01 November 2017

Brian Potterill
Ofcom
Riverside House
2a Southwark Bridge Road
London SE1 9HA

Dear Brian,

Wholesale Local Access market review: recovering the costs of investment in network expansion

Having reviewed responses to Ofcom's consultation on 'recovering the costs of investment in network expansion', which was issued as part of Ofcom's Wholesale Local Access market review, it is clear that other communications providers share the concerns set out in Sky's response to that consultation. BT and Virgin Media were the only operators supporting the so-called 'voluntary' approach, which would bypass the process for designating a universal service provider and require Openreach's customers – rather than industry more widely – to foot the bill for delivering what is effectively a universal service obligation.

Sky remains of the view that a universal broadband service with minimum download speeds of 10 Mbps is important for social inclusion and supports the delivery of positive economic outcomes in the UK. The Universal Services Directive provides the appropriate legal framework for delivering universal broadband service and we are keen to support Government and Ofcom to facilitate rollout in a robust, timely and legally sound way.

You will have seen articles in the press that various operators are considering taking legal action if Government were to pursue an agreement with BT for the rollout of a universal broadband service, with costs recovered from Openreach's customers via a charge control. Sky has not engaged with the press on this issue, but we are considering our options should Government decide to bypass the universal service regulatory framework.

Without prejudice to Sky's view that it is neither legitimate nor appropriate to recover the costs of the universal service network expansion via regulated charges we consider that, if Ofcom were to adopt that approach, a bespoke set of arrangements should apply to the costs and revenues associated with the network expansion – in recognition of its unique characteristics.

First, BT should be required to maintain separate, public accounts detailing the costs that have been incurred in delivering the proposed network extension, its operating costs, and its revenues – including revenues earned from the proposed surcharge. As set out in Sky's response to the consultation, depreciation in those accounts should be based on historic cost accounting rather than current cost accounting. This would enable proper, appropriate transparency for stakeholders in relation to the proposed universal service network expansion.

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Benefits derived from delivering universal services should also be deducted from this account. This would include revenue from customers that take higher speed broadband services as a result of the investment, as well as a contribution reflecting the brand benefits derived from delivering universal broadband.

Second, Ofcom should introduce a mechanism to allow excess revenues to be returned to Openreach customers.

Ordinarily, RPI-X charge controls permit operators to retain the benefit if they deliver services below the costs that were estimated at the time of setting the charge control. As set out in Sky's response to the consultation, that standard principle is inappropriate in this case. In particular, the standard mechanism would deliver an unreasonable windfall to BT if either (i) it fails to meet rollout obligations, or (ii) its roll-out is cheaper than anticipated.

In relation to the latter, there is a significant likelihood that this will be the case, for two reasons:

(a) as set out in Sky's response to the consultation, there is a high degree of uncertainty about the scale of the roll-out, in terms of the number of homes that are required to be passed, because this depends on a number of other initiatives;

(b) the BDUK experience provides good evidence that BT has tended to over-estimate costs in the past. The National Audit Office found in 2015 that BT's actual costs for BDUK (Broadband Delivery UK) were 38% lower than its estimated price and, since BDUK's launch, around £645 million in funding provided to BT has been clawed back. That is over 40% of the total £1.7bn funding provided to BT to date.

This process could be managed fairly simply through an annual rebate to those customers. Interest should also be payable to ensure that Openreach does not benefit unfairly from over-recovery from contributors to the cost of funding the network expansion.

Third, there should be a monitoring programme to prevent overbuild in areas where other communications providers have expressed an interest in rolling out a network capable of achieving download speeds exceeding 10 Mbps.

An agreement between Openreach and Government for Openreach to deliver the universal service obligation prevents other interested communications providers tendering to be designated the universal service provider of a particular region. Nevertheless, those operators may decide to build out their own network. Openreach should not be able to use money received from its customers for the purposes of universal service delivery to compete with alternative network operators in areas where there investment is plainly commercially justifiable.

Finally, any further announcements by Ofcom or the Government on this matter should refer to 'Openreach' rather than 'BT' as the relevant party to any such arrangements, in keeping with the spirit of the Commitments accepted by Ofcom from BT in January. This would reflect the fact that BT Group is not funding the rollout of the fixed network (other than to the extent that they are a customer of Openreach).

We would be happy to discuss any of the issues in this letter.

Yours sincerely,

Matthew Braovac
Director of Legal – Consumer, Corporate, Competition