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# Three's response to Ofcom's consultation on compensating providers delivering universal services

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## Non-Confidential

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# Executive Summary

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Universal services are important to ensuring that everybody has reasonable access to telecoms services wherever they live. Where the market fails to provide this basic level of service, a subsidised solution may be required. The failure to provide basic broadband services to fixed locations across the UK is a failure of the fixed broadband market: one that fixed operators, or Government, should carry the burden for.

There is currently no Universal Service Obligation (USO) for mobile services. Yet over the past decade the industry has implemented several measures to increase mobile coverage across the country for the benefit of UK consumers: from the 2014 agreement with Government to provide coverage to 90% of the UK landmass by 2017, to the Shared Rural Network which will see 95% of the UK's landmass covered by mobile broadband by 2025.

In developing these initiatives, mobile operators have never sought funding from fixed telecoms operators. For the final 1% of premises therefore, it is right that fixed operators – or Government, should it choose to – cover any net cost burden that might arise from BT/KCOM delivering the fixed broadband USO.

In this document, we set out why including mobile operators in an industry fund would not be fair or consistent with the principles of least market distortion, transparency, proportionality or no undue discrimination. In addition, we set out considerations for the process in calculating net cost including the new types of intangible benefits that must be considered; as well as the timeline for considering net cost claims.

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# 1. Introduction.

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## 1. Introduction

- 1.1. This document sets out Three's response to Ofcom's consultation on compensating providers delivering universal services published on 7 November 2019.
- 1.2. Our response covers two broad areas:
  - **The potential inclusion of mobile operators in an industry fund:** we do not consider that mobile operators should be included in any net cost sharing mechanism as it would violate the principles of, proportionality, transparency and no undue discrimination. In addition, we do not consider that having a fixed-only industry fund (i.e. by excluding mobile) would cause market distortion. We cover these points in section 2.
  - **The comprehensive assessment of BT's benefits from providing USO:** Ofcom has indicated that these might be low or insignificant. We disagree and suggest that the expansion of BT's brand to include EE, BT Mobile and BT TV may give a new value to these indirect benefits, as well as larger direct benefits. We cover these points in section 3.
- 1.3. We conclude on the above two points in section 4 and additionally address each questions of the consultation in section 5 for completeness.

## 2. Mobile providers should not be part of an industry fund.

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### 2. Executive summary

- 2.1. The Universal Service Directive, which provides the regulatory framework for the Universal Service Obligation (USO), gives three options for funding any unfair net cost burden on the designated Universal Service Provider(s): public funding, an industry fund, or a combination of the two.
- 2.2. The Government is in favour of an industry-funded mechanism. An industry fund would enable BT to recover any unfair net cost of the obligation via contributions to a fund by others in the sector. Ofcom has said that it has the power to recover costs from providers of Electronic Communications Networks (ECNs), providers of Electronic Communication Services (ECSs) or a subset of both these groups. Ofcom does not think it appropriate to specify a particular set of contributors in the funding regulations.
- 2.3. Ofcom will base the decision on which ECNs or ECSs should contribute based on the principles of least market distortion, transparency, proportionality and no undue discrimination. When assessing least market distortion, Ofcom indicates that a wider pool of contributors will reduce the amount each must contribute, and therefore the chances of market distortion.
- 2.4. Ofcom will consider the group of contributors on a case-by-case basis in respect of each net cost claim.
- 2.5. We understand that each net cost claim may carry specific considerations on who the contributors to any potential fund should be. However, we feel that this should be balanced with the uncertainty that leaving open decisions creates for the wider industry. Given the regulation follows the recent development of a particular USO (i.e. the provision of 10Mbit/s broadband to a fixed location), we consider a more developed analysis of principles for industry funding would hold true for all net cost claims until the nature of the USO changes in the future.
- 2.6. Therefore, with this in mind, we have set out why mobile operators should not contribute to an industry fund for this USO:
  - Given the mobile industry's work on the Shared Rural Network in preventing social and economic disadvantage with respect to communications, having to contribute to a similar exercise for the fixed broadband industry, for which objectives only differ by minor technical differences is disproportionate;
  - Requiring mobile to contribute to upgrades in the Openreach network which other fixed operators will benefit from in the medium to long term (and from which mobile will never benefit) is discriminatory;
  - Remaining public funds for fixed roll-out programmes is likely to make any industry funding mechanism less transparent; and

- Fixed broadband and mobile broadband are not substitutable services, as set out in the Wholesale Local Access market review. Therefore, not including mobile will not cause distortion in the fixed market.

2.7. Given this analysis, we consider that Ofcom should analyse further who should be contributing to the current version of the USO.

### **Given the mobile industry's initiatives in bringing coverage to all, contributing to a fixed industry version is disproportionate**

2.8. The USO was set up as a result of an assessment of the state of broadband usage across the UK and the availability of those services to those who were not able to attain the average connection speed. Crucially, this analysis used to set the objective for the USO was based wholly on an analysis of fixed broadband provision.

2.9. In its advice to Government, Ofcom set out evidence about the objective of a 10Mbit/s USO based on the performance of fixed connections taken up by the UK population<sup>1</sup>. Whilst there was an assessment of whether mobile will be suitable to deliver the USO at 10Mbit/s and other technical characteristics, it is clear that mobile broadband was not considered in the objective of setting a 10Mbit/s broadband USO. Notably, chapter 4 of that document ("What is the scale of the problem?") was entirely an analysis of how fixed technologies at the time failed to guarantee 10Mbit/s for certain customers.

2.10. Clearly this focus on fixed broadband is because fixed broadband is the predominant technology used for the accessing functional internet at a fixed location. But most of the analysis used for setting the objective misses the very similar aims of policies in the mobile sector which seek to bring mobile broadband coverage to underserved areas across the country:

- **800MHz licence coverage obligation:** an obligation was placed on one 800MHz licence to provide 2Mbit/s broadband indoors to 98% of premises across the UK<sup>2</sup> by the end of 2017. Telefonica fulfilled these conditions by the end of 2017. Due to competition in the mobile sector, the rest of the industry also provide indoor mobile data coverage to 98% of premises.<sup>3</sup>
- **Voice coverage obligation:** In 2015<sup>4</sup>, MNOs agreed to an obligation to provide voice coverage to 90% of the UK's landmass by the end of 2017. All four MNOs met this obligation by the end of 2017.
- **Shared Rural Network:** In November 2019, the four MNOs and Government agreed in principle a proposal to develop a shared rural network to achieve 95% 4G mobile landmass coverage by 2025. The plan will see 280,000 additional premises covered by 4G mobile in that period

2.11. These initiatives are funded through interactions between the Government and MNOs<sup>5</sup>. In the case of the Shared Rural Network, MNOs will be funding a significant proportion of the coverage improvement themselves. Notably, these initiatives, which all had the objective of reducing the social and economic disadvantage faced by consumers not having access to voice and data services, were not funded by the fixed telecoms industry.

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<sup>1</sup> Ofcom, *Achieving decent broadband for everyone, Technical advice to UK Government on broadband universal service*, December 2016

<sup>2</sup> Additional conditions were placed on each constituent nation of the United Kingdom

<sup>3</sup> Ofcom, *Connected Nations Summer 2019 update, dashboard, low speed data coverage all operators*

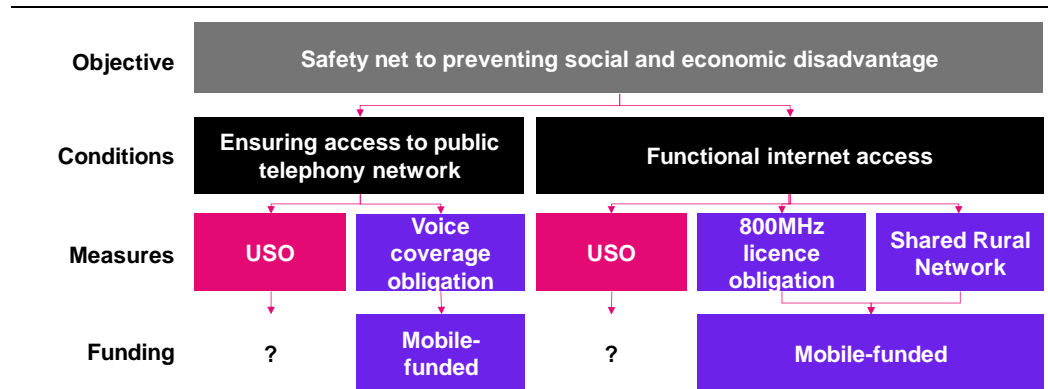
<sup>4</sup> Ofcom, *Voice Coverage Obligation Notice of Compliance Methodology*, January 2015

<sup>5</sup> i.e. Implied discount on the auction price of the coverage obligation licence or reduced Annual Licence Fees for 900MHz/1800MHz licences

## Mobile providers should not be part of an industry fund. continued

2.12. We show this relationship below in Figure 4, where we look at the main initiatives of the current USO. The mobile industry initiatives discussed above fulfil both the general access to a public telephony network (through the voice coverage obligation) and functional internet access (800MHz licence obligation and the Shared Rural Network).

**Figure 4: Relationship between objectives and initiatives.**



Source: Three analysis

### Requiring contributions from non-Openreach access operators would be discriminatory

2.13. A key part of Ofcom's principles of setting up an industry fund is 'no undue discrimination'. This would rely on treating all contributors equally and ensuring that no contributor gains or loses out more than any other contributor.

2.14. Ofcom noted in the consultation that:

*"...there may be particular types of USO interventions which could stand to deliver additional benefits to certain providers... In such cases, it may be appropriate to consider whether the type and/or scale of those benefits may mean that those providers...are differently situated to other providers."*

2.15. According to BT's proposal as set out in their response to a 2018 Ofcom consultation<sup>6</sup>, out of the 600,000 USO-eligible premises, BT will:

- cover 450,000 with commercial Fixed Wireless Access (FWA);
- not be able to serve 110,000 premises because they will exceed the reasonable request threshold of £3,400<sup>7</sup>; and
- be required, therefore, to provide broadband universal service to the 40,000 remaining premises who currently are out of specification.

2.16. KCOM has explained<sup>8</sup> that it has now completed its FTTP rollout across its areas, and therefore can provide the USO to all properties, presumably with no further funding required.

<sup>6</sup> *Implementing the broadband Universal Service Obligation BT's Response to Ofcom's request for expressions of interest in serving as Universal Service Provider for broadband*, 4 September 2018, Updated January 2019

<sup>7</sup> Further analysis in BT's submission suggests that the majority of those properties significantly exceed the threshold, which means that they are unlikely to be able to cover any excess costs

<sup>8</sup> <https://www.kcomgrouppltd.com/about-us/our-business/news-and-media/hull-becomes-uk-s-first-city-to-complete-rollout-of-ultrafast-full-fibre-broadband/>

- 2.17. We note that as FWA is being offered commercially by BT, it does not require compensation from an industry fund. We also note that BT's proposed escalation process for any unexpected poor performance of its FWA product eventually requires it to build a fixed network solution for individual USO requestors.
- 2.18. As a result, any potential funding from a USO will be purely aimed at investing in BT's fixed broadband infrastructure, and in particular, in Openreach access network assets.
- 2.19. If BT were the only potential provider of retail services to the USO customer, then, in theory, any gains that BT makes (retail margins, intangible benefits) would be offset by costs in the net cost calculation to make BT no better, no worse off, in accordance with the principles of the Universal Service Directive.
- 2.20. However, as Ofcom states, the USO product is not a special product that is exempt from competition. As soon as the initial contract period is completed for the USO customer, they are free to switch to any other available Openreach or BT Wholesale broadband provider. We note that this is a strong possibility: in Ofcom's Connected Nations 2018 report, it reported whilst 70% of premises were located in rural areas, 30% were in urban areas. In addition, according to Ofcom's most recent Wholesale Broadband Access Market review (2018), the proportion of premises connected to exchanges with no competition from non-BT fixed operators (Market A) has dropped dramatically to 0.9% of UK premises. There is potentially a good chance, therefore, that even rural premises have a choice of fixed broadband providers.
- 2.21. As a result, the USO funding regime is subject to perverse incentives from non-BT Openreach operators. Namely:
- These operators (such as Sky and TalkTalk) can win customers after one or two years depending on the customer's initial term with BT. They will then benefit from retail margins which would otherwise have been earned by BT.
  - This will also result in the net cost being higher as BT loses retail margins from the USO customer after the initial contract term is finished. The gains made by the other Openreach operators are not taken into account in the net cost calculation. As a result, all industry contributors pay into a fund that operators which use Openreach's network would disproportionately benefit from.
- 2.22. It is clear, therefore, that those operators on the Openreach network will benefit from network upgrades that they, through must-offer practices now or in the future, will be able to serve customers on. MNOs on the other hand will only end up paying for additional increases in net cost should the universal service provider lose the retail margin gains from providing the USO.
- 2.23. Therefore, it is more efficient and non-discriminatory to restrict the group of providers who contribute to the USO to those who are likely to benefit from the infrastructure upgrades: the fixed broadband providers.

### **With many public sector funding schemes still active, the assignment of funding is unlikely to be transparent**

- 2.24. There are still a number of public sector funds available for the development of fixed broadband across the UK.



- 2.25. The Reaching 100 programme (Scotland), Superfast Cymru (Wales), and the Local Full Fibre Networks programme (all-UK) are still active and could see a further number of premises being connected to broadband well in excess of 10Mbit/s.
- 2.26. The eligibility criteria for the USO proposes that any premises that is due to be covered by a publicly-funded programme in the immediate 12 months from the date of the request would be ineligible for the USO. However, we note that these programmes are at different levels of development which means that the forward look at the start of universal broadband service at the end of March 2020 will be unclear.
- 2.27. The risk is that the USO is delivered to premises who might subsequently (after 12 months) receive state funding through an alternative programme. Where BT is the recipient of this funding, there is a risk that BT is compensated twice for any upgrade: once by industry for the USO and then again by the state for the alternative funding programme.
- 2.28. Because of this potential risk, our preference would be for Government to at least part-fund the USO. We note that a state-funded USO need not meet the same criteria set out in the Universal Service Directive as an industry-funded USO<sup>9</sup> and would therefore enable the objectives set out by the various local and regional state-funded programmes to be delivered through a system of demand-led infrastructure upgrades that the USO offers.

### **Excluding mobile from the fund will not lead to fixed market distortion**

- 2.29. Ofcom explained that least market distortion might mean that if contributors that are providing substitute services are not all included in the fund, then those who are contributing will experience market distortion as they have to take on a net cost that their competition does not have to bear.
- 2.30. In the case of considering fixed market providers and mobile market providers, we do not see a competitive constraint held by mobile operators over fixed operators. This was concluded by Ofcom in its last Wholesale Local Access (WLA) Market Review<sup>10</sup>.
- 2.31. There are two important points raised by Ofcom in its conclusions on the WLA market review:
- 2.32. Firstly, customers do not currently view mobile and fixed products as substitutes, but rather as complements. Ofcom said:
- “...only 5% of households only connect to the internet at home using a 3G or 4G mobile connection. This suggests that the vast majority of consumers view mobile data services as desirable in addition to fixed line broadband, and not a substitute.”*
- 2.33. We agree with this current assessment of the market. Whilst mobile technologies have been developing to compete with fixed technologies to provide the main connection to the household, fixed broadband connections are generally still taken up.

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<sup>9</sup> The main restriction for a state-funded USO would instead be adhering to state aid rules

<sup>10</sup> Wholesale Local Access Market Review

- 2.34. Whilst access to the internet has moved towards wireless devices (smartphones and tablets), but smart TVs and set-top boxes are still fixed by nature and rely on high throughput connections to deliver video content.
- 2.35. Secondly, given consumers' views on the requirement for both fixed and mobile connections, it is unsurprising that Ofcom finds that there is little churn to mobile should there be an increase in price of a fixed broadband connection. Based on market research, Ofcom estimates that there is less than a 4-5% loss in fixed customers to mobile-only broadband as a result of a theoretical 10% price rise<sup>11</sup>. This added to Ofcom's evidence base that mobile broadband was not a direct competitor to the fixed broadband market. As a result, we conclude that there is very little evidence that excluding mobile providers (or their relevant revenue) from the group of fund contributors will lead to a distortion in the fixed market. Ofcom would be going against its own conclusions in the 2018 WLA market review to arrive at such a conclusion. Given the inherent overlap between the WLA market and the USO regulation, it is unlikely that a different conclusion would be required for the USO.

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<sup>11</sup> Wholesale Local Access Market Review Statement, Annex 5

# 3. Net cost should include a complete study of benefits.

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## 3. Executive summary

- 3.1. In its consultation, Ofcom considers that the calculation of the net cost should consider at least the following:
  - Costs (and whether they were efficiently incurred) of providing USO;
  - Revenues and other direct benefits from providing USO; and
  - Indirect benefits derived from the USO.
- 3.2. We agree with previous proposals that only efficient investment undertaken by BT should be included in any net cost calculation, and that this, therefore, restricts the allowable cost of the USO to upgrades made in the access network (and not any further investment made in the core network).
- 3.3. For revenues, we consider that a lot has changed since the last assessment of BT's net cost of providing universal services as defined in 2006. Since then, BT has launched BT TV, BT Mobile and acquired EE.
- 3.4. Ofcom should, therefore, include incremental revenues from BT Mobile, EE and BT TV in its net cost assessment. The incremental revenues from BT Mobile and EE should also be considered in any consideration of the industry funding mechanism – namely the distortion that BT creates from potentially upselling EE mobile subscriptions to USO customers. We also note that, due to the data bandwidth required to view BT TV, revenue from new BT TV customers would be unequivocally extra revenue for BT as in the counterfactual, customers would not have been able to access BT TV.
- 3.5. Therefore, when considering the impact of these services, the indirect benefits applicable to BT's provision of the USO in the last review are applicable today:
  - **Ubiquity:** BT benefits from customers who leave a USO area and move to a profitable area where they stay with BT.
  - **Lifecycle:** over time, customers who are initially unprofitable become profitable as they take up more services (such as BT Mobile, EE, BT TV, other BT add-ons or an upgraded broadband package).
  - **Marketing and brand:** advertising a nationwide presence brings a marketing benefit to BT. This is consistent with BT's recent efforts to market itself as a 'national champion'.<sup>12</sup>
- 3.6. Some of these benefits may be harder to estimate than incurred costs, certainly on an annual basis. However, given Ofcom's position on achieving finality for any given net cost claim, it will be important for Ofcom to invest in a robust framework that sets out how benefits will be calculated.

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<sup>12</sup> <https://www.ft.com/content/627ede7e-ea73-11e9-a240-3b065ef5fc55>

**The last USO review of BT's net costs concluded no unfair burden**

3.7. Ofcom's last review of the USO was conducted in 2005/06<sup>13</sup>. In that review, Ofcom estimated that:

*"the current costs of USO for BT are around £57-74m and the benefits are around £59-64m. Ofcom has concluded that these estimates are reasonable and believes is unlikely to be an undue financial burden currently on BT as a result of USO"*

3.8. Since that period, many universal service conditions are no longer incurring costs, such as call boxes and text relay services.

3.9. As a result, the main costs and benefits for providing the USO will come from the provision of broadband and as such is the focus of our response and what we would expect to be the main assessment for Ofcom when calculating net costs and unfair burdens.

**BT has introduced new revenue streams since the last review, with more opportunities to upsell to USO customers**

3.10. The previous USO ("Telephony USO") carried some opportunities for BT to gain revenue from the upselling of broadband to customers who were simply requesting access to a public telephone network. However, due to BT's relatively limited business areas at the time, there was not much further scope for extra revenue.

3.11. Since then, BT has acquired a MNO in EE, and also launched BT TV services which are commonly bundled with broadband contracts. Both present BT with significant opportunities to enhance its revenue from providing the USO:

- **BT Mobile:** operates as an MVNO on BT's EE network and its mobile plans are crucially offered as a bundle with other BT broadband products (or offered standalone but with a discount if the customer is already subscribed to BT's fixed broadband service). Contracts range between £9 and £30 per month SIM free<sup>14</sup> with higher prices for handset-bundled contract.
- **EE:** operates as an MNO currently with separate branding to BT. It is bundled with EE fixed broadband (which operates over BT wholesale broadband).
- **BT TV:** BT TV is an IPTV service that BT offers and which has gained popularity with the increase in offerings from BT Sport. BT offers BT TV as part of a bundle when customers initially sign up to BT broadband but also as an add-on at a cost of between £15 and £25 per month.<sup>15</sup>

3.12. With full mobile and TV upgrades, BT could have a potential incremental revenue of £55 per month per customer before line rental and broadband subscriptions are taken into account. This could have a significant downward impact on the net cost of providing USO.

3.13. We note that every BT TV subscription that is taken up after connection because of the USO would be purely incremental revenue: this is because IPTV is unlikely

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<sup>13</sup> Ofcom, *Review of the Universal Service Obligation* March 2006

<sup>14</sup> BT website, accessed 12 December 2019

<sup>15</sup> BT website, Accessed 12 December 2019

to be delivered reliably with a connection of less than 10Mbit/s and therefore these households would not have had a BT TV connection absent the USO.

### **BT will continue to enjoy considerable intangible benefits as a result of providing the USO**

- 3.14. Intangible benefits were an important part of the net cost calculation in Ofcom's last USO analysis in 2006. These benefits will be similarly important to BT with the new broadband USO.

#### *Ubiquity*

- 3.15. The nationwide presence of BT continues to be an important factor in its business. Even when customers move from unprofitable areas to profitable areas, there is a strong likelihood that they will stay with BT.

#### *Lifecycle*

- 3.16. As discussed above, the presence of add-on services being offered by BT today should be considered both when they generate revenue immediately after being provided with broadband universal service, but also in the estimates under the overall lifecycles of consumers.
- 3.17. There are two aspects to consider with respect to the lifecycles of consumers. Firstly, is the movement of customers from being unprofitable to being profitable. For example, it may be that the lowest priced package available to make a customer profitable through an FTTC connection is BT's 'Superfast fibre essential' but the customer may switch during or at the end of their contract to 'Superfast fibre' or 'Superfast fibre 2' which are more expensive packages that will yield greater revenue for BT.
- 3.18. Secondly, when considering the upgrade to these packages, bundling becomes a larger factor for BT to keep customers. For example, BT TV or BT Mobile may be offered as part of a bundle to reduce churn. This factor should also be considered when considering lifecycle benefits from providing USO.

#### *Marketing and brand*

- 3.19. With a multi-product offering, marketing and brand is arguably more important now than when BT was providing only other universal services.
- 3.20. We acknowledge that the benefits from marketing on phone boxes are no longer relevant to the marketing benefits that BT enjoys. However, BT has recently launched a significant campaign from which it will benefit for being a nationwide USO provider.
- 3.21. In October 2019, BT launched a campaign to set itself out as the 'national champion'<sup>16</sup>. It has returned to having a physical presence on in retail stores by co-branding with EE. The delivery of the broadband USO therefore presents a potential to enhance this brand and benefit from increased marketing scores with all of its consumers across the UK.
- 3.22. We also note that, as BT plans to offer FWA through its EE brand, if a customer requests a USO, there could be additional marketing benefits for EE as well. This might be particularly relevant to its home broadband package which has not been marketed heavily to date.

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<sup>16</sup> <https://www.ft.com/content/627ede7e-ea73-11e9-a240-3b065ef5fc55>

### **Ofcom should consider a framework and template for how it plans to estimate indirect benefits**

- 3.23. We note from the template<sup>17</sup> provided by Ofcom in conjunction with the consultation template that it proposes an alternative schedule instead for the entry of indirect benefits. This puts the initiative on BT to estimate its own indirect benefits. BT's incentives would be to reduce the level of indirect benefits to the lowest level or omit any potential indirect benefits. Even if these were unintended, it would lead to a more protracted process with Ofcom if the expectations or areas of indirect benefits are not set out from the outset.
- 3.24. As a result, we would consider it necessary for Ofcom to set out in greater detail the areas of indirect benefits for which it considers that BT should collect information. This would give the whole industry more certainty about the scale of any potential net cost.

### **Ofcom should therefore delay the first net cost calculation in order to take into account all benefits**

- 3.25. In its consultation, Ofcom proposes that its determination of any net cost burden being compensated for would be final.
- 3.26. As a result, we consider that any assessment for such a net cost burden should provide the best chance for Ofcom to take into account all the actual and potential benefits discussed above. In addition to the above, Ofcom should also provide the best chance to actually measure take-up where it has been assumed, which would not be possible after only one year of BT providing USO.
- 3.27. We note that the best evidence for indirect and other revenue benefits would be from assessing the take-up of USO consumers for a period of time. There are a few considerations for collecting this evidence:
- **Requiring time for USO customers to request and start broadband services:** it is unknown how many consumers will request a service in the first year of operation.
  - **Requiring time for the first broadband contracts to elapse to judge switching and upgrade rates:** only when the requestor's first broadband contract is up for renewal can Ofcom judge whether they switch to another Openreach operator, upgrade to an enhanced BT broadband offering, or take up further ancillary services such as BT TV.
  - **Requiring time for aggregated demand to transpire:** this is particularly true where FTTC has been used to deliver USO. The more customers that take it up, the lower the potential net cost
- 3.28. We, therefore, disagree that a net cost claim can be submitted annually and encourage Ofcom to hold BT to account to assess the above benefits. We estimate 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 USO. Three years is 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 direct and estimation of indirect benefits.
- 3.29. We acknowledge that Ofcom is trying to balance the proportionality of assessing net costs frequently against the time taken to compensate universal service

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<sup>17</sup> Proposed template for the Universal Service Provider to complete when making a net cost claim

providers for any net cost burden. However, there are two other factors that would weigh the balance towards assessing net costs after a period of time to reflect:

- **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.
- **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.

3.30. If Ofcom has a strong preference for the finality of net cost determinations, then it needs to 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. The only way to ensure this is to assess the net cost fully ex-post (rather than estimate the majority of benefits ex-ante). BT has proven that it has the financial ability to bear the time delay should it be subject to a net cost burden.

# 4. Conclusion.

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## 4. Summary

- 4.1. The USO is an instrument used to address the failure of the fixed broadband market in delivering decent broadband to anyone who requires it. It is, therefore, principally right that the fixed broadband market (or public funding) is required to fund any shortfall in the provision of the USO
- 4.2. The mobile broadband market is a separate market. This has been determined in various market review decisions by Ofcom. The mobile market has engaged in its own initiatives and regulations designed to address the delivery of decent mobile services to the UK population nationwide, including most recently the Shared Rural Network proposal. Indeed, the Government themselves have said that they “are intending to amend the Communications Act 2003 to make clear that universal service provisions can extend to mobile services”<sup>18</sup>, which suggests that fixed broadband provision and mobile services provisions are two separate issues.
- 4.3. Ofcom has said that when it decides who should contribute to any industry funding mechanism, it should consider the principles of least market distortion, no due discrimination, proportionality and transparency. We show in section 2 above that most of these principles are violated should Ofcom include mobile operators in the industry funding mechanism.
- 4.4. Ofcom has also said that any determination should be final and close the assessment of net cost compensation for that USO. We highlight in section 3 above that there is much to consider in adhering to finality, and that approaches that involve forecasting significant amounts of likely benefits to the USP could see fund contributors pay more than necessary to an industry fund. Ofcom’s last assessment of the net cost of the USO in 2005/06 took place after at least three years of service and, therefore, sufficient historical data with which to assess the true burden of the USO. We consider a similar approach would allow for a more accurate assessment of net cost for the broadband USO.
- 4.5. Finally, we would encourage Ofcom to set out in more detail an assessment of the contributors to an industry fund. The uncertainty at this time of high 5G investment (and indeed fibre investment for fixed broadband operators) is exacerbated by a delayed assessment of likely industry funding contributors.



## 5. Answers to Ofcom's specific consultation questions.

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Below we provide answers to Ofcom's specific consultation questions.

**Q1 Do you agree with our proposed procedures for commencing a review of a net cost of complying with universal service conditions?**

Ofcom should put greater weight on its relevant circumstances set out in its consultation (paragraphs 4.5a) and 4.5b): that a commencement of any review should be under the expectations of full actual information (rather than estimated) and that the proportionality of any of Ofcom's work should be mindful of BT's potential share in any industry funding mechanism and its financial strength.

**Q2 Do you agree with our proposed procedures for making an application requesting compensation for any unfair burden?**

No comment.

**Q3 Do you agree with our proposed procedures when making determinations when assessing a net cost claim, including our proposed approach to finality?**

We agree with the approach to finality but therefore Ofcom should put significant weight on its comments in the consultation (paragraph 4.20), which highlights the need to consider the possibility of more information being available in the future before deciding whether to commence a review. We discuss these points from paragraph 3.25 onwards above.

**Q4 Do you agree with our proposal on the information the Universal Service Provider should provide alongside an application to review a net cost?**

No comment.

**Q5 Do you agree with our proposed approach to calculating, verifying and auditing a net cost?**

No comment.

**Q6 Do you agree with the proposed factors we will consider when assessing an unfair burden?**

No comment.

**Q7 Do you agree with our proposed approach to determining whether an industry fund should be set up?**

Ofcom makes an important point in its consultation (paragraph 7.5) on determining the requirement for an industry fund. Where it appears that public funds may be used, the calculation of any amount to be collected from an industry fund will be postponed. With various public funding programmes for fixed broadband still available across the UK, and the potential for new programmes to be implemented by the new Government, we consider this point important for ensuring any industry fund is

efficient and strictly necessary. We discuss this point more in paragraphs 2.24-2.28 above.

**Q8 Do you agree with our proposed approach to determining which providers will contribute to any industry fund?**

No, we consider that keeping the potential contributors unknown creates uncertainty, and also disagree with the assessment that a wider pool of contributors reduces the potential for least market distortion. Overall, we think it is already clear that including mobile operators in an industry fund would be disproportionate, not lead to least market distortion, not be transparent and cause undue discrimination. We discuss these points in detail in chapter 2 above.

**Q9 Do you agree with our proposed approach on calculating contributions from fund contributors?**

No, the net relevant turnover approach must only follow where all of the contributors' inputs and outputs have been taken into account in terms of who contributes. We note that fixed operators and mobile operators have very different cost bases. It would be discriminatory therefore to choose a contribution mechanism where fixed operators can have a lower net turnover because of the fact that they can net off considerable Openreach/BT wholesale input costs, but mobile network operators cannot reduce net turnover where the majority of inputs are not provided by fund contributors if restricted to fixed and mobile operators only. A less distortionary approach would be to exclude mobile operators from the industry fund.

**Q10 Do you agree with our proposed approach to collecting contributions to an industry fund?**

No comment.

**Q11 Do you agree with the proposed process by which we would compensate the Universal Service Provider?**

Ofcom's proposed backstop for non-payment of any unpaid contributions by fund contributors risks distorting the finality of any determination. We consider this point, along with the fact that the USP was assessed to be financially strong enough to bear any net cost of the USO before any compensation is paid, means that Ofcom should not pursue contributors (who have already correctly paid) for others' unpaid contributions.

**Q12 Do you have any comments on the specific provisions of the draft funding regulations?**

No comment.

**Q13 Do you agree with our proposed approach to the choice of the counterfactual for the calculation of a net cost of the broadband USO?**

Ofcom proposes that the counterfactual should assume that no alternative provider would have been designated to provide USO. However, we consider that the counterfactual would have developed over time absent the USO. In particular, the continued improvement and coverage of 4G networks (including through the Shared Rural Network) and the growth of a) 4G home broadband and b) mobile-only households should mean that the counterfactual could well have started with a loss

of margin to mobile operators in some USO areas (thereby making the benefit from providing USO much larger for the USP).

**Q14 Do you agree with our proposal to use a NPV methodology to calculate a net cost of the broadband USO?**

In principle, an NPV methodology can be used to simplify the calculation of financial outcomes, but it is not suitable for an approach where industry is expected to pay in response to final determinations, neither is it suitable when intangible benefits need to be considered. We disagree with Ofcom's statement in the consultation (paragraph 9.12) that "the risk of material forecasting errors is reduced in this instance". Revenues and customer behaviour would be almost entirely estimated, as well as any future efficiencies gained from operating services for USO.

**Q15 Do you agree with our proposed reporting requirements in respect of the broadband USO?**

No comment.

**Q16 Is there anything else you would like to tell us about the proposals set out in this document?**

Overall, the scope of the USO, the USPs in place and the proposed technology to be put in place by these USPs have to date been developed to a reasonably detailed level. This consultation stands in contrast to previous, more detailed, Ofcom decisions on the USO, and only addresses the principles without addressing how those principles could manifest given other certainties in the delivery of the USO.

We therefore urge Ofcom to reduce uncertainty for the industry by analysing in more detail the principles it has set out for the industry funding requirements, interactions with public funding and the approach to benefits calculations.