



Compensating providers delivering universal services

Response to Ofcom's consultation

January 2020

Executive summary

Ofcom's proposed approach to compensating universal service providers ("USPs") delivering universal services is broadly sensible.

We agree that Ofcom should assess objectively the net costs from providing universal service – including considering all tangible and intangible benefits that could accrue to the USP as widely as possible – and should only consider establishing an industry fund to compensate USPs if the net cost is likely to be significant.

It is not possible at this stage to estimate accurately the number of premises that are likely to be eligible for the broadband USO and, therefore, to 'size up' the costs, benefits and any potential 'net cost' funding gap. Much depends on the scope and scale of commercially viable fixed wireless access ("FWA") across the UK as well as BT's own commercial fibre rollout. It is important that these commercial avenues are fully pursued in order to minimise the scope and distortive effects of any broadband USO to premises that would not otherwise receive adequate broadband speeds. Given the current uncertainty, Ofcom must consult again once it has more detail about the scale of any net costs of the USO and before deciding on the best and most proportionate way to deliver the USO (including whether it should be funded via an industry fund).

However, if Ofcom decides to introduce an industry fund, we consider there are three key factors that need to be considered:

- the USP experiences enormous benefits from providing the USO. Ofcom needs to consider all tangible and intangible benefits as widely as possible when assessing whether there is an unfair net cost burden to the USP;
- if Ofcom decides that there is an unfair net cost burden and it is appropriate to compensate the USP by establishing an industry fund, all electronic communications network ("ECN") and electronic communications service ("ECS") providers must contribute because this approach will spread the costs as widely as possible and ensure that as many of the potential beneficiaries of universal service contribute to the cost of delivering it; and
- the best way to share any net cost among all ECN and ECS providers and to avoid double-counting is to use the 'net relevant turnover' approach that Ofcom has suggested. This approach is consistent with the European legislative framework.

We set out these points in more detail below.

Ofcom needs to consult again once it has a better understanding about the scale of premises that will be eligible for the USO before deciding whether it is proportionate and justified to introduce an industry fund

A key challenge for Sky (and industry) is that the consultation does not quantify the number of premises that are likely to be eligible for the broadband USO.

- Ofcom indicates that in the most recent Connected Nations report, it identified 578,000 premises that cannot get decent broadband. Assuming that the cost of providing a broadband connection to each premise is the maximum £3,400 then the total USO cost could be as much as £2bn.
- However, Ofcom also refers to BT's suggestion that it could connect 450,000 of these premises using FWA and that 110,000 premises would be above the maximum cost threshold, leaving only 40,000 eligible premises. This could bring the cost down to below £136m.

This is clearly a wide range with a lot depending on the scope and scale of commercially viable FWA across the UK as well as BT's own commercial fibre rollout. It is important that these commercial avenues are fully pursued in order to minimise the scope and distortive effects of any broadband USO.

There is a real risk that without proper scrutiny Ofcom could set perverse incentives on BT to reduce the scale of its FWA plans and other commercial deployments and instead fall back on reaching more premises via a broadband USO. Universal service provision needs to be used only as a last resort when all other commercial solutions have failed.

Before deciding whether to introduce an industry fund (and on who should contribute to that fund) Ofcom needs to provide more detail about the scale of premises that would be eligible for the USO and the associated costs and benefits. Without a better understanding of the size and scale of the problem, it is impossible for industry to assess whether introducing an industry fund is a proportionate and justified response.

Ofcom needs to consider all the considerable benefits to the USP from providing the USO when assessing whether there is an unfair net cost burden

Ofcom states that when calculating the net cost burden to the USP of providing the USO it will take account of all costs and benefits that accrue to the USP, including intangible benefits.

Ofcom should not underestimate the enormous and widespread benefits to BT of being designated as the broadband USP. In an intensely competitive retail broadband market, such a designation would provide BT with a significant competitive advantage by positioning it as the 'national champion' for broadband to consumers and extending the availability of BT's retail broadband services to even more premises than its competitors.

More specifically, the European Commission describes the range of benefits to a USP very broadly. We outline what this could mean in practice for BT in the table below.

USP benefits	What this could mean for BT
Ubiquity	<ul style="list-style-type: none"> If a customer moves from an uneconomic area into an economic area, this benefit arises when they are biased towards choosing BT (either because they are less aware of other CPs or because of a positive perception based on their past experience with BT).
Life cycle effect	<ul style="list-style-type: none"> This occurs if a customer that is currently unprofitable to serve becomes profitable in the future (e.g. because BT's costs to deploy fibre reduce over time).
Marketing benefits, brand image and loyalty	<ul style="list-style-type: none"> BT is positioned as the national champion with a broader reach than competitors. This impacts a customer's perception of BT's brand (relative to that of other, competing CPs) and may impact BT's ability to win customers in non-USO areas.
Access to subscriber data and information	<ul style="list-style-type: none"> This benefit relates to the value to BT of having access to personal data from customers in USO areas.
Benefits arising from increasing network reach	<ul style="list-style-type: none"> Enables BT to achieve greater economies of scale and supports its ability to deliver more products and services to more premises across the UK.

Ofcom needs to assess prudently these tangible and intangible benefits and weigh them against the efficient and necessary costs to the USP of providing the USO. We are particularly pleased to see Ofcom's proposal that its net cost calculation will be audited – and suggest that an independent auditor is appointed rather than Ofcom auditing itself – and its acknowledgement that even if there is a net cost this does not give rise automatically to a right to compensation for the USP.

Properly quantifying the benefits is important because Ofcom needs to (i) avoid BT being unfairly compensated by the scheme, and (ii) ensure that if there is a net cost that needs to be recovered from other ECN and ECS providers, that cost is minimised as much as possible to avoid distortion to competition.

If Ofcom decides that there is an unfair net cost burden and it is appropriate to establish an industry fund, all ECN and ECS providers within the UK should contribute

The guiding principle to designing an industry fund is to seek contributions in a way that achieves the least market distortion. The Universal Service Directive is clear that this means costs should be recovered in a way that minimises the impact on end-users and suggests this could be achieved by spreading costs as widely as possible.

As a point of principle, we consider that the best way to achieve this is to use general taxation to fund the USO. This is because it will reflect more accurately that universal service results in wide ranging social and economic benefits and will spread the costs as widely as possible and, hence, reduce distortion.

However, because the Universal Service Directive only allows Ofcom to seek contributions from ECN and ECS providers, the next best alternative is to ensure that all of industry (including fixed and mobile operators and at all levels of the supply chain) contributes.

This will have the least distortive impact on competition because it will spread the costs as widely as possible and ensure that as many of the potential beneficiaries of universal service – as is allowed under the European legislative framework – contribute to the cost of delivering it.

Ofcom’s approach to calculating net relevant turnover is correct and complies with the European legislative framework by avoiding double counting

We support Ofcom’s approach to calculating net relevant turnover which, in effect, involves taking a CP’s wholesale or retail revenues and deducting wholesale payments made to other CPs.

This approach is transparent and neutral and avoids the risk of double-counting both the outputs and inputs of different CPs. If Ofcom simply assessed the turnover generated by different CPs, then contributions would be imposed both on the inputs and outputs of CPs that purchase wholesale network access from other CPs.

There is also a further economic justification for this approach in that vertically integrated CPs – that own the underlying network infrastructure – will receive more of the benefits of the increased broadband connectivity that the USO will deliver than retailers.

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