



SKY'S RESPONSE TO OFCOM'S CONSULTATION ON WHOLESALE LOCAL ACCESS MARKET REVIEW – RECOVERING THE COSTS OF INVESTMENT IN NETWORK EXPANSION

EXECUTIVE SUMMARY

1. Sky has long supported the Government's desire to deliver a universal broadband service with minimum download speeds of 10 Mbps. Ubiquitous access to broadband of a reasonable minimum speed is important for social inclusion and supports the delivery of positive economic outcomes in the UK.
2. However, BT's proposal to deliver a network rollout that would be funded through increased regulated charges for its key wholesale products, such as line rental, is fundamentally flawed.
3. There is no legal basis for recovering universal service delivery costs via an SMP charge control and to do so would circumvent the correct procedure – establishing a universal service obligation.
4. Ofcom is seeking to shoehorn the recovery of BT's anticipated costs into the SMP framework by characterising BT's proposed delivery of a universal broadband service as a "commercial", 'business as usual' network deployment. This does not withstand scrutiny. BT is not rolling out its network pursuant to a commercial strategy. BT has publicly stated that it would not extend its network in this way without a change to the regulatory environment. Indeed, the only reason that BT is proposing to expand its network is because Government is seeking a provider to deliver a form of universal broadband service. Thus, this network deployment is a Government-initiated expansion, not a commercially driven one. The network rollout costs are not incurred in the normal delivery of WLA services but in the delivery of a universal service obligation and, as such, it is simply not within Ofcom's powers to recover these costs via an SMP charge control.
5. Moreover, seeking to recover the costs of BT's universal broadband service via WLA charges is bad for consumers and competition. The universal service framework seeks to minimise the impact of universal service obligations by spreading the cost of their delivery broadly and in a non-discriminatory way among firms. The proposal set out in the Consultation, however, would adopt the narrowest base for recovery of the cost of delivering the USO, thereby significantly increasing the likelihood of costs being passed on to consumers of the most basic telecoms services, such as line rental – an area where Ofcom already has concerns about the charges faced by vulnerable customers.
6. The narrow base proposed for the recovery of BT's broadband USO investment is also discriminatory – being faced only by broadband providers who are dependent on use of BT's network – thereby distorting competition at the retail level of the sector.
7. The universal service regime provides a legally sound and well-established framework for delivering a universal broadband service and allowing the provider to recover its costs in a transparent, non-discriminatory and proportionate manner. It has been successfully

implemented in a number of other countries; nowhere else has universal service delivery funded via charges for regulated services been implemented.

8. The universal service regime has a number of key advantages over the approach set out in the Consultation.
9. First, it provides legal certainty. It is a tried and tested framework designed specifically for the purpose of promoting universal access to communications services. This mitigates the challenges of trying to fit the recovery of BT's costs within the SMP framework.
10. Second, it enables Ofcom to implement a non-discriminatory and proportionate cost recovery mechanism. The universal service framework stipulates that net rollout costs should either be recovered from public funds, as is the case for BDUK, or an industry levy. Ofcom has previously supported the latter approach, which would see fair contributions from all industry players and not just BT's WLA customers.
11. Third, it promotes transparency and provides a mechanism for tying funding to the delivery of broadband investment. The current proposal envisages splitting BT's commitment to invest from the cost recovery mechanism. This would make it impossible to tie cost recovery to the actual delivery of BT's investment. To the extent that costs have been overestimated (e.g. due to greater than expected rollout by other providers or as a result of BDUK funded expansion), the universal service regime would allow Ofcom or Government to claw back funding. Under the regime proposed in the Consultation, BT would simply benefit from a windfall. Similarly, BT would receive a windfall were it to delay its investment during the charge control period, with no opportunity under the regime proposed in the Consultation to claw back that underspend.
12. Finally, it allows other communications providers the opportunity to be designated as the universal service provider throughout the UK or in parts of it. This would incentivise potential providers to develop more efficient rollout plans. Moreover, it sets out a clear framework that would enable Government to engage with operators other than BT for future rollout plans.
13. Sky also has material concerns about the timing of Ofcom's consultation and its impact on the WLA market review. The consultation is premature. Putting aside the fundamental legal issues with Ofcom's proposal, there are insufficient details regarding BT's proposal for Ofcom to evaluate its implications properly, or for stakeholders to comment on its detail effectively.
14. It is likely to be months before BT's proposal is finalised. At that stage, Ofcom would have to consult again. It is difficult to see how this could be achieved without delaying the conclusion of the WLA market review even further. UK consumers are already being disadvantaged by a one year gap in regulation of WLA services. Any further delay must be avoided.

SECTION 1: BACKGROUND

- 1.1 The Government has long held ambitions to deliver faster broadband services throughout the UK. This is an objective that Sky fully supports. We agree with Government that access to good broadband speeds is important for both digital inclusion and future economic outcomes in the UK.¹
- 1.2 To date, the most significant Government intervention aimed at this objective has been Broadband Delivery UK (“BDUK”) programme, launched in December 2010. This provided an initial budget of £830 million of public funds to support infrastructure investment in less densely populated areas where there was a “*challenging business case*”² for rollout of high speed broadband. In total, Government, local authorities and European Union funding combined have contributed over £1.7 billion to extend superfast broadband coverage across the UK.
- 1.3 At the same time, and particularly more recently, Government, with input from Ofcom, has been moving towards the provision of a universal broadband service obligation. This has developed from a commitment in 2009 to ensure all households would have minimum download speeds of 2 Mbps³ to proposals in 2015 for a minimum speed of 10 Mbps.⁴ Since 2015 Government and Ofcom have continued to work towards delivering a universal broadband service of at least 10 Mbps, including:
- (a) a Government consultation on a 10 Mbps universal service obligation (“USO”) and a separate request from Government for a report from Ofcom on the design of the USO in March 2016;⁵
 - (b) an announcement in the Queen’s Speech in 2016 that legislative measures would be introduced to mandate a broadband USO of at least 10 Mbps;
 - (c) a report from Ofcom to the Government in December 2016 on designing the USO,⁶ and
 - (d) the inclusion of new USO powers in the Digital Economy Act 2017, which enable the Government to introduce a universal service order mandating download speeds of at least 10 Mbps.⁷
- 1.4 Ofcom’s 2016 Statement discussed funding options for a broadband USO in some detail, based on an assumption – in line with the Universal Service Directive (“USD”) – that the principal options were (i) public funding, (ii) an industry fund, or (iii) a combination of public

¹ Sky has previously expressed its support for the Government’s introduction of a universal service obligation for broadband. See Sky’s Response to Ofcom’s Call for Inputs on Designing the Universal Service Obligation. (https://www.ofcom.org.uk/_data/assets/pdf_file/0034/47779/sky.pdf.)

² Paragraph 15, ‘Britain’s Superfast Broadband Future’, BIS and DCMS Report, 8 December 2010.

³ Paragraph 4.40, Government Budget Report 2009. See also paragraph 23 of ‘Digital Britain Report’, DCMS, June 2009.

⁴ ‘Government plans to make sure no-one is left behind on broadband access’, DCMS press release, 7 November 2015. (<https://www.gov.uk/government/news/government-plans-to-make-sure-no-one-is-left-behind-on-broadband-access>.)

⁵ ‘A new broadband universal service obligation consultation’, DCMS, 23 March 2016.

⁶ ‘Achieving decent broadband connectivity for everyone: Technical advice to UK Government on broadband universal service’, Ofcom statement, 16 December 2016 (“Ofcom’s 2016 Statement”). (https://www.ofcom.org.uk/_data/assets/pdf_file/0028/95581/final-report.pdf.)

⁷ Section 1, Digital Economy Act 2017, which amended section 65 of the Communications Act 2003.

funding and an industry fund. Given Government's stated preference for industry to fund the broadband USO, Ofcom focused on the design principles for an industry fund. Ofcom stated:

*"The USD requires any industry fund to be transparent, non-discriminatory, proportionate, and cause the least market distortion. It defines 'least market distortion' as meaning the costs should be recovered in a way that minimises the impact on end-users of communications services, and suggests this could be achieved by **spreading costs as widely as possible**. This would be the guiding principle for any fund design."*⁸ (Emphasis added.)

- 1.5 The "guiding principle" of "spreading the costs as widely as possible" was subsequently used in the Ofcom document to evaluate the merits of alternative fund design options.
- 1.6 In July 2017 the Government announced that it had received a 'voluntary proposal' from BT to "roll out at least 10 Mbit/s universal broadband for the entire country"⁹. Few details about the proposal have been made publicly available. What is known is that BT is proposing to deliver fixed broadband services with download speeds of at least 10 Mbps to 99% of households by 2020, with the remaining households receiving broadband by fixed wireless or satellite. Plainly, this is the delivery of the Government's USO by another name, not a commercially-driven decision by BT to extend its network.
- 1.7 The announcement was accompanied by:
 - (a) the publication of a further Government consultation on USO design, including draft secondary legislation;¹⁰ and
 - (b) a proposal that – contrary to the guiding principle of "spreading the costs as widely as possible" – the costs of the proposed USO investment would be narrowly focused on users of BT's wholesale local access ("WLA") services and that Ofcom would consider this proposal as part of its WLA market review.
- 1.8 The latter proposal gives rise to the current Ofcom consultation, which sets out its view of the level of surcharge on standard wholesale charges for BT's WLA services required to pay for BT's USO network expansion during the next WLA charge control period.

SECTION 2: IT IS NEITHER APPROPRIATE NOR LEGITIMATE TO USE SMP REGULATION TO RECOVER THE COSTS OF BT'S USO INVESTMENT

- 2.1 Ofcom's consultation sets out the implications of recovering the cost of BT's USO network expansion via regulated charges for broadband lines supplied in the WLA market. Ofcom calculates a surcharge that would be added to standard charges for WLA services to pay for the network expansion. In this Section 2 we set out the reasons why it is neither appropriate nor legitimate to use SMP regulation in this way.

⁸ Paragraph 9.5, Ofcom's 2016 Statement.

⁹ 'Universal broadband to reach every part of the UK', DCMS press release, July 2017. (<https://www.gov.uk/government/news/universal-broadband-to-reach-every-part-of-the-uk>)

¹⁰ 'A new broadband Universal Service Obligation: consultation on design', DCMS, July 2017. (https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/634016/USO_consultation_document.pdf)

BT's proposed investment cannot be characterised as a 'commercial deployment'

- 2.2 The approach to the setting of charge controls for regulated services under the telecoms SMP framework is now well established. Regulated charges are set to enable the provider to recover their reasonable costs of providing the relevant services, including a reasonable return on capital employed. Both operating costs and capital assets must be relevant and efficiently incurred in order to be taken into account when setting regulated charges.¹¹
- 2.3 Ofcom has sought to characterise the USO network extension proposed by BT as a normal 'business as usual' investment of the type that would automatically be taken into account when setting BT's regulated charges for WLA services. This is incorrect, for the following reasons.

The proposed network deployment would not occur without Government intervention

- 2.4 Costs can only be considered to be efficiently incurred if BT would have incurred them when conducting 'business as usual' investment in providing WLA services. That is not the case here. BT's proposal is in fact a response by BT to delivering a Government policy objective, and predicated on Government altering the "regulatory environment" in such a way as to make the proposed investment commercially viable. This is clear from BT's response to the Ofcom call for inputs on 'Designing the broadband universal service obligation'. In that submission BT noted that it was willing to invest in "a service as required by the Government" subject to the "right regulatory environment"¹².
- 2.5 Furthermore, it is clear from the Consultation that the network expansion contemplated by BT is beyond its normal commercial plans. The "qualifying premises" that are contemplated by the Consultation are stated as being:

*"premises that would not be able to achieve the 10 Mbit/s specification set out in BT's proposal by the end of the proposed WLA charge control in March 2021 following completion of current state sponsored programmes and ongoing commercial rollout."*¹³

- 2.6 It is clear, therefore, that the network deployment envisaged in BT's proposal would not occur absent Government intervention and BT being assured that Government action would be taken to enable it to earn a return on its investment. It would be a material error of fact for Ofcom to characterise any of BT's costs in deploying a network to 'qualifying premises' as "efficiently incurred", or 'business as usual' in the context of providing WLA services.

Ofcom recognises that the costs of "network expansion" are distinct from other WLA costs

- 2.7 The abnormal nature of this network expansion is further evident from the way that the costs involved are treated separately by Ofcom from other costs incurred by BT in delivering WLA services. Ofcom is consulting separately on (i) these network expansion

¹¹ An RPI-X charge control, such as that used by Ofcom, may also require the regulated firm to reduce charges in real terms over the charge control period to provide an incentive for it to become more efficient.

¹² Page 1, BT's response to the Ofcom call for inputs on 'Designing the broadband universal service obligation' ("BT's 2016 Submission"). (https://www.ofcom.org.uk/data/assets/pdf_file/0019/42481/bt.pdf.)

¹³ Paragraph 2.3 of the Consultation. All paragraph references are to the Consultation unless otherwise indicated.

costs (the Consultation) and (ii) the other costs involved in the WLA market review. In the latest charge control consultation, which was published after the Consultation, Ofcom has included a line for “Additional cost for network expansion”,¹⁴ which is intended to take into consideration the outcome of the Consultation.¹⁵

2.8 Ofcom’s network expansion model is used to calculate a ‘surcharge’ for the financing of the cost of the proposed USO network expansion, which would be added to wholesale charges for WLA services calculated in the normal way. Such an approach is unprecedented.

2.9 These factors demonstrate clearly that the proposed network expansion cannot reasonably be regarded as a ‘business as usual’ investment for the purpose of setting charge controls for BT’s WLA services.

The magnitude of the investment is significantly higher than ‘business as usual’ investments

2.10 From the limited information available, the proposed USO investment would be the most significant infrastructure rollout programme undertaken by Openreach since its FTTC programme began. Both the forecast cost of the programme, at over half a billion pounds, and its extent – covering more than 450,000 households – indicate clearly that the proposed investment cannot simply be regarded as a ‘business as usual’ extension of BT’s existing network.

Openreach has failed to follow its own procedures for commercial investments

2.11 The unusual nature of BT’s USO network expansion is further indicated by the process by which it has been developed and announced.

2.12 It is now well-established that significant new investments by Openreach – particularly those that its wholesale customers are expected to pay for, via their wholesale charges – should be subject to consultation with its wholesale customers. Indeed, a requirement for Openreach to consult in this way has been central to the commitments recently given by BT to Ofcom (the “Commitments”)¹⁶. BT has committed to ensure that a formal consultation process is followed “in relation to significant investments related to the future development of Openreach LoB’s networks and products”.¹⁷ Although these commitments have not come into force, Openreach is expected to “act consistently with the spirit, as well as the letter of the Commitments.”¹⁸

2.13 However, despite the scale and significance of the proposed USO network expansion, and the proposal to recover its costs via wholesale charges for WLA services, there has been no consultation by BT with its customers. Instead, the proposal has been offered to Government, and announced out of the blue. Industry has only seen such details as have

¹⁴ Table 1.1, ‘Wholesale Local Access Market Review: Further consultation on proposed charge control for wholesale standard and superfast broadband’, Ofcom, 14 September 2017.

¹⁵ Paragraphs 3.162 and 3.163, *Ibid.*

¹⁶ ‘Commitments of BT plc and Openreach Limited to Ofcom’, BT, 10 March 2017. (<https://www.btplc.com/UKDigitalFuture/Agreed/CommitmentsofBTPlcandOpenreachLimitedtoOfcom.pdf>.)

¹⁷ Paragraph 11.2, Commitments.

¹⁸ Paragraph 2.19, ‘Delivering a more independent Openreach: Statement on releasing the BT Undertakings pursuant to section 154 Enterprise Act 2002’, Ofcom, 13 July 2017 (“Ofcom’s DCR Statement”). We comment in more detail on the implication of Openreach’s failure to consult its customers on the proposed network expansion at Annex 2.

been included in BT and Government press releases and BT's wholesale customers have been entirely excluded from providing any input.

- 2.14 This process provides further compelling evidence that the proposed USO network expansion cannot reasonably be regarded as 'business as usual'.

It is inappropriate to use SMP regulation to compensate BT for delivering a broadband USO

- 2.15 There are several reasons why Ofcom it is inappropriate to use SMP regulation to compensate BT for delivery of a universal broadband service.

A narrow base for the recovery of USO costs leads to distortions to competition and a greater risk of costs being passed on to consumers

- 2.16 Ofcom's 2016 Statement considered options for funding a 10 Mbps universal broadband service obligation in some detail, and set out key principles Ofcom considered that any such options should be evaluated against.

- 2.17 Ofcom identified two key considerations for determining the most appropriate method of recovery of the costs of USO investment: (i) the impact on competition among different types of operator, and (ii) the impact on providers' costs and their incentive to pass costs on to consumers in higher prices.

- 2.18 Ofcom's position in that statement on these issues was clear: the narrower the base of contributors to the recovery of USO costs: (i) the greater the risk of distortions to competition, and (ii) the higher the risk of costs being passed on to consumers in higher prices. Ofcom stated:

*"In general, spreading contributions as widely as possible across providers would reduce the potential for competitive distortion and the potential burden placed either on providers or their customers."*¹⁹

- 2.19 In relation to a proposal only to recover costs from all fixed broadband providers, Ofcom stated:

"A small base of contributors could increase the financial burden on contributors.

"If contributors passed the cost on to their customers, the impact on customers would be greater.

*"Risks distortions to competition if higher prices in the fixed broadband market cause consumers to substitute fixed broadband for mobile broadband."*²⁰

- 2.20 Ofcom's Statement did not consider the *even narrower* and discriminatory base for recovery of broadband USO costs now contemplated in the Consultation – which must give rise to even greater concerns about distortions to competition and higher prices to consumers.

- 2.21 A discriminatory increase in the input costs of operators that are dependent on Openreach's network would either result in a competitive distortion at the retail level or provide a windfall to operators that do not rely on Openreach's network. A competitive

¹⁹ Paragraph 9.17, Ofcom's 2016 Statement.

²⁰ Figure 9.2, *Ibid.*

distortion would occur if operators on Openreach's network passed on cost increases to consumers whilst Virgin Media, or other broadband providers, did not follow suit. This difference could make it harder for communications providers on Openreach's network, such as Sky and TalkTalk, to compete.

- 2.22 On the other hand, if Virgin Media and other broadband providers matched the higher prices of operators that depend on Openreach's network, this would result in them increasing their margins at the expense of consumers.
- 2.23 As Ofcom observed, the risk of costs of delivering a broadband USO being passed through to consumers increases the narrower the base for recovery of those costs because the amount of cost borne by operators increases. The wider the recovery base the smaller is the cost that each bears, increasing the likelihood that it is absorbed into their costs via reduced margins, rather than passed on to consumers.
- 2.24 In this context, it is important to note that the cost increases set out in the Consultation are non-trivial. Although the impact is small in the first year of the charge control (as relatively little investment cost has been incurred in this period), it increases rapidly, and by the end of the charge control period adds 2.3% to the annual charge for MPF rental – rising to over 3% thereafter²¹. At a time when UK consumers are under substantial pressure due to rising prices, an approach to the recovery of the costs of the broadband USO that is most likely to be passed onto them is particularly inappropriate.
- 2.25 Moreover, these additional charges would be levied on the most basic telecoms products, such as line rental, an area where Ofcom already has concerns about the charges faced by vulnerable customers.

The problem of determining the level of investment required

- 2.26 A further reason why it is inappropriate to recover the cost of the USO investment via regulated charges is that the level of such investment is critically dependent on the number of premises that must be addressed by the new network. Yet this number is a residual, and depends on (among other things) the number of premises covered by commercial rollout of high speed broadband services (by both BT and other operators), government funded programmes in Wales, Scotland and Northern Ireland, and those covered by Government's BDUK programme.²² There is a considerable level of uncertainty about both these variables – particularly the number of premises that will be covered by the Government's BDUK programme in which a substantial amount (around £650 million) of underspend has been identified and should be available for redeployment.²³
- 2.27 The dependency of the level of USO investment on these variables means that there is an exceptionally high level of uncertainty about the level of investment required to deliver the broadband USO. Accordingly, seeking to fund it through a guaranteed level of revenue delivered via regulated wholesale charges is wholly inappropriate: there is a significant risk that BT will be delivered windfall gains, by being provided with revenues that it does not need to fund USO investment that it, ultimately, does not need to make. It would be far more appropriate to fund *actual* investments made by BT *ex post*, via standard USO mechanisms.

²¹ Assuming that baseline MPF rental charges at least remain constant.

²² See paragraph 4.11 of Ofcom's 2016 Statement.

²³ The Great British Broadband Boost', DCMS press release, 9 September 2017. (<https://www.gov.uk/government/news/the-great-british-broadband-boost>.)

The proposed approach risks creating incentives to delay investment

- 2.28 The proposed approach, whereby BT is compensated for the costs of its proposed network extension via a surcharge levied on existing customers, gives rise to a risk of incentives to delay investment. Under RPI-X charge controls, once controls are set firms have a strong incentive to minimise costs in order to increase their profits. In relation to existing assets and operations, provided quality of service is maintained such an incentive is positive – it encourages regulated firms to become more efficient and such efficiencies can then be reflected in subsequent charge controls. Similarly, in the case of new investments this incentive encourages investments to be made at least cost, discouraging ‘gold plating’.
- 2.29 However, in the case of the proposed USO network expansion there would be a countervailing adverse incentive not to undertake all the planned investment during the charge control period. BT would receive the revenue guaranteed by the charge control, because it is levied on all existing users of its WLA services, regardless of how much of the USO network expansion it undertakes. Any shortfall in investment would increase BT’s profits.²⁴
- 2.30 The fundamental issue here is that charge controls have no mechanism for ensuring that planned investments that are reflected in regulated charges are actually incurred, or for the recoupment of payments made to a regulated firm where promised investments are not made. By contrast, this is exactly what is able to be achieved under bespoke USO approaches, where firms are compensated only for costs that they have actually incurred.

It is not legitimate to recoup the cost of the proposed broadband USO network expansion via SMP regulation

- 2.31 The standard USO framework provides the only legitimate way of recovering the costs of a broadband USO.
- 2.32 Member States are obliged to minimise market distortions when ensuring the implementation of universal service.²⁵ The USD is clear that:
- “Least market distortion 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.”²⁶*
- 2.33 The ‘least market distortion’ requirement is crucial to the proper and legal delivery of universal service. Government is bound by this requirement and, to the extent that the universal service provider is permitted to recover its costs, Government must either:²⁷
- (a) compensate the provider from public funds; or
 - (b) share the costs between providers of electronic networks and services, using a mechanism that is transparent, non-discriminatory and proportionate, and minimises market distortion.

²⁴ Of course, BT would be likely, *ex post*, to cite numerous obstacles which prevented it fully incurring all the costs of the planned investment during the relevant period.

²⁵ Article 3, USD.

²⁶ Recital 23, USD.

²⁷ Article 13, USD.

- 2.34 These options are exhaustive. Neither Government nor Ofcom can establish a compensation mechanism that does not fall within these categories. As such, Ofcom cannot introduce a compensation mechanism that recovers the costs of universal service network expansion from only some communications providers, or through an increased charge control which disproportionately affects those operators that acquire other WLA services from BT. This has been recognised by Ofcom, who recommended to the Government that the net costs of broadband rollout to qualifying premises should be paid for by all fixed broadband providers, if not more broadly.²⁸
- 2.35 Concomitantly, allowing BT to recover the cost of the proposed broadband USO network expansion via the WLA charge controls would be a misuse of Ofcom’s powers to impose SMP conditions.
- 2.36 Ofcom has the power to introduce SMP conditions where it is appropriate and proportionate for the purpose of promoting efficiency, promoting sustainable competition and conferring the greatest possible benefit on the end users of a public electronic communications service.²⁹ Ofcom’s power to impose price controls is intended to prevent excessive pricing or margin squeeze by an SMP operator in a market where there is ineffective competition.³⁰ SMP conditions cannot be used to compensate operators with market power for the costs of delivering public policy objectives pursuant to bilateral negotiations with Government.
- 2.37 Ofcom has undertaken no proper legal analysis of this issue. Ofcom’s only consideration of the legality of the proposed approach is at paragraphs 2.10 and 2.11 of the Consultation where Ofcom simply references the legal framework described in Annex 5 (Regulatory Framework) and Annex 6 (Approach to market definition and SMP assessment) to Ofcom’s March 2017 WLA Consultation. There is no discussion in those sections of the proposed network expansion, whether described as a commercial rollout or delivery of a USO.
- 2.38 Ofcom only considers different options for recovering the cost of the proposed broadband USO investment via regulated charges for BT’s wholesale services. In doing so, it fails to consider a key alternative option of the application of the universal service regulatory regime. This is a fundamental flaw in Ofcom’s analysis.
- 2.39 Notwithstanding this fundamental point, in order to assist it in conducting its assessment of whether the setting of an SMP condition is appropriate for its fulfilment of its statutory duties Ofcom has developed “*six principles of cost recovery*”³¹. Ofcom has sought to consider options for recovery of the cost of the proposed broadband USO investment against these principles in the Consultation. In doing so, however, Ofcom has had regard to irrelevant considerations and has failed to have regard to a number of important considerations.
- 2.40 Ofcom rejects three of the principles of cost recovery (cost minimisation, cost recovery and practicality) as being irrelevant to its decision in this case.³² We consider that in the case of practicality, in particular, the decision not to consider the option of recovery of

²⁸ Paragraph 9.16, Ofcom’s 2016 Statement.

²⁹ Section 88 of the Communications Act (2003). The relevant legislative framework for the setting of SMP conditions is set out at Annex 1.

³⁰ Recital 20 and Article 13, Directive 2002/19/EC of the European Parliament and of the Council of 7 March 2002 on access to, and interconnection of, electronic communications networks and associated facilities, as amended by Directive 2009/140/EC (the “Access Directive”).

³¹ These are set out at paragraph 6.11 of the Consultation.

³² Paragraph 6.12.

costs via the standard universal service regime leads to a material error in Ofcom's decision to exclude this matter from its analysis.

2.41 In relation to the remaining three principles (the impact on effective competition, cost causation and distribution of benefits), we consider that there are material errors in Ofcom's analysis:

- (a) the principle of effective competition: Ofcom's guiding principles require that "*the mechanism for cost recovery should not undermine or weaken the pressures for effective competition.*"³³ Yet the proposed mechanism for cost recovery would impose financial contributions on a segment of the market – namely, those operators that are dependent on the use of Openreach's network. By not requiring contributions from at least all fixed broadband providers, the inevitable result is a distortion of competition by conferring a pricing advantage on operators not reliant (or less reliant) on the Openreach services subject to the surcharge.
- (b) the principle of cost causation: Under the regulatory accounting principle of causality, costs must be allocated "*to the services that "cause" the costs (and revenues) to arise*"³⁴. As discussed above, however, the costs under contemplation in the Consultation would not be incurred pursuant to the delivery of BT's commercial WLA services. Ofcom recognises in the Consultation that none of the options available to it under its WLA proposals are consistent with the principle of cost causation.³⁵
- (c) the principle of distribution of benefits: Ofcom's guiding principles for cost recovery specifically recognise that costs should be recovered from the beneficiaries, especially where there are externalities. The beneficiaries from the delivery of broadband at speeds of 10 Mbps to premises across the UK would be numerous, extending well beyond end-users. As BT itself has acknowledged in its response to Ofcom's call for inputs, cost distribution should consider the breadth of players who sell and benefit from broadband. BT, for example, considers this to go beyond just communications providers to include players such as Amazon Prime, Netflix, Skype, Facebook, Google, and the BBC who benefit from enhanced connectivity.³⁶ By concentrating on a small sub-segment of fixed broadband retailers for the purposes of the recovery of the costs of the proposed broadband USO network expansion, Ofcom has failed to have regard to relevant considerations in relation to the distribution of benefits from that investment.

2.42 The reality is that a proposal to recover the costs of delivery of a broadband USO is not in conformity with the legal tests that Ofcom is required to meet when imposing or amending SMP conditions. It is an illegitimate application of that regime.

³³ Paragraph 6.11.

³⁴ Section 2.1, 'Guidelines for implementing the Commission Recommendation C(2005) 3480 on Accounting Separation & Cost Accounting Systems under the regulatory framework for electronic communications', ERG Common Position, ERG (05) 29. (http://berec.europa.eu/doc/publications/consult_accounting_sep/erg_05_29_erg_cp_rec_as_and_cas_final.pdf.) See also Schedule to section 5 of Annex 1 (Direction), 'Directions for Regulatory Financial Reporting', Ofcom statement, 30 March 2015. (https://www.ofcom.org.uk/data/assets/pdf_file/0018/59112/statement.pdf.)

³⁵ Paragraph 6.15.

³⁶ Page 10, BT's 2016 Submission.

SECTION 3: THE USO FRAMEWORK IS THE RIGHT WAY TO RECOVER COST OF DEPLOYMENT

- 3.1 The proposal to apply the SMP framework to the recovery of the costs of the proposed broadband USO network expansion is all the more perplexing in view of the fact that there is a clear, well-established legal framework – the universal service framework – that facilitates the roll-out of broadband services to areas where there is no business case for commercial deployment. Not only is this the more legitimate method of compensating BT (or any other universal service provider) for the costs of delivering a universal broadband service, it has clear advantages for consumers and operators over the proposed route set out in the Consultation.

The USO framework is designed to secure delivery of universal service in an appropriate way

- 3.2 The objective of the universal service framework is simple: it enables Government to secure the delivery of a minimum set of services to all end-users at an affordable price, whilst minimising any distortion of competition by ensuring that providers are compensated for the net costs involved and that the net cost burden is recovered in the most competitively neutral way.³⁷
- 3.3 In other words, the universal service framework enables Government to do precisely what it is trying to achieve: to ensure that consumers have a broadband connection with download speeds of at least 10 Mbps, and that the service provider is compensated appropriately. It is wholly unclear why Government (and Ofcom) would attempt to deliver a universal broadband service within the SMP regulatory framework when the universal service framework has been designed for this purpose.

The USO framework ensures that the USO is delivered in a transparent, accountable and efficient manner

- 3.4 In contrast to the proposal to recover the costs of BT's USO network expansion via revenues from regulated services, the USO framework ensures that the USO is delivered in a transparent, accountable and efficient manner.
- 3.5 Under the universal service framework, the universal service provider must publish information about its compliance with the USO, including details about its compliance with technical specifications and quality of service parameters.³⁸ Ofcom may also appoint an auditor to review that published information.³⁹
- 3.6 Additionally, under the universal service framework, Ofcom would be required to publish an annual report setting out the cost of meeting the USO, identifying contributions made by undertakings and identifying market benefits that have applied to the universal service provider.
- 3.7 This transparency in respect of (i) the universal service provider's delivery against its commitments, and (ii) the costs of meeting the USO, helps mitigate the risk that universal service providers are over-compensated. Ofcom would be able to use these publications to ensure that the universal service provider is meeting its obligations, is only compensated for those costs that it has efficiently incurred, and repays any contributions from the universal service fund if they are no longer considered appropriate.

³⁷ Article 4, USD.

³⁸ S.67(2), CA03.

³⁹ S.67(5), CA03.

- 3.8 The USO framework also enables the benefits that an operator receives from providing a universal service to be taken into account when determining the amount of compensation. The USD is clear that a universal service provider may only recover the “net cost” of providing the universal service, which is “the difference between the net cost for a designated undertaking of operating with the universal service obligations and operating without the universal service obligations”⁴⁰. By contrast, under the approach proposed in the Consultation, BT recovers the full cost of its investment; no account is taken of any benefits that it accrues from providing a universal broadband service.

The USO framework is flexible and can accommodate changes in the minimum broadband specifications

- 3.9 Under the UK legislative framework for universal service, the Secretary of State may direct Ofcom to review and report to Government on any aspect of the universal service order.
- 3.10 As Ofcom recognised in its technical advice to Government, the ability to review the universal service policy is a key benefit of a USO.⁴¹ The importance of an appropriate review mechanism reflects the pace at which consumer demand for internet services has evolved and the likelihood that “demand for connections that are faster, or more highly specified in other ways (e.g. contention) will grow in the future.”⁴² Likewise, prior to any existing USOs being amended, proper consideration would also need to be given to the evolution of supply and innovations in delivery the technologies available.
- 3.11 In light of the potential to create inefficiencies and disincentives for broadband investment, the process for USO revision must ensure that further intervention is proportionate and non-discriminatory and, importantly, pursuant to adequate consultation with industry. This is exactly what the USD seeks to achieve.

The USO framework can achieve the benefits of demand aggregation

- 3.12 BT has asserted that its voluntary proposal enables a more efficient rollout than the universal service framework due to its ability to aggregate demand. This is fallacious. A universal service provider is able to stimulate demand and aggregate it through publicity, much as BT would do if it pursued its voluntary proposal and as it has done when deploying broadband services, whether commercially or funded by BDUK.

The USO framework enables Government to appoint different universal service providers

- 3.13 While Sky anticipates that BT would be designated the universal service provider in the majority of the UK, an open and transparent process would, at least, allow other players to put themselves forward in certain regions both at this stage and for future USO projects. The USD requires that the designation of the universal service provider is done through an efficient, objective, transparent and non-discriminatory mechanism, where no undertaking is *a priori* excluded from the process.
- 3.14 Whilst Ofcom raised concerns as to likelihood of a competitive process to bring forward interested providers, the alternative process laid out in Ofcom’s 2016 Statement was a process whereby all providers are considered and an appropriate provider is chosen subject to a proper consultation process. Ofcom’s intention in this regard would be “to

⁴⁰ Annex IV, Part A, USD.

⁴¹ Paragraph 12.1, Ofcom’s 2016 Statement.

⁴² *Ibid.*

designate the most efficient USP(s) to ensure overall policy costs policy are proportionate, and the minimum level of funding is required.”⁴³

- 3.15 The proposal by Government to enter into a bilateral arrangement with BT which informally designates BT as the UK’s universal service provider has the effect of circumventing both these proposals for USO designation. The result is a less effective, discriminatory and opaque process which *a priori* excludes all but BT from designation and removes the incentive for efficient investment from the very beginning.
- 3.16 It potentially also leaves Government beholden to BT in allowing BT to make changes to the services delivered to these ‘qualifying premises’ or investing in further network expansion and requiring either its original request of regulatory forbearance⁴⁴ or for its wholesale customers to cover a proportion of these additional costs. These highly undesirable outcomes would be avoided under the standard USO framework.

The USO framework has been used to improve broadband access throughout the EU

- 3.17 The Universal Service framework, together with the rest of the Communications Regulatory Framework, sets out clear processes to harmonise communications regulation throughout the EU. These processes for specifying the criteria for minimum service, identifying the universal service provider and recovering costs have been successfully implemented in five EU Member States,⁴⁵ with several other European countries are also considering introducing similar universal broadband service requirements.
- 3.18 As part of its technical advice to government, Ofcom considered a number of international case studies.⁴⁶ Ofcom found that where ‘formal’ broadband USOs have been implemented, they vary in technical specificity, speed and the mechanisms implemented for funding the net costs of the service. Outside the formal USO route, Ofcom identified several countries that have introduced mechanisms to secure universal availability of affordable broadband.⁴⁷
- 3.19 There are *no* examples of universal service being delivered under an arrangement similar to the one proposed by BT. Significantly, Ofcom did not identify any cases where national regulators considered it appropriate to allow the costs of universal service to be passed on to industry through wholesale access charges. In all cases, whether universal service broadband is delivered through a legislative USO or a mechanism falling “*outside the formal broadband USO*”⁴⁸, the costs of delivery are borne by: (a) the universal service provider itself (where there is no net cost to the operator); (b) government; or, as in most instances, (c) industry, through contributions to an industry fund.
- 3.20 Having recognised the successful introduction of a broadband USO by a number of national regulators, Ofcom now proposes to disregard EU and international precedent and to depart from the bespoke framework established by the USD. Neither Ofcom nor Government has put forward a reason for this departure from the framework.

⁴³ Paragraph 11.6, Ofcom’s 2016 Statement.

⁴⁴ Page 8, BT’s 2016 Submission.

⁴⁵ Paragraph A9.1, Ofcom’s 2016 Statement.

⁴⁶ Annex 9, *Ibid.*

⁴⁷ Paragraph A9.3, *Ibid.*

⁴⁸ *Ibid.*

SECTION 4: FURTHER FLAWS IN OFCOM'S APPROACH

- 4.1 As set out above, it is neither appropriate nor legitimate to recover the costs of the proposed extension to BT's network, required to deliver a universal high speed broadband service, via charges for BT's WLA services. The points set out in this section of Sky's response are submitted without prejudice to this fundamental point.

The Consultation is premature and procedurally flawed

- 4.2 A fundamental concern with the Consultation is the lack of certainty regarding whether BT will commit to expand its network and, if so, how it will do so.
- 4.3 In Ofcom's March 2017 WLA consultation, Ofcom noted that BT could use LR-VDSL and other new technologies in difficult to reach areas through commercial deployment, alongside any USO but that it did "*not have sufficient data on which to assess whether BT will undertake such a rollout or what costs may be incurred*"⁴⁹. That position remains the same today. Little has been published about BT's proposal, and the Consultation takes a speculative approach about what would be provided by BT and how. We understand that Government itself has little more certainty at this stage.
- 4.4 As noted above, there is also significant uncertainty surrounding the number of premises that need to be covered by the network expansion, and the total cost of the investment.
- 4.5 The present circumstances are very similar to those arising from the four mobile network operators' agreement to extend voice and text coverage to 90% of the geographic land mass of the UK.⁵⁰ In that case, Ofcom resisted calls to consult on the full impact of the Government agreement on annual licence fees until *after* the mobile network operators' licences had been formally varied. At that point the operators' obligations were absolutely clear, legally binding and had a defined legal framework for enforcement.
- 4.6 These material uncertainties render the Consultation premature. There are insufficient details regarding BT's proposal for Ofcom to evaluate its implications properly at this point in time, or for stakeholders to comment on its detail effectively. As a result, the current consultation is procedurally flawed

The proposed approach risks extending the charge control lacuna

- 4.7 Currently, there is a 'lacuna' in the charge control for BT's WLA services whereby the previous charge control has come to an end without a new control being put in place. Such lacunae are typically significantly disadvantageous to purchasers of BT's WLA services and their customers, given that new charge controls are often set at lower levels than previous charge controls. That is almost certainly the case with the current lacuna.
- 4.8 The proposal to recover the costs of BT's USO network investment from regulated WLA charges raises significant, complex issues that are likely to require considerable time and effort on Ofcom's part to work through. In line with its previous responses to Ofcom's WLA consultations, there is little doubt that BT and Openreach will also deliver large submissions on Ofcom's approach, raising many points that will need to be taken into account. As a result, there is a significant risk that the current proposal will result in

⁴⁹ Paragraphs 1.29 and 1.31, 'Wholesale Local Access Market Review', Ofcom consultation, 31 March 2017 ("Ofcom's March 2017 WLA Consultation").

⁵⁰ 'Government secures landmark deal for UK mobile phone users', DCMS press release, 18 December 2014. (<https://www.gov.uk/government/news/government-secures-landmark-deal-for-uk-mobile-phone-users>.)

further delays to the start date for the new charge control, and further detriment to consumers.

It is inappropriate to apply current cost accounting to the proposed investment

4.9 It is standard practice for Ofcom to apply current cost accounting to BT's assets when calculating wholesale charges for its services (at least for assets purchased after 1997).

4.10 However, the use of current cost accounting has a specific rationale: to ensure that charges are set that send appropriate entry decisions to potential rival infrastructure operators. Ofcom has put this as follows:

*"The reason for the change [from historic cost accounting to current cost accounting] is that it allowed regulated prices to be set based on what it would cost to replace the network or for somebody else to build the same thing. Thus, if somebody could do it cheaper than BT then they should be encouraged to build their own network and under-cut BT's prices. Ofcom still believes that this is the right way to do things **where, as in most cases, entry signals are a major consideration.**"⁵¹*
(Emphasis added.)

4.11 A key issue with the use of current cost accounting is that the depreciation charge on relevant assets is maintained as long as the assets remain in use, at levels that are normally significantly higher than those that would arise under a historic cost accounting approach, particularly later in the lifetime of those assets.

4.12 Accordingly, in circumstances where entry signals are not a major consideration, it would be preferable to include depreciation in the calculation of wholesale charges on a historic cost basis.

4.13 The proposed investment is one where entry signals are wholly irrelevant. The areas of the UK where the proposed investment will occur are those where deployment of high speed broadband is deemed to be uncommercial for one operator, let alone competitors.

4.14 There is no practical impediment to calculating depreciation on the proposed USO investment on a different basis to the rest of BT's access network. Ofcom has already constructed a separate model for this investment, which is intended to be used to calculate surcharges to be added on to wholesale charges calculated in the normal way. All that is required is that Ofcom calculates the depreciation component of these surcharges based on a historic cost accounting methodology within its separate model, which will result in a declining depreciation charge, and a lower surcharge, as the assets grow older.

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⁵¹ Paragraph 1.5, 'Valuing copper access: Final statement', Ofcom, 18 August 2005.

ANNEX 1: THE RELEVANT LEGAL PROVISIONS

A1.1 This section sets out the legal provisions that are relevant when imposing a charge control via an SMP condition and why, based on those provisions, Ofcom's approach in the Consultation is procedurally flawed and, if implemented, would be *ultra vires*.

SMP Conditions are intended to foster competition, not to secure revenue for inefficient investments, even if those investments are socially desirable

A1.2 Ofcom may impose SMP conditions under s.45 CA03. This includes the ability to impose price controls.⁵² This power derives from Article 8 of the Access Directive, which permits regulators to impose price controls:

"in situations where a market analysis indicates that a level of effective competition means that the operator may sustain prices at an excessively high level, or may apply a price squeeze, to the detriment of end-users".

A1.3 Plainly this is not the position in the current case. The Consultation envisages BT's customers paying for inefficient investment by BT, rather than protecting them from a price squeeze.

Ofcom has failed to take account of key factors prior to proposing an SMP Condition

A1.4 Prior to imposing an SMP condition, Ofcom must be satisfied that the condition.⁵³

- (a) is objectively justifiable in relation to the networks or services to which it relates;
- (b) does not discriminate unduly against any persons or group of persons;
- (c) is proportionate to what the condition is intended to achieve;
- (d) is transparent in relation to what it is intended to achieve.

A1.5 Specifically in respect of SMP conditions relating to network pricing, Ofcom must be satisfied that:⁵⁴

- (a) absent the SMP condition, there is a risk of adverse effects arising from price distortion. This arises where an SMP operator may set its prices at an excessively high level or impose a price squeeze with adverse effects on end users; and
- (b) the condition is appropriate to promote efficiency, promote sustainable competition and confers the greatest possible benefit on end users of public electronic communications services.

A1.6 Further, Ofcom may only act in accordance with its general duties and in accordance with its duties for the purpose of fulfilling EU obligations. This means that Ofcom must:

- (a) further the interests of citizens in relation to communications matters and to further the interests of consumers by promoting competition;⁵⁵

⁵² Section 87(9)(a), CA03.

⁵³ Section 47(2), CA03.

⁵⁴ Section 88, CA03.

- (b) have regard to the principles of transparency, accountability, proportionality and consistency;⁵⁶
- (c) ensure that actions are targeted only at cases in which action is needed;⁵⁷
- (d) have regard to the desirability of promoting competition in relevant markets;⁵⁸
- (e) have regard to the interests of consumers in respect of choice, price, quality of service and value for money;⁵⁹ and
- (f) act in accordance with the Community requirements.⁶⁰ These include the requirement to promote competition; to secure that Ofcom's activities contribute to the development of the European internal market; to promote the interests of all EU citizens; to take account of the desirability of technical neutrality; to encourage the provision of network access and interoperability; and to encourage compliance with applicable standards.

A1.7 It is not clear to Sky how Ofcom can be satisfied that the above factors are met in relation to the proposal set out in the Consultation. As noted at paragraph 2.37, above, there is no discussion of these issues in the Consultation or in Ofcom's March 2017 WLA Consultation.

⁵⁵ Section 3(1), CA03.

⁵⁶ Section 3(3), CA03.

⁵⁷ *Ibid.*

⁵⁸ Section 3(4)(b), CA03.

⁵⁹ Section 3(5), CA03.

⁶⁰ Section 4, CA03.

ANNEX 2: FAILURE BY BT TO CONSULT ITS WHOLESALE CUSTOMERS ON THE PROPOSED USO NETWORK EXPANSION IS CONTRARY TO THE COMMITMENTS RECENTLY GIVEN TO OFCOM

- A2.1 As part of its Strategic Review of Digital Communications (“DCR”), Ofcom recognised the need to remove BT’s ability to discriminate against its competitors by taking network investment decisions which favoured its downstream retail business. The desire to address this systemic failure and ensure independent decision-making by Openreach in relation to network investment was central to its consideration of BT’s Commitments.
- A2.2 In accepting the Commitments from BT, Ofcom placed has significant weight on the ability of the proposals to remove BT Group’s ability to influence Openreach’s network investment decisions on the basis that, going forward, Openreach: (a) will be responsible for setting its own strategy; and (b) will consult with its customers on major future network investment decisions.⁶¹
- A2.3 Among the measures proposed to be put in place by BT to ensure the decision-making independence of Openreach, it has committed, through both the Openreach Board and the Openreach executive, to ensure that:
- (a) a formal consultation process is followed “*in relation to significant investments related to the future development of Openreach LoB’s networks and products*”; and
 - (b) that, as part of this process, all communications providers are treated equally and their representations are considered and addressed.⁶²
- A2.4 Whilst the Commitments have not yet formally come into force, Ofcom has made clear its expectation that Openreach operates “*with greater independence and a focus on the equal treatment of its customers from the outset, even before the Commitments formally come into effect*.”⁶³ The requirement for Openreach to adhere as far as possible to the Commitments ahead of formal adoption is consistent with Ofcom’s requirement that Openreach and BT “*live by the ‘spirit’, as well as the ‘letter’, of the Commitments, developing a culture that values independent decision-making*.”⁶⁴
- A2.5 Accordingly, it is of profound concern to find no consultation at all on the first major network investment proposed by BT since the agreement of the Commitments. The decision making process by which the offer has been made by BT, as well as the details of the offer itself, remain entirely hidden from and uninformed by consultation Openreach’s customers. Ofcom concluded in its DCR that, given the risks to competition that it had identified, continuing the *status quo* in terms of BT’s current decision-making process was not an option. Yet BT’s decision to make a ‘voluntary offer’ to Government to deliver the broadband USO, with the cost to be met via charges to its wholesale customers, is entirely in line with the *status quo*.
- A2.6 BT’s voluntary proposal to Government runs contrary to the letter of BT’s Commitments for two reasons:

⁶¹ Page 10, Ofcom’s DCR Statement.

⁶² See Commitment 11, Commitments.

⁶³ Paragraph 1.29, Ofcom’s DCR Statement.

⁶⁴ Paragraph 1.21, Ofcom’s DCR Statement.

- (a) the decision to make the offer, which commits Openreach to substantial network investment, appears to have been taken at BT Group level and does not reflect an independent decision-making process led by Openreach; and
- (b) the proposed network expansion, which BT estimates would involve an investment of between £450m and £600m, clearly constitutes a “*significant investment related to the future development of Openreach LoB’s networks and products*”, requiring proper consultation with communications providers through the proposed Openreach Customer Consultation Process.⁶⁵

A2.7 The failure to engage in any form of customer consultation in relation to the proposed investment highlights BT’s intention to continue to exert influence over Openreach decisions and avoid appropriate consultation with communications providers for as long as Ofcom allows. Ofcom has described the degree and nature of Openreach-led engagement with industry on major, strategic network investment as one of the metrics by which it will measure the effectiveness of the Commitments.⁶⁶ By this measure the Commitments are already failing to address Ofcom’s concerns.

A2.8 If Ofcom is to adhere to its stated intention of holding BT to both the letter and the spirit of the new model, the only appropriate course is for BT to publish full details of its proposals to Government and consult properly with its wholesale customers before taking any decision about whether to submit a proposal to Government to expand its network.

⁶⁵ Paragraph 11.2, Commitments.

⁶⁶ Paragraph 1.26, ‘Delivering a more independent Openreach Update on BT’s voluntary notification under s.89C Communications Act 2003 and consultation on releasing the BT Undertakings pursuant to section 154 Enterprise Act 2002’. Ofcom consultation, 17 March 2017. (https://www.ofcom.org.uk/_data/assets/pdf_file/0035/98855/Openreach-consultation-2017.pdf.)

ANNEX 3: OFCOM'S CONSULTATION QUESTIONS

Question 3.1: Do you agree with our approach to assessing the number of qualifying premises to include in our analysis? Please provide reasons and evidence in support of your views.

- A3.1 No. Sky does not agree with Ofcom's approach to assessing the number of qualifying premises. There is too much uncertainty regarding future commercial deployment by BT, Virgin Media and other infrastructure operators for Ofcom to form a view on the number of qualifying premises. Further, it is uncertain how many premises that are not commercially viable would be connected as part of the BDUK rollout.
- A3.2 This uncertainty makes it even more important to ensure that there are rigorous procedures in place to ensure that BT is not over-compensated (such as a clawback mechanism) and that it is incentivised to roll out any USO network in the most efficient manner.

Question 4.1: Do you agree with our approach to assessing the technologies and technology mix that should be used as the basis for calculating the costs of BT's proposed rollout? Please provide reasons and evidence in support of your views.

- A3.3 No. Sky does not agree with Ofcom's approach to assessing the technologies and the technology mix. LR-VDSL has been excluded on the basis that full cabinet migration costs would be higher. The benefits to BT may also be significantly greater and Ofcom has made no attempt to estimate these benefits.
- A3.4 Ofcom recognises in the Consultation⁶⁷ that there is considerable uncertainty around the costs relating to:
- (a) migrating customers on ADSL, ADSL2+ and SDSL onto LR-VDSL;
 - (b) other communications providers' system development to use Openreach fibre systems;
 - (c) project management in Openreach and other telecoms providers in liaising to ensure customer migration is effectively managed;
 - (d) reduced usage of LLU (e.g. the costs of ceasing and removing tie cables).
- A3.5 Similarly, Ofcom does not have clarity over how BT would serve Exchange Only lines, or how BT would use a fibre to the remote node approach (whether G.Fast or VDSL2).⁶⁸
- A3.6 It is premature to have a consultation on BT's costs of network expansion before Ofcom has a basic understanding of these costs, let alone a proper understanding of them.

Question 5.1: Do you agree with our proposed approach to modelling the costs of BT's proposed network expansion? Please provide reasoning for your answer.

- A3.7 Please see Section 4 of this response, which sets out Sky's reasons for its view that depreciation in Ofcom's model should be calculated on a historic cost basis rather than current cost.

⁶⁷ Paragraph 4.22.

⁶⁸ Paragraphs 4.25 and 4.26.

Question 6.1: Do you agree with our proposal to recover the costs over all broadband lines?

A3.8 No. Sky considers Ofcom's approach to be too narrow. The USD, which was designed to facilitate universal service rollout, states that costs must be recovered from public funds or by sharing the costs between providers of electronic networks and services, using a mechanism that is transparent, non-discriminatory and proportionate, and minimises market distortion.

A3.9 Ofcom's proposed approach would share the costs of USO network deployment across Openreach's WLA customers only. Ofcom itself did not consider such a narrow distribution of the costs in the December 2016 Statement. In that Statement, Ofcom it considered that, at the very least, all fixed broadband providers should contribute to the rollout of broadband services to qualifying households.

Question 6.2: Do you agree with our proposed approach to implementing recovery from all broadband lines?

A3.10 No. Sky does not agree with Ofcom's approach at implementing recovery from all lines. The very basis of this approach is flawed as, for the reasons set out in response to Question 6.1 above, it contravenes the USD.