸ TalkTalk non-confidential response to the November 2019 consultation, page 3.

³¹⁹ Virgin Media non-confidential response to the November 2019 consultation, page 5.

³²⁰ Virgin Media non-confidential response to the November 2019 consultation, page 5.

³²¹ UKCTA non-confidential response to the November 2019 consultation, paragraph 14.

³²² S. Carter non-confidential response to the November 2019 consultation, pages 4-5.

reduced to reflect the additional savings that could have been made.³²³ Gigaclear asked that we consider the Universal Service Provider's opportunity to utilise alternative networks as the choice of efficient network solution is likely to be an increasingly relevant question, particularly as the USO service quality threshold increases over time.³²⁴

- 9.36 Broadway Partners noted that inviting an alternative provider to provide a service at competitive cost is the best way to provide incentive for the Universal Service Provider to maximise its efficiency.³²⁵

The choice of discount rate

- 9.37 Vodafone noted that the regulated cost of capital tends to reduce in line with the risk-free rate and that there is a valid argument that the risk associated with the provision of broadband in USO areas is even less risky than delivering telecoms services in other areas that are subject to increased competition.³²⁶

Our decision

NPV methodology

- 9.38 Our proposed approach to the calculation of a net cost is set out at a high level in Section 5. In the specific case of the broadband USO, we expect a significant proportion of any capital expenditure to be incurred as the upgraded connections are built, which we expect will occur in the near term. However, some incremental costs (or savings) and a significant proportion of the benefits are likely to occur over the lifetime of the assets, which in this case may be more than 20 years for certain parts of the infrastructure built.
- 9.39 A NPV methodology allows for the net value of expected costs and benefits to be calculated, with the timing of cashflows taken into account by applying a discount rate to future cashflows. In the event of a net cost (i.e. a negative NPV), this framework can also be used to calculate the amount of compensation as a lump-sum that would be necessary to deliver a break-even investment. That is, an NPV of zero, which under the regulatory framework should represent the difference in net cost of operating with and without the broadband USO.
- 9.40 A NPV calculation can be carried out at any point in the asset lifetime and has the advantage that a net cost, over the whole lifetime of the assets, can be assessed in one calculation. This will avoid the need for multiple calculations over the lifetime of the asset.
- 9.41 A NPV calculation undertaken before costs and revenues have been incurred will rely more heavily on forecasts of future cashflows. As we expect that the bulk of any net cost will consist of capital expenditures incurred relatively early in the process, the majority of the net cost will have been incurred and therefore will not need to be estimated. Future capital

³²³ INCA non-confidential response to the November 2019 consultation, pages 2-4.

³²⁴ Gigaclear non-confidential response to the November 2019 consultation, page 1.

³²⁵ Broadway Partners non-confidential response to the November 2019 consultation, pages 3-4.

³²⁶ Vodafone non-confidential response to the November 2019 consultation, paragraph 7.5(f).

costs are likely to be low and operating costs are likely to be similar to those incurred in other parts of the Universal Service Providers' network. This means the risk of material forecasting errors in relation to cost is reasonably low.

- 9.42 On the other hand, and as Three notes, a significant proportion of the revenues will have to be estimated. However, by working closely with the Universal Service Providers, we consider that a reasonable set of assumptions, with which to accurately estimate these revenues, can be adopted. For example, as a starting point, we expect that the Universal Service Providers will be able to identify whether its new broadband USO customers are:
- a) customers who were previously purchasing a pre-existing broadband service from the Universal Service Provider;
 - b) customers who were previously purchasing a broadband service from another provider using the Universal Service Provider's network; or
 - c) customers who were not previously purchasing a broadband service using the Universal Service Provider's pre-existing network.
- 9.43 For each of these groups, the Universal Service Provider could then estimate an average revenue per user (ARPU) and combine this with the number of customers in each group to estimate the pre-existing revenue it received from customers before it started providing them with broadband USO connections.
- 9.44 By the time a request for funding has been submitted, the Universal Service Provider should have already collected information on the revenues generated from new broadband USO customers (i.e. its existing broadband USO revenues). The Universal Service Provider could make use of this information alongside other evidence (for example the average revenues accrued from FTTC or FTTP lines deployed in non-USO areas), to forecast future broadband USO revenues. For future revenues, the provider would also have to consider assumptions regarding take-up and churn, but again we expect that these assumptions could be evidenced (for example by basing the assumptions on similar rates observed in areas where the Universal Service Provider has previously rolled out a fibre network) and on projections used in other areas of its business.
- 9.45 We note that while there is some level of uncertainty in forecasting revenues, a potential approach such as the one outlined above, which makes use of information gathered throughout the broadband USO process and evidence-based assumptions, should limit the chance of material forecast error.
- 9.46 We disagree with Vodafone and UKCTA's concern that the NPV calculation is set up in such a way that BT will over-recover its capital costs. While in this instance costs are likely to be known with more certainty, and revenues will need to be projected, this does not necessarily lead to over-recovery. Any forecasts used in a net cost calculation should take account of all likely outcomes in order to minimise the risk of unintended over-recovery. If that is the case, there is no reason to believe that the Universal Service Provider would be more likely to over-recover its costs when using an NPV calculation.

- 9.47 An NPV calculation is not the only way to measure a net cost and may not be our approach in other cases. For example, a net cost could be calculated and/or compensated on an ongoing basis over the lifetime of the broadband USO, by calculating the net cost for a defined period based on depreciation and a return on assets. This approach would still rely on assumptions regarding the profile of depreciation over time which can be difficult to determine accurately in cases where the bulk of the costs is caused by new assets being laid down. An ongoing evaluation could also be a more burdensome approach as it will necessitate further periodic calculations into the future, compared to an NPV approach which only requires a single calculation for each request for funding. We also note that to the extent that the Universal Service Provider submits a series of separate requests for funding, the risk of material error should be reduced as each successive calculation will be able to make greater use of actual data (e.g. data on take up rates).
- 9.48 Given the expected scale of the broadband USO, that it will require new assets, and the fact that much of any net cost will be incurred relatively early in the lifetime of those assets, we have decided to give guidance indicating our use of an NPV methodology to calculate any net cost of the broadband USO. We consider an approach based on depreciation and return on assets would not be appropriate in this instance.
- 9.49 A member of the public also suggested an alternative approach based on modern equivalent asset costs for assets that existed prior to the Universal Service Provider being designated.³²⁷ In this instance, we are not concerned with cost recovery (or pricing) of legacy network assets, but cost recovery of new assets required to meet the broadband USO. Assets that existed prior to the Universal Service Provider being designated should not give rise to costs that are incremental to the broadband USO and so are not relevant when calculating a net cost. Where the new infrastructure involves lower operating costs than legacy infrastructure, we envisage reflecting that efficiency in any net cost calculation (as explained later in this section).
- 9.50 We consider that the NPV methodology we have decided to give guidance on can appropriately manage the risk of forecasting errors and is administratively efficient as it removes the need for multiple calculations over the lifetime of the assets.
- 9.51 Finally, we recognise that the Universal Service Provider should be compensated for the time value of money (i.e. the interest) for the period between a determination of a net cost and repayments being made from the fund. We will set out the interest rate to be applied in such a case at the time we make a net cost determination.

Expenditure to date

- 9.52 We believe that most of the costs incurred prior to the date of any claim will be in the form of capital expenditure. We would include forecast capital expenditure if the Universal Service Provider can demonstrate that such expenditure will necessarily be incurred for the

³²⁷ S. Carter non-confidential response to the November 2019 consultation, pages 4-5.

ongoing provision of built broadband USO connections and services (not speculative or prospective connections or services) and the asset replacement cycle is reasonable.

- 9.53 We expect the Universal Service Provider to seek to provide services in the broadband USO areas on the same commercial terms as are available outside the broadband USO areas. Where this is the case, and as set out above, we would expect most of the direct (or ongoing) costs and revenues of providing a broadband USO service to be similar to those of providing a service on a commercial basis.
- 9.54 In respect of the broadband USO specifically, any capital expenditure incurred prior to the Universal Service Provider being designated in relation to shared assets, such as ducts, which have spare capacity and are then used to provide broadband USO services will be excluded. However, where existing assets have been extended or improved to provide broadband USO connections and services, it would likely be appropriate to consider these post designation costs as part of a net cost calculation. Likewise, where broadband USO infrastructure has additional use beyond the broadband USO (e.g. 5G), the Universal Service Provider must clearly explain and evidence how it has allocated the joint and common costs of that infrastructure.

Future cashflows

Costs and revenues

- 9.55 In respect of operating costs in relation to the broadband USO, these would only be included to the extent that they would not be offset by the avoidance of other operating costs that would otherwise have been incurred. For example, pre-USO operating costs of an old technology may be higher than the operating costs of a new technology.
- 9.56 While the level of operating costs could increase (e.g. if additional activities were necessary), we consider it more likely that they would decrease in light of the evidence gathered during various market reviews which shows that cost efficiencies tend to be realised following the investment in new equipment and technology. Operating cost savings would reduce a net cost of the broadband USO, all other things being equal.
- 9.57 Building new connections would likely cause incremental changes in revenues earned by the Universal Service Provider. These could include revenues from new customers, additional revenues from existing customers taking higher speed services (as higher speed services are typically charged at a premium to slower speed services) or additional revenue from services the Universal Service Provider may sell as part of a package accompanying a higher speed broadband connection (e.g. pay-TV services) made possible or improved when delivered over a higher speed connection. These incremental revenues would reduce a net cost of the broadband USO, all other things being equal.
- 9.58 It is also possible that our assumptions relating to future take up of broadband USO connections and services would differ from those used for the purposes of demand aggregation, as they would reflect more up to date information.
- 9.59 The assumptions included in our forecasts will be informed by data supplied by the Universal Service Provider, but we will not rely solely on this data. We will also take

account of other relevant information in relation to the cost and revenues of deploying the technology used to deliver broadband connections, for example information acquired from the Universal Service Provider or other providers when undertaking other regulatory functions (such as market reviews) or market monitoring.

- 9.60 Depending on the scale of the request and the nature of the available evidence, we may estimate future cash flows using a margin per line scaled by forecast line volumes. This would mean calculating the future cashflow based on an estimated margin contribution per service or average service. If we adopt this approach, we will set out our assumptions and basis for the margin as part of any consultation on a draft determination of a net cost assessment.

Indirect benefits

- 9.61 The Universal Service Directive explains that an estimate, in monetary terms, of the indirect benefits that an undertaking derives by virtue of its position as the Universal Service Provider, should be deducted from the direct net cost of the USO in order to determine the overall cost burden.³²⁸
- 9.62 Potential indirect benefits include those related to enhanced brand recognition, the benefits of increased ubiquity of the service, lifecycle benefits and increased access to subscriber data. We will review the evidence of any indirect benefits as part of a net cost assessment. However, we explain each of these benefits and provide a preliminary view of their relevance in relation to the broadband USO below.
- a) Brand recognition – Universal Service Providers may gain where the customer perception of its brand increases (relative to that of alternative providers), increasing its ability to win customers in non-USO areas. In this regard, several stakeholders commented that BT has sought to market itself as a ‘national champion.’
 - b) Ubiquity – Universal Service Providers may gain an advantage if, when customers from broadband USO areas move to non-USO areas, they are biased towards the Universal Service Provider (either because they are less aware of other providers or because of a positive perception of the Universal Service Provider).
 - c) Subscriber data – Universal Service Provider may gain where they are able to access personal data from customers in broadband USO areas.
 - d) Lifecycle benefits – Universal Service Providers may gain when a customer that is currently unprofitable to serve becomes profitable in the future either because the costs of serving this customer reduce over time, or the revenues gained from this customer increase over time. As stated above, we propose an NPV approach that evaluates a net cost over the lifetime of the assets and so the benefit the Universal Service Provider receives should be directly accounted for in the forecasts of costs and revenues. Further counting of these as indirect benefits would involve double-

³²⁸ As explained in Section 5, the Universal Service Directive also refers to ‘intangible benefits’. For the avoidance of doubt, where we discuss matters related to indirect benefits, we consider that the same applies for ‘intangible benefits’.

counting. We do not therefore propose that life cycle benefits as defined here should be counted as an indirect benefit for the broadband USO.

- 9.63 As stated above, we will have to review evidence of indirect benefits as part of a net cost assessment and so we require the Universal Service Provider to provide an estimate of indirect benefits, with an explanation of how this was calculated including any relevant supporting information. We note that the Universal Service Provider must do this, even if it is using an alternative schedule for the entry of indirect benefits in the templates.³²⁹
- 9.64 While we have not considered the above categories of benefits in detail, we note that indirect benefits accrued from the broadband USO may be limited by the fact that BT and KCOM already have ubiquitous networks (across the UK and Hull area respectively) due to their pre-existing telephony USO, through which they already provide broadband. We also consider that, the modest scale of the broadband USO may mean it is unlikely to give rise to large indirect benefits.
- 9.65 We recognise that there may in principle be a cost to the Universal Service Provider if societal expectations around what the broadband USO should provide (and how quickly) do not match the reality of delivering the universal service obligations. Once again, we would review any evidence of these costs as part of a net cost assessment, however, we consider that if such a cost were to exist, it would likely be low for BT and KCOM.

Efficiency

- 9.66 In line with the Universal Service Directive, it is important that the Universal Service Provider has used the most efficient technology to deliver broadband USO connections and that it has incurred an efficient level of costs in delivering those connections.
- 9.67 We recognise that stakeholders were concerned that the Universal Service Provider might not use the most efficient technology to deliver the broadband USO and that BT may be able to gold-plate its broadband USO obligations (perhaps by deploying full-fibre instead of potentially cheaper technology). With respect to both of these points this, we first note that BT is already using FWA to reduce the number of premises eligible for the broadband USO.
- 9.68 For the premises that remain eligible for the broadband USO, it is for the Universal Service Provider to evidence in its net cost submission that it has considered all of the technologies that are available in the given area and chosen the most efficient option. If, upon reviewing this evidence, we concluded that the Universal Service Provider had used an inefficient technology, we would make an appropriate adjustment in our net cost calculation. However, this would be unlikely to require us to conduct a full technical review of BT's network (as TalkTalk considered might be necessary).
- 9.69 We note that that in some cases FTTC is likely to be a viable technology for delivering a broadband USO connection and it may also be less expensive to deploy than full-fibre. However, in other cases full-fibre may be more efficient than FTTC, given the higher

³²⁹ By 'alternative schedule' we mean an appendix to the net cost template.

operating costs of FTTC and the fact that cabinet-based technology which only serves a small number of dispersed premises may be very costly.³³⁰ As outlined above, the Universal Service Providers would have to evidence their decision either way.

- 9.70 Efficiency also includes ensuring that the Universal Service Provider has used third-party infrastructure where it is cheaper, or quicker, for it to do so. Where the Universal Service Provider has not used third-party infrastructure, it will have to explain why it was more efficient to deliver broadband USO connections using its own network. However, we do not expect the Universal Service Provider to undertake a specific costing valuation of each alternative network, as suggested by INCA, as we consider that this would be disproportionate.³³¹
- 9.71 Finally, we also consider that the Universal Service Providers have an incentive to be efficient as USO funding is not guaranteed and will only be provided if a net cost is deemed unfair. Furthermore, even if a net cost is deemed unfair, we expect the Universal Service Providers will still have to contribute to the fund.

The choice of discount rate

- 9.72 We recognise that Universal Service Providers will need the opportunity to earn an appropriate rate of return on USO investments to reflect the opportunity cost of capital for such investments. Providing the opportunity to earn such a rate of return is consistent with the principle that the USO should be cost neutral for a Universal Service Provider i.e. the provider should not have a cost advantage or disadvantage from delivering the USO.
- 9.73 Considering this, our guidance is that future cash flows should be discounted using the cost of capital associated with the relevant line of business. Where available, we will use the cost of capital from a regulatory decision (e.g. a charge control) most applicable to the line of business in question, at or around the time of the main capital expenditure programme for the USO.
- 9.74 Vodafone argued in its response that the provision of broadband in USO areas is likely to be less risky than delivering telecoms services in other areas that are subject to increased competition. The issue of the appropriate rate of return for fixed broadband in different areas of the country forms part of the Wholesale Fixed Telecoms Market Review 2021-2026 and we would expect any decision related to the broadband USO specifically, to be consistent with the rate used for any service or market most relevant for broadband USO areas.
- 9.75 We will use a cost of capital consistent with the financial modelling of any future cashflows – i.e. consistent with whether cashflows are in real or nominal terms, and whether they are pre- or post-tax. However, for the purposes of the funding regulations and the templates

³³⁰ Full-fibre deployment could also generate higher revenues than FTTC connections, which would lower any net cost of the USO.

³³¹ We discuss our approach to accounting for third-party infrastructure in the [June 2019 statement](#), paragraph 6.55-6.61.

we are not required to specify the actual rate. This would be a decision at the time of any net cost assessment.

Maintenance of records and reporting requirements

9.76 In the June 2019 statement³³², we imposed the following universal service conditions on BT and KCOM.

- a) Condition F.1. The Universal Service Providers must maintain records for a minimum period of six years from the date on which these records are created. These records must be sufficient to: (i) demonstrate the Universal Service Providers' compliance with the universal service conditions; and (ii) provide adequate evidence and explanations in support of any potential request made by them for compensation for complying in relation to any one or more of the universal service conditions applied to them.³³³ These obligations require the Universal Service Providers to ensure that they retain sufficient information including source data such as invoices, vouchers, and timesheets.
- a) Condition F.2. The Universal Service Providers must separately record actual costs, revenues, and assets associated with the provision of broadband USO services.³³⁴ As a result of this obligation, the Universal Service Providers are required to be able to demonstrate how they have calculated the incremental cost and revenue elements, and explain the transactions underlying the cost of providing broadband USO connections.
- b) Condition F.3. The Universal Service Providers must comply with all such reporting requirements as Ofcom may from time to time direct under those universal service conditions.³³⁵

Our November 2019 consultation

9.77 In our November 2019 consultation, we proposed to give regulatory financial reporting directions to BT and KCOM under universal service condition F.3 which would set out certain information that must be provided in relation to the broadband USO in the event that a request for compensation is made. The proposed directions included financial templates for the Universal Service Providers to complete if they decided to make a request for funding.

³³² Ofcom, June 2019. [Delivering the Broadband Universal Service Statement: Designating Universal Service Providers and setting conditions](#), page 138, paragraph 9.89.

³³³ Universal service conditions F.1 of Schedules 1 and 3 of Ofcom's notification which was contained in Annex 1 to the June 2019 statement.

³³⁴ Universal service conditions F.2 of Schedules 1 and 3 of Ofcom's notification which was contained in Annex 1 to the June 2019 statement.

³³⁵ Universal service conditions F.3 of Schedules 1 and 3 of Ofcom's notification which was contained in Annex 1 to the June 2019 statement.

Responses to our November 2019 consultation

- 9.78 All respondents who expressed a view agreed with the proposed reporting requirements.
- 9.79 KCOM said that the final reporting direction (and associated Annex) should not, in principle, preclude KCOM from making a broadband USO funding submission.³³⁶ [§<].³³⁷ KCOM also made the point that it may use Fibre to the Basement (FTTB) to deliver USO connections and that the template should not necessarily prescribe FTTP as the only qualifying technology eligible for compensation.³³⁸
- 9.80 BT made a range of suggestions such as including flexibility on the choice of base year for repayments, removing the reference to current revenue and various other technical adjustments.³³⁹
- 9.81 BT welcomed our discretion to agree changes to the NPV cost template and asked for clarity that changes can be made to the proposed, and other future USO templates, in agreement with them.³⁴⁰
- 9.82 KCOM also said that it understood that the financial reporting provisions only pertain to the broadband USO and, as such, in the event that Ofcom considers that the telephony universal service obligations should remain in force, any net cost calculations in respect of these obligations would be captured under the general provisions.³⁴¹

Our decision

- 9.83 In light of the consultation responses, we have decided to adopt our proposals in relation to the reporting requirements. We are introducing directions and financial templates that will apply to both BT and KCOM. The cost categories set out in the templates apply to both BT and KCOM. [§<]³⁴²
- 9.84 In respect of ‘qualifying technologies,’ as explained in the June 2019 statement³⁴³, we did not specify that FTTP or any other the technology had to be used to deliver broadband USO connections. We set out in the November 2019 consultation that different technologies would require different NPV timeframes³⁴⁴ and while the templates were designed in the expectation that FTTP was likely to be the technology used to deliver broadband USO

³³⁶ KCOM non-confidential response to the November 2019 consultation, page 3.

³³⁷ Ofcom meeting with KCOM on 16 March 2020.

³³⁸ KCOM non-confidential response to the November 2019 consultation, page 3.

³³⁹ BT non-confidential response to the November 2019 consultation, Annex 2.

³⁴⁰ BT non-confidential response to the November 2019 consultation, page 16.

³⁴¹ KCOM non-confidential response to the November 2019 consultation, page 2.

³⁴² Ofcom meeting with KCOM on 16 March 2020.

³⁴³ Ofcom, June 2019. [Delivering the Broadband Universal Service Statement: Designating Universal Service Providers and setting conditions](#), page 72, paragraph 6.21.

³⁴⁴ Ofcom, June 2019. [Delivering the Broadband Universal Service Statement: Designating Universal Service Providers and setting conditions](#), page 74, paragraph 6.31.

connections, we included a requirement in the template for the Universal Service Providers to complete additional templates where different technologies were used.³⁴⁵

- 9.85 We also proposed to give flexibility to change the templates specified in the directions with Ofcom's consent.³⁴⁶ In light of the submissions made by KCOM and BT, we have decided to adopt that approach to ensure that they are able to request variations to the templates to ensure that the information submitted reflects most closely their situation, including their chosen technology used to deliver the broadband USO.
- 9.86 In respect of BT's suggested changes to the template, with the exception of removing the 'Current Revenue' tab, we consider that the suggestions are useful for the template, are not significant and do not preclude KCOM from completing the template. We have therefore incorporated BT's suggestions into our final templates. In respect of current revenue, while we agree that broadband USO revenue will be minimal in the first year, the templates also included information on broadband revenue from existing customers, which is a significant input into the counterfactual calculation.³⁴⁷
- 9.87 Finally, we confirm KCOM's understanding that the reporting provisions contained in the directions only apply to the broadband USO. As we explain in Section 2, the funding regulations apply to costs incurred in connection with all universal service conditions currently in force (including obligations under the telephony USO) and any obligations which may be enforced in future. Therefore, in the event that the Universal Service Provider makes a request for funding in relation to its obligations under the telephony USO, this would be covered by the provisions contained in the funding regulations.

Broadband USO regulatory financial reporting directions

- 9.88 As explained above, we specify in the funding regulations information that the Universal Service Providers should be required to submit for all universal service obligations. In addition to that, we have decided that it would be appropriate to give directions to BT and KCOM under universal service conditions F.3 which set out certain information that must be provided in relation to the broadband USO specifically in the event that BT and/or KCOM decide to make a request for compensation.³⁴⁸
- 9.89 The directions included in Annex 3 specify that the information that is required to be provided to Ofcom must include a calculation of the NPV as this reflects our guidance on the approach to performing a net cost calculation for the broadband USO as outlined above. The appropriate timeframe over which the NPV is calculated would depend on what

³⁴⁵ (Row 35, 1- NPV Calculation tab).

³⁴⁶ Please refer to Annex 3 of this document, Directions on financial reporting, part 3, 3a.

³⁴⁷ Retail revenue can be based on wholesale volumes – e.g. If the Universal Service Provider is unable to determine whether end-users were previously supplied by itself or a competitor, if it has wholesale information that would enable it make a good estimate (its own retail arm buys a different service from that typically used by other downstream providers), this estimate should be used to calculate its own retail volumes.

³⁴⁸ Where we refer to "a request for compensation for complying in relation to any one or more of the universal service conditions" in the universal service conditions and directions, this is equivalent to "a request for a review of the extent (if any) of the financial burden of complying in relation to any matter with any one or more of the universal service conditions" in section 70(1) of the Act and the funding regulations.

assets have been laid down and are included within each specific request. The directions do not set out a specific timeframe and this will be a matter for the Universal Service Provider in the first instance. We have decided that the NPV calculation should contain:

- a) a total amount of all cash costs incurred in complying with the relevant universal service conditions, broken down by actual cash costs before the request is made and an estimate of future cash costs from that date going forward; and
- b) a total amount of all revenues and/or other benefits received and/or foregone in complying with the relevant universal service conditions, broken down by revenues and/or other benefits before the request is made and an estimate of future revenues and/or other benefits from that date going forward.

9.90 The reason for requiring the provision of this information is to support our assessment of any request for compensation which may be made by BT and/or KCOM by ensuring that we have access to the relevant information and explanations.

9.91 We appreciate that the Universal Service Providers would be unable to include actual costs, revenues and/or other benefits up to the exact date on which they submit any request for compensation given that they would need to ensure appropriate internal review and governance before any such submission is made. We have therefore decided that the Universal Service Providers must provide actual figures up to a cut-off date which is as close as reasonably practicable to the date of their request, taking account of the availability of the most up-to-date actual figures.

9.92 The requirements to provide the information specified in the directions (set out in Annex 3) supplement the obligations on BT and KCOM to supply further information under the funding regulations and universal service conditions in the event that BT and/or KCOM decide to make a request for compensation.

Legal tests

9.93 For the reasons set out above and summarised below, we are satisfied that the directions (as set out in Annex 3) meet the relevant tests set out in the Act. When imposing directions under section 49 of the Act in a particular case, we must be satisfied that the legal tests in section 49(2) of the Act are met. We consider that the directions are:

- a) objectively justifiable, in that they seek to ensure that the Universal Service Providers provide to Ofcom appropriate information to support any request for compensation they may make so that Ofcom is able to discharge its duties in respect of funding of any unfair burden associated with the broadband USO; the obligations therefore seek to ensure that Ofcom has sufficient information to assess and verify any possible future requests for funding of the broadband USO as required by the legislation;
- b) not unduly discriminatory, as the obligations apply to BT and KCOM as the Universal Service Providers who are entitled to make a request for compensation;
- c) proportionate, since we have balanced the need to ensure that the obligations are not unduly burdensome for the Universal Service Providers with the need to ensure that

Ofcom has sufficient information to assess and verify any possible future requests for funding of the broadband USO; and

- d) transparent, in that the directions are clear about what information the Universal Service Providers would be required to provide to Ofcom and the format in which this information should be supplied; further, we have sought to be transparent in devising the directions through public consultation.

9.94 We also consider that the directions meet our duties and the Community requirements under sections 3 and 4 of the Act. They further the interests of citizens in relation to the communications matters and the interests of consumers in the relevant markets as well as promote the interests of EU citizens because they seek to ensure that we have sufficient information to assess and verify any future requests for funding of the broadband USO. This will help ensure that Ofcom is able to discharge its duties in this area.

A1. Funding regulations

A1.1 We have published the [funding regulations](#) alongside this statement.

A2. Regulatory impact assessment – Decision to make the Electronic Communications (Universal Service) (Costs) Regulations 2020

Introduction

- A2.1 The analysis set out in this document is a regulatory impact assessment (“RIA”) relating to the Electronic Communications (Universal Service) (Costs) Regulations 2020 (the “funding regulations”).
- A2.2 Impact assessments provide a valuable way of assessing different options for regulation and showing why the preferred option was chosen. They form part of best practice policymaking. This is reflected in section 7 of the Communications Act 2003 (the “Act”), which imposes a duty on Ofcom to carry out impact assessments where our decisions would be likely to have a significant effect on businesses or the general public, or when there is a major change in our activities. This is also consistent with Government practice.
- A2.3 As a matter of policy, we are committed to carrying out and publishing impact assessments in relation to the vast majority of our policy decisions. For further information about our approach to impact assessments, see the guidelines, [Better policy-making: Ofcom’s approach to impact assessment](#), which are on our website.
- A2.4 This RIA relates to our decision to make the funding regulations we will follow when assessing any net costs of the provision of a universal service and, where appropriate, compensating the Universal Service Provider for those costs. The funding regulations apply to any assessments of net costs incurred in connection with all present universal service conditions as well as universal service conditions which may be imposed in the future.

Legislative background

- A2.5 Universal service means the provision of a defined minimum set of communications services of specified quality which are available to all consumers at an affordable price.³⁴⁹ The purpose of a universal service is to act as a safety net where market forces alone do not deliver affordable access to such minimum set of communications services.
- A2.6 The scope of the universal service is determined in the UK by the Secretary of State by making an order. In that order, the Secretary of State specifies the minimum set of services that must be provided. To date, the Secretary of State has made the following orders under section 65 of the Act:

³⁴⁹ See the definition of universal service contained in Article 2(j) of Directive 2002/21/EC of the European Parliament and of the Council of 7 March 2002 on a common regulatory framework for electronic communications networks and services as amended.

- a) The Electronic Communications (Universal Service) Order 2003 which set out that publicly available telephone services and other specified services (together the “telephony universal service”) must be provided, made available or supplied throughout the UK; and
 - b) The Electronic Communications (Universal Service) (Broadband) Order 2018 which extended the universal service to broadband connections and services of specified quality (together the “broadband universal service”).³⁵⁰
- A2.7 Sections 71(2) and 71(3) of the Act state that a person designated by Ofcom to provide a universal service must be compensated for the net cost of providing that service where Ofcom has established that that cost represents an unfair burden on the provider. Compensation may be made through one of the following mechanisms: (i) public funds; (ii) an industry fund established by Ofcom by regulations; or (iii) a combination of public and industry funding.
- A2.8 Ofcom is responsible for deciding how the funding process should operate in practice and what rules and procedures should apply to that process.³⁵¹ The funding regulations contain the rules and procedures which we consider to be appropriate. We are putting the funding regulations in place so that a Universal Service Provider can be compensated for any unfair cost burden associated with delivering a universal service.³⁵²

Purpose and intended effect

- A2.9 The intention of the funding regulations is to put in place a series of rules and procedures which will be followed when assessing any net cost of the provision of a universal service and, where appropriate, compensating a Universal Service Provider for all or part of those costs in exercise of the powers given to Ofcom under sections 70 and 71 of the Act.
- A2.10 In relation to the assessment, collection and distribution of contributions to a fund which may be established by Ofcom, the funding regulations ensure that the processes are carried out in a way which best reflects the following principles:
- a) transparency;
 - b) proportionality;

³⁵⁰ The requirement to secure universal service in the UK derives from the Universal Service Directive which has been implemented into UK law through the Act and secondary legislation. The UK will continue to be required to comply with EU obligations until the end of the transition period (i.e. 31 December 2020). The European Electronic Communications Code (the “Code”), which was adopted by the European Parliament and the Council of the European Union on 11 December 2018, replaces (among other things) the Universal Service Directive with effect from 21 December 2020 (see article 125 of the Code). The UK Government indicated in its consultation in July 2019 that its intention was to implement the Code in full into UK law by 21 December 2020, therefore retaining the universal service framework in the UK subject to the changes introduced by the Code. The consultation is available at: <https://www.gov.uk/government/consultations/implementing-the-european-electronic-communications-code>

³⁵¹ Section 71 of the Act.

³⁵² Section 71(4)-(5) of the Act.

- c) no undue discrimination; and
 - d) least market distortion.³⁵³
- A2.11 The funding regulations will apply not only to any net costs associated with the broadband universal service and the telephony universal service, but also to any net costs associated with universal service conditions which may be imposed in future.
- A2.12 The funding regulations will give stakeholders who are potentially affected (including Universal Service Providers and potential contributors to the industry fund) clarity about the process Ofcom will follow to determine any compensation.

The citizen and/or consumer interest

- A2.13 Our principal duty under section 3 of the Act is to further the interests of citizens in relation to communications matters; and of consumers in relevant markets, where appropriate by promoting competition. We have therefore taken account of the impact of our decisions upon both citizen and consumer interests in the markets we regulate.
- A2.14 The Act requires that the rules and procedures for compensating for any unfair net cost are contained in regulations made by Ofcom. In deciding to make these funding regulations, we have considered the wider impact on stakeholders. The making of regulations which provide the rules and procedures that govern the assessment of the net cost of providing a particular universal service and, where appropriate collecting and distributing contributions to any net cost forms part of the process of implementing a universal service. The decision to make the funding regulations will be of benefit to (or at least is not harmful to) the interests of citizens and/or consumers for the following reasons:
- a) a mechanism by which a Universal Service Provider can be compensated for the unfair net costs associated with providing a universal service is a necessary part of the provision of a universal service. We consider that clear rules and procedures relating to the assessment of the net cost and the provision of compensation to a universal service provider (where appropriate) are important to support the delivery of universal services and are therefore beneficial to citizens and consumers.
 - b) Laying down the rules and procedures by which a Universal Service Provider can be compensated for any net costs incurred in delivering a universal service is intended to provide clarity about the process which in turn is likely to provide an additional incentive for the Universal Service Provider to deliver the universal service. The delivery of the universal service will be of benefit to eligible consumers.
 - c) The approach to calculating a net cost of delivering the universal service as set out in the funding regulations requires Ofcom to have regard to the extent to which this cost was efficiently and necessarily incurred. The funding regulations also require Ofcom to

³⁵³ Section 71(6) of the Act obliges Ofcom to exercise the power to make regulations in the manner which they consider will secure that the assessment, collection and distributions of contributions is carried out in accordance with these principles.

consider and seek to minimise potential distortions to competition and user demand that may arise as a result of establishing an industry fund. That approach is ultimately for the benefit of citizens and consumers.

Costs

Costs to Business

- A2.15 Universal Service Providers are likely to incur costs associated with complying with the processes and procedures set out in the funding regulations.
- A2.16 In the event that it is necessary to assess, collect and distribute contributions to compensate for any unfair net cost burden, potential contributors to an industry fund (which may include the Universal Service Provider) are likely to incur costs of complying with the rules and procedures set out in the funding regulations.
- A2.17 As explained above, the Act requires that the rules and procedures for compensating for any unfair net cost are contained in regulations made by Ofcom. In making decisions on those rules and procedures, we have had regard to the principle of proportionality (amongst others). We believe that our chosen rules and procedures strike an appropriate balance between minimising the cost burden on businesses and ensuring that the process of determining compensation is for the benefit of citizens and consumers. For example, when deciding on the rules and procedures to include in the regulations, we have balanced: (i) the cost to the universal service provider of complying with these rules and procedures; and (ii) the need to ensure that our processes are suitably robust and allow for a high degree of scrutiny to ensure that a Universal Service Provider is compensated for the costs, but only those costs, to which it is properly entitled.

Costs to Ofcom

- A2.18 There will be costs associated with implementing the rules and procedures set out in the funding regulations. We have had regard to the principle of proportionality when designing them. While this must be balanced against other principles and objectives, we have sought wherever possible and appropriate to design these rules and procedures in a way which minimises the costs associated with subsequent implementation.
- A2.19 There are one-off administrative costs associated with making statutory instruments. We consider the implementation costs to be low. Moreover, the costs, such as they are, will also be offset by the benefits outlined in this document.

Conclusion

- A2.20 We consider that, overall (and taking into account that they are an integral part of the provision of universal services as a whole) making the funding regulations is likely to generate a net benefit for UK businesses, citizens and consumers and at worst would have

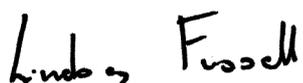
a neutral outcome. Taking into account the different costs and benefits, we consider that the most appropriate way forward is to make the funding regulations.

Equality Impact Assessment

- A2.21 Ofcom is required by statute to assess the potential impact of all our functions, policies, projects and practices on race, disability and gender equality. Equality Impact Assessments (“EIAs”) also assist us in making sure that we are meeting our principal duty of furthering the interests of citizens and consumers regardless of their background or identity.
- A2.22 Following an initial assessment of our policy decision, we considered that it is reasonable to assume that any impacts on consumers and citizens arising from the funding regulations would not differ significantly between different groups or classes of UK consumers and citizens.
- A2.23 We do not consider that there is evidence to suggest that the decision to make the funding regulations would have a direct, financial impact which would be significantly greater on any specific groups, including based on gender, race or disability or for consumers in Northern Ireland, relative to consumers in general.
- A2.24 We have not carried out a full EIA in relation to race equality or equality schemes under the Northern Ireland and disability equality schemes. The decision to make the funding regulations is not intended to, and appears unlikely to, have a significant differential impact on different gender or racial groups, on consumers in Northern Ireland or on disabled consumers compared to consumers in general. The funding regulations seek to set an appropriate framework for the funding process, including reviewing any net cost claim submitted by the Universal Service Provider and compensating the Universal Service Provider for any unfair cost burden. This work therefore forms part of our duty to implement the universal service in order to ensure that all eligible consumers, irrespective of their race, disability, gender, income or the part of the UK they live in, can benefit from the universal service on reasonable request.

Declaration

I have read the Regulatory Impact Assessment and I am satisfied that the benefits exceed the costs.

Signed: 

Date: 28 May 2020

Lindsey Fussell, Group Director, Consumer Group

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A3. Directions on financial reporting

A3.1 We have [published the directions](#) alongside this statement.

A4. Guidance on calculating turnover

A4.1 This annex provides guidance on the calculation of turnover for the purposes of calculating the amount of any contributions that are due to an industry fund. In particular, it discusses the deductions that should be made to gross relevant turnover, in order to arrive at the net relevant turnover figure that will form the basis of the calculations of contributions to the industry fund.

Gross relevant turnover

A4.2 The starting point for computing the net relevant turnover is the determination of the gross relevant turnover (“relevant turnover”).

A4.3 Relevant turnover is any turnover resulting from “relevant activities”, carried out wholly or partly in the United Kingdom. Relevant activities include:

- a) the provision of electronic communications services (“ECS”) to third parties;
- b) the provision of electronic communications networks (“ECN”), ECS and network access to communications providers (“CPs”); or
- c) the making available of associated facilities to CPs.

A4.4 Relevant turnover should be calculated in accordance with Ofcom’s guidance on establishing relevant turnover for the purposes of administrative charging.³⁵⁴ It should be noted that the ECN/ECS providers, who are subject to Ofcom’s administrative levy, already produce a relevant turnover calculation (for the purpose of determining the levy due).

A4.5 Net relevant turnover is calculated by subtracting “allowable deductions” from the relevant turnover figure. The general principles for determining which costs amount to allowable deductions are discussed below.

Allowable deductions

A4.6 As set out in section 7, we intend to base the calculation of contributions on net turnover. This will avoid the double imposition of contributions on the inputs and the outputs of undertakings.³⁵⁵ Net turnover is calculated by deducting payments made to other providers for inputs which already form the basis of a contribution to the industry fund by that other provider.

A4.7 We also set out in section 7 that the scope of the industry fund could include all providers of ECN and ECS, but that it could also be restricted to a particular category of providers. Where that is the case then revenues generated from the supply of ECN and ECS that are

³⁵⁴ The [guidance for the calculation of the gross relevant turnover](#) is available on the Ofcom website.

³⁵⁵ Annex IV of the Universal Service Directive.

determined to be out of scope will not form the basis of contributions to the industry fund and can be deducted from the relevant turnover of all suppliers.

- A4.8 In order to avoid contributions being imposed on both the inputs and outputs of undertakings, a deduction is also allowable for payments made to third parties for ECNs/ ECSs, where that payment will form part of the relevant turnover of another contributor. In other words, allowable deductions are effectively wholesale payments which form part of the relevant turnover of other contributors and so already form the basis of a contribution to the industry fund.
- A4.9 We consider that, as all ECN/ECS providers are already required to follow Ofcom's guidance on establishing gross relevant turnover for the purposes of administrative charging, they should be able to identify (with reasonable accuracy) the subset of payments made to ECN/ECS providers that will feature in another provider's relevant turnover submission.
- A4.10 We will also set out in any determination the providers that will contribute to the industry fund. Therefore, providers should be able to determine which payments they make to other providers which will form part of the revenue used as the basis for contributions made by those other providers to the industry fund.

A5. Consultation responses: implementation of the broadband USO

A5.1 This annex provides an overview of comments we received in relation to designation of the Universal Service Providers and the wider implementation of the broadband USO. These comments aren't directly relevant to the issues we cover in the funding statement however we provide our response to these points below for completeness.

Responses on implementation of the broadband USO

Impact on publicly funded schemes and alternative network providers

Responses to our November 2019 consultation

A5.2 Respondents highlighted issues that could arise from the interaction between the broadband USO, publicly-funded rollout schemes and commercial fibre rollout. The Advisory Committee for Northern Ireland ("ACNI") commented that Ofcom should, through engagement and awareness raising, ensure consumers are informed so they can take up services that best meet their needs.³⁵⁶

A5.3 Wansdyke Ltd was concerned about network overbuild where networks have already been, or are in the process of being built which meet the specification of the broadband USO.³⁵⁷

Our response

A5.4 As set out in the June 2019 statement, the Order prescribed how the broadband USO should interact with ongoing publicly-funded broadband interventions for eligibility purposes.³⁵⁸ In particular, consumers who request a broadband USO connection are not eligible if their home or business is due to receive decent and affordable broadband as the result of a publicly-funded intervention within one year of the date of their broadband USO request.

A5.5 We agree with the points raised by ACNI and carefully considered what consumer awareness obligations to place on the Universal Service Providers as part of the designation process. There is a general requirement on the Universal Service Providers to take reasonable steps to ensure they raise awareness of the broadband USO.³⁵⁹ Following the launch of the broadband USO, BT updated its website with information on how the broadband USO works and an eligibility checker tool which consumers can use to carry out

³⁵⁶ ACNI non-confidential response to the November 2019 consultation, page 2.

³⁵⁷ Wansdyke Ltd non-confidential response to the November 2019 consultation, pages 3-4.

³⁵⁸ Ofcom, June 2019. [Delivering the Broadband Universal Service: Designating Universal Service Providers and setting conditions](#), page 48.

³⁵⁹ Ofcom, June 2019. [Delivering the Broadband Universal Service: Designating Universal Service Providers and setting conditions](#), page 64.

an initial check to see if they are eligible. BT will shortly be writing to consumers to raise awareness and provide information on how to request a connection.

- A5.6 Premises that already have access to service which meets the broadband USO specification will not be eligible for a broadband USO connection. Under our formal information gathering powers we collect coverage information from network providers three times a year. We provide the Universal Service Providers with access to a full list of premises that do not have access to decent broadband in the geographic areas for which they are designated. This list also enables the Universal Service Providers to check if decent broadband is available from another network at a specific location and to direct consumers to contact those named network provider(s) serving that location. This process will enable the Universal Service Providers to carry out the consumer eligibility-checking process properly and effectively and reduces the risk of network overbuild.³⁶⁰

Satellite

Responses to our November 2019 consultation

- A5.7 Virgin Media commented that when BT receives a request for a broadband USO connection, BT must check whether there is a satellite service available that meets the technical specification of the broadband USO. If there is, Ofcom must not include any portion of the costs incurred in the assessment of any net cost.³⁶¹

Our response

- A5.8 As set out in the June 2019 statement, we noted that capacity available from existing satellites was insufficient to meet broadband USO needs.³⁶² Consequently, the availability of satellite services does not currently affect eligibility for the broadband USO. Therefore, we do not anticipate the costs of satellite deployment to be included in any request for funding.
- A5.9 In future years, satellite services may be able to deliver broadband services in the UK that meet the technical specification of the broadband USO. As explained earlier, under our formal information gathering powers we collect coverage information from network providers three times a year. If there are developments in broadband technologies, including satellite services, we will consider the case for their inclusion in the *Connected Nations* reports at that time. If these services become available commercially to premises previously without decent affordable broadband, we would not expect any costs that BT incurs in subsequently building connections to these premises to form part of any net cost

³⁶⁰ As set out in our June 2019 Statement, there are circumstances where a network operator may be overbuilt. This could happen if the service it offers meets the specification of the broadband USO but it chooses to price this above the eligibility price threshold of £45 per month.

³⁶¹ Virgin Media non-confidential response to the November 2019 consultation, page 5.

³⁶² Ofcom, June 2019. [Delivering the Broadband Universal Service: Designating Universal Service Providers and setting conditions](#), page 24.

of the broadband USO because premises with access to decent affordable broadband are ineligible for the broadband USO.

Switching from a broadband USO service

Responses to our November 2019 consultation

- A5.10 The Federation of Communication Services (“FCS”) said that any connections provided under the broadband USO should be available for switching to another provider at the end of the initial minimum contract period where the customer wishes to do so.³⁶³
- A5.11 Wansdyke Ltd said that where a customer is in receipt of a broadband USO service and wishes to switch to a service with a higher specification when it becomes available from an alternative provider, the Universal Service Provider should be required to waive the remaining period of the customer’s contractual commitment.³⁶⁴

Our response

- A5.12 In our June 2019 statement we set conditions that would apply to the Universal Service Providers as they deliver broadband USO connections and services, including additional protections for consumers connected under the broadband USO.³⁶⁵ We did not include any specific provisions for when a customer could switch to a new provider as we considered the existing, standard rules that apply to contractual commitments are sufficient to protect broadband USO customers. Consequently, in response to FCS’s point, consumers will be free to switch to alternative providers at the end of their minimum contract period.

Review of the broadband USO

Responses to our November 2019 consultation

- A5.13 ACNI commented that a speed of 10 Mbit/s is unlikely to be sufficient to meet the needs of consumers, citizens and microbusinesses in coming months and years, and noted that the Digital Economy Act 2017 requires a review when UK uptake of superfast broadband reaches 75%. However, ACNI are of the view that given the rate at which consumer demand for faster speeds is growing, and the length of time taken to implement any changes, the trigger point for a review should be earlier.³⁶⁶

Our response

- A5.14 The Digital Economy Act 2017 includes an automatic review of the USO to ensure it remains relevant. It stipulates that the technical specification of the USO must be reviewed when at least 75% of premises in the UK subscribe to a broadband service that provides a

³⁶³ FCS non-confidential response to the November 2019 consultation, page 2.

³⁶⁴ Wansdyke Ltd non-confidential response to the November 2019 consultation, page 4.

³⁶⁵ See the June 2019 statement, [Annex 1: Legal instruments](#).

³⁶⁶ ACNI non-confidential response to the November 2019 consultation, page 1.

download speed of at least 30Mbit/s.³⁶⁷ It is for Government to commission a review or consider any revisions to the broadband USO. However, we will continue to monitor demand and use of broadband services to inform our understanding of how people's needs for connectivity will evolve in future.

Quality of fixed wireless services

Responses to our November 2019 consultation

A5.15 ACNI noted that there are a range of factors which can impact on performance for consumers on fixed wireless services such as network capacity, the number and location of premises being served, line of sight and consumer equipment. ACNI asked Ofcom to do everything in its power to ensure that fixed wireless broadband delivers as good and reliable a service as fixed line access.³⁶⁸

Our response

A5.16 In the June 2019 statement we explained how we had undertaken monitoring of BT's 4G home broadband service (provided through the EE brand) to better understand its capability to deliver the technical specification of the broadband USO.³⁶⁹ The results provide us with reassurance that the service is likely to be able to deliver the technical specification of the USO in most cases. If BT's fixed wireless service is available to a consumer, and delivers a decent broadband service, they will not be eligible for the broadband USO.

A5.17 We have placed quality of service commitments that BT will be required to meet when delivering its fixed wireless service. If a customer feels the fixed wireless connection is not delivering decent broadband BT will:

- a) seek to provide advice to the consumer on improving the performance of existing equipment, for example, ensuring the placement of the router is in the optimal place.
- b) Where this is unable to improve the service, the customer will be offered an external antenna at the cost of £100 to help boost the quality of the connection received.

A5.18 If it is still not possible for the consumer to receive a decent broadband connection, the consumer will be eligible for the broadband USO.³⁷⁰

A5.19 We also plan to work with fixed wireless providers more generally to understand the performance of their broadband services.

³⁶⁷ At the time of this document, our *Connected Nations* 2019 report stated 94% of premises have access to superfast broadband and only 54% of premises have signed up to them (or 57% of those able to take superfast services have done so).

³⁶⁸ ACNI non-confidential response to the November 2019 consultation, page 1.

³⁶⁹ Ofcom, June 2019. [Delivering the Broadband Universal Service: Designating Universal Service Providers and setting conditions](#), page 22.

³⁷⁰ The consumer would be eligible for a connection under the broadband USO where the estimated cost of providing the connection falls under the reasonable cost threshold of £3,400.

Premises above the reasonable cost threshold

Responses to our November 2019 consultation

A5.20 ACNI said that it recognises a proportion of the hardest to reach premises in Northern Ireland will fall outside the £3,400 reasonable cost threshold for the broadband USO and will need another funded solution to secure broadband access. ACNI said it will take a strong interest in Ofcom's work to provide information and advice to inform and enable the next wave of publicly-funded solutions, and to work to keep this high on the policy agenda.³⁷¹

Our response

A5.21 As part of our programme of work on universal coverage, we are continuing our analysis to understand the challenges around access to broadband services in the hardest to reach areas of the UK.³⁷² We will examine the characteristics of the homes and businesses that will be unlikely to get a decent broadband service from any existing schemes, including the broadband USO, and are discussing with government what options are available for improving these connections.

Designation of BT and KCOM as Universal Service Providers

Responses to our November 2019 consultation

A5.22 Broadway Partners disagreed with many of our proposals on the basis that it disagreed with the premise that a Universal Service Obligation should accord a monopoly right to the designated provider and that BT and KCOM should not be the default option for providing the broadband USO, but a backstop option. Instead, a mechanism should be introduced to allow broadband USO requests to be opened to the market and served by the provider with the most appropriate and efficient technology available, at the lowest cost.

A5.23 Broadway Partners also said Ofcom should require BT to publish details of the premises that it claims would cost more than the reasonable cost threshold and allow these to be subject to market competition.³⁷³

Our response

A5.24 We decided our approach to designation in the December 2018 consultation, where we set out that it was appropriate to use a direct designation process rather than a competitive process in designating the Universal Service Provider. We also explained that we had received 8 expressions of interest and assessed each of the interested providers against

³⁷¹ ACNI non-confidential response to the November 2019 consultation, page 2.

³⁷² Ofcom, April 2020. [Statement: Ofcom's Plan of Work 2020/2021](#), page 22.³⁷³ Broadway Partners non-confidential response to the November 2019 consultation, page 1.

³⁷³ Broadway Partners non-confidential response to the November 2019 consultation, page 1.

our two step assessment criteria.³⁷⁴ In the June 2019 statement, we said that having considered each of the providers against the criteria, we considered that BT and KCOM would be best placed to deliver the broadband USO and designated them as Universal Service Providers.³⁷⁵ Having considered these issues extensively at the point of designation we do not think it is appropriate to open broadband USO requests to other providers as it is not clear how such a mechanism would work or how these connections would be funded.

- A5.25 Additionally, when the Universal Service Providers make an application for funding, they will need to demonstrate that the technology or technologies used to deliver broadband USO connections were efficient choices.
- A5.26 We disagree with Broadway Partners' request that BT should publish the list of premises above the reasonable cost threshold. The list of eligible premises that we share with BT is derived from the coverage information we collect from providers three times a year for our *Connected Nations* report. As this information is commercially confidential to the networks providing the information, we put in place strict requirements on the Universal Service Provider so that they use this information only for the purposes of complying with their broadband USO obligations.³⁷⁶ They must also ensure that this information is only accessed by named employees and agents of the Universal Service Providers who are working on the delivery of the broadband USO. Therefore, it would be inappropriate to require BT to publish this list.

³⁷⁴ The interested providers were Airband; Bentley Walker, Broadway Partners, BT, Hyperoptic, KCOM, Quickline and Viasat.

³⁷⁵ Ofcom, June 2019. [*Delivering the Broadband Universal Service: Designating Universal Service Providers and setting conditions*](#), pages 26-29.

³⁷⁶ Ofcom, June 2019. [*Delivering the Broadband Universal Service: Designating Universal Service Providers and setting conditions*](#), page 106.

A6. Glossary

Access network: An electronic communications network which connects end-users to a service provider running from the end-user's premises to a local access node and supporting the provision of access-based services. It is sometimes referred to as the 'local loop' or the 'last mile'.

Allowable deductions: include payments made to other providers for inputs which already form the basis of a contribution to an industry fund, as well as the revenues from relevant activities which are determined to be out of scope to form the basis of contributions to the fund.

Bandwidth: The maximum amount of data that can be transmitted along a channel.

Broadband: A service or connection generally defined as being 'always on', providing a bandwidth greater than narrowband.

Broadband speed: The speed at which data are transmitted over a broadband connection, usually measured in megabits per second (Mbit/s).

Broadband universal service: The broadband connections and services of specified quality brought within the scope of the universal service by the 2018 Order.

Broadband USO: Introduced by the 2018 Order to give homes and businesses the right to request a decent and affordable broadband connection.

Contention ratio: The degree to which bandwidth is shared between different end-users at the same network node. When more end-users share the same bandwidth within a network this can lead to a slowdown in performance.

DCMS: Department for Digital, Culture, Media and Sport.

Decent broadband: A broadband connection that enables full and effective social and economic participation in a digital society, which was defined in the 2018 Order as a line capable of delivering at least 10Mbit/s download and 1Mbit/s upload sync speeds (as well as having other specified characteristics).

Download speed: Also downlink or downstream speed. Rate of data transmission from a network operator's access node to a customer, typically measured in Mbit/s.

ECN: Electronic Communications Networks, as defined in section 32 of the Act.

ECS: Electronic Communications Services, as defined in section 32 of the Act.

Excess costs: Any costs of providing a broadband connection which are more than £3,400 excluding VAT.

Fibre to the Cabinet (FTTC): Access network consisting of optical fibre extending from the access node to the street cabinet. The street cabinet is usually located only a few hundred metres from the subscribers' premises. The remaining segment of the access network from the cabinet to the customer is usually a copper pair.

Fibre to the Premises (FTTP): A form of fibre optic communication delivery in which the optical signal reaches the end-user's home or business. Also known as full-fibre broadband.

Fixed broadband: Broadband delivered over a fixed line to a customer's premises.

Fixed Wireless Access (FWA): Broadband delivered over radio waves to a customer's premises.

Latency: The time it takes a single packet of data to travel from a user's PC to a third-party server and back again. The figure is most commonly measured in milliseconds, and a connection with low latency will feel more responsive for simple tasks like web browsing.

Mbit/s: Megabits per second. A unit measuring the bit-rate.

Net cost: The cost of complying with one or more universal service conditions less the direct and indirect benefits of being designated as a Universal Service Provider.

Net Present Value (NPV): The present value of a stream of cashflows over time.

Net relevant turnover: is calculated by subtracting allowable deductions from the relevant turnover figure.

Number-Independent Interpersonal Communications Services (NIICS): 'Over the top' services brought within scope of the definition of ECS by the Code.

Reasonable cost threshold: A cost threshold set by Government in the 2018 Order to determine eligibility for the broadband USO. A Universal Service Provider is not obliged to supply a broadband USO connection, where the cost of providing that connection exceeds £3,400; unless the end-user pays the excess costs over £3,400.

Relevant activities: Relevant activities include the provision of ECS to third parties; the provision of ECN, ECS and network access to communications providers; or the making available of associated facilities to communications providers.

Relevant turnover: The turnover that an undertaking generates from relevant activities, carried out wholly or partly in the UK.

Sync speed: The modem sync speed is the maximum speed achievable between a consumer's premises and their internet service provider's network.

Telephony universal service: The publicly available telephone services and other specified services set out by the 2003 Order which must be provided, made available or supplied throughout the UK.

Universal Service Directive: European Parliament and Council Directive (EC) 2002/22 (OJ L108, 24.4.2002) on universal service and users' rights relating to electronic communications networks and services.

Universal Service Provider: For both the telephony and broadband USO, KCOM has been designated as the Universal Service Provider for the Hull area, and BT as the Universal Service Provider for the rest of the UK.

USO: Universal Service Obligation.

The 2003 Order: The Electronic Communications (Universal Service) Order 2003 as amended by the 2018 Order.

The 2018 Order: The Electronic Communications (Universal Service) (Broadband) Order 2018.

The Act: The Communications Act 2003 as amended.

The Code: Directive (EU) 2018/1972 of the European Parliament and of the Council of 11 December 2018 establishing the European Electronic Communications Code.

Upload speed: Also uplink or upstream speed. Rate of data transmission from a customer's connection to a network operator's access node, typically measured in Mbit/s.

Weighted Average Cost of Capital (WACC): Weighted average cost of capital typically estimated as an average of the company's cost of equity and cost of debt weighted by gearing.