the independent networks cooperative association

# Ofcom Strategic Review of Digital Communications

**INCA response to Discussion Document – October 2015**

## Executive Summary

1. The Independent Networks Co-operative Association (INCA) - the body representing the UK's independent network sector – welcomes this Review, which provides a once in a decade opportunity to shape the UK's digital communications future.

2. Much has changed since the market last underwent this scale of review in 2005, including a substantial increase in demand for fast and reliable connectivity and a move away from the copper network towards fibre and other future-looking networks.

3. There has been another significant development – the evolution of the independent sector from small, community-based groups primarily addressing rural not-spots, to larger players who are increasingly behaving as competitors to BT and Virgin. They are reaching a significant and increasing proportion of the UK's urban and rural premises; attracting substantial and rising investment; and are building future-proofed networks to compete head-to-head with the incumbent, rather than merely acting as "in-fill". This has been achieved despite a regulatory framework that is tilted towards the incumbent.

4. The change that this sector has already undergone, combined with its potential impact given a more pro-competitive environment, justifies a rethink about its role in meeting the UK's future broadband needs, and the way that regulation is shaped around it.

5. The current regulatory framework is ripe for revision, as it is already delivering sub-optimal competition. This is evidenced by the poor quality of service from Openreach, stagnant investment from BT in Openreach, anti-competitive behaviour from BT, and the risk of BT re-monopolising next generation networks. INCA is therefore calling for a swift referral by Ofcom of the market to the Competition and Markets Authority.

6. INCA does not at this stage argue for a specific outcome from such an investigation, believing that further work is needed to understand the market and the ramifications of possible remedies. What must emerge, however, is a framework that maximises competition and investment from all players, and recognises that the UK has viable options, beyond BT and Virgin, for achieving the digital communications network it needs for the future.

**Introduction - a window of opportunity in which to shape the UK's broadband future**

7. INCA is the body representing the UK's independent network sector; we welcome the opportunity to respond to this consultation. Ofcom's Strategic Review, alongside the two recently launched European Commission reviews, provides a once in a decade window of opportunity in which to shape the future of the UK's digital communications sector.

8. Ofcom's last Strategic Review, ten years ago, was successful in stimulating competition on BT's copper network, which brought broadband to the masses and underpinned the digital revolution of the past decade. However, much has changed since 2005, including:

    a. As Ofcom's Discussion Document has identified, there has been a surge in consumer demand for fast and reliable connectivity, driven by the availability of new data-hungry devices, apps and services, such as video streaming and cloud-based storage. This is remarkably different from the last Review - when a debate was still taking place about what bandwidth might be used for - and has yet to take account of the next wave of data-based developments, for example the Internet of Things, smart city developments and new innovations like driverless cars[1]. Crucially, the need for fast and ubiquitous connectivity is no longer viewed as merely beneficial but as essential, for individuals, businesses and wider society.

    b. Service level competition on the copper network played a big role in kick-starting first generation broadband take-up in the UK. Today we need to focus more on competitive investment in new digital infrastructure - fibre and wireless - that will deliver ubiquitous coverage of high speed, symmetric and reliable services. Fibre networks in particular also have much lower opex costs than hybrid copper/fibre networks and so offer the opportunity for lower costs for consumers and businesses. Despite this, the primary focus of current regulation remains the copper network.

    c. The make-up of players in the market has also changed. Alongside the BT, the incumbent, and Virgin Media, there has been an explosion in investment in superfast and ultrafast broadband networks from alternative operators. This independent sector is investing heavily and not just in the margins, as was perhaps the case at the last Review. As we will argue, these players are

[1] http://www.wsj.com/articles/SB10001424052702304815004579417441475998338

beginning to offer real competition to the incumbent, and have the potential to provide a viable alternative for meeting the UK's connectivity needs.

9. As a result of these changes, we believe that the current regulatory framework is no longer fit for purpose. It is already leading to detrimental outcomes, including poor service quality and reliability on the Openreach network and continuing difficulties in delivering even basic 2mbit/s services to hard-to-reach areas. These issues will only worsen with time, as the expectations placed on the UK's digital infrastructure increase.

10. A world-class digital infrastructure is central to the future outcomes of the UK and its citizens, but we do not believe the current framework is capable of delivering it. Instead, an updated framework, which supports open competition and investment from all players, is urgently required. This can only be achieved through bold regulatory moves, starting with a referral of the market to the Competition and Markets Authority by Ofcom.

11. As the body that brings together many of these new players, our role is to promote the sector, explain the context in which it operates and help create more awareness amongst policy-makers, investors, regulators and communities of the benefits that these companies bring. We see our role in responding to this Review as providing the context and top-line arguments in support of the sector, rather than answering each question posed in turn.

**INCA members' role at the heart of the UK's future broadband market**

12. INCA represents the non-incumbent builders and operators of next generation digital networks. Our membership is diverse and includes large companies like Vodafone and Sky alongside new entrants, such as CityFibre, Gigaclear, UK Broadband, Hyperoptic, Fluidata and ITS Technology Group. Our members build and operate fibre, wireless, satellite and hybrid networks. They operate in both urban and rural areas. They work on the basis of private sector investment and do not demand large state subsidies before seeking to address harder to reach areas. Some of our members are public sector organisations, others are community-based networks.

13. There are several striking features about the sector today as opposed to 2005 (when the independent sector was largely characterised either by a growing range of LLU operators or small, community-based groups primarily addressing rural not-spots),

which together warrant a rethink about the role that non-incumbent players can play in delivering the UK's future broadband needs:

a. *Increased level of coverage:* a recent internal INCA survey[2] reveals that members' services already pass 1.2m premises in the UK, and that on current projections they could pass 10m premises by 2018-20. Collectively, the independent sector is therefore beginning to represent a 'third' player in the market.

b. *Differentiated products and services:* while some INCA members do focus on delivering Universal Broadband (2mbit/s) services in some of the hardest to reach areas of the UK, most are building networks that deliver superfast and ultra-fast networks from the get go. They are attempting to attract customers away from others in the market by competing on superior quality of product and service. Few, if any, operate on the basis of "build it and they will come". Instead they develop clear strategies to address take up before they start building networks. Consequently take up levels are often extremely high, particularly in rural areas that are otherwise poorly served. For example Gigaclear's business model is based on achieving 30% or higher take up before investing in FTTP infrastructure in a village. Community scheme B4RN achieves 60%+ take up in some parishes with its gigabit fibre network.

c. *Significant scale of investment:* members' confidence in both consumer demand for ultra-fast, reliable broadband and their own ability to meet that demand is being backed by substantial and rising investment[3]. While some of our members are community-funded projects, most are commercial for-profit entities, backed by investors looking to make a return on that investment with little or no reliance on public subsidy. This level of investment is being achieved despite a challenging competitive environment. We believe that much greater investment is waiting to be unlocked, given the right regulatory and policy support.

d. *Not just rural not-spots:* where the independent networks are choosing to build is also key - not just in hard-to-reach areas where the incumbent sees no commercial incentive, but in cities and urban areas, where companies

[2] INCA online survey of 20 members conducted for BDUK, Summer 2015
[3] For example CityFibre had a successful public listing on AIM; Hyperoptic have raised around £50m of investment from one of the Soros funds; Gigaclear have raised £50m of private investment – more than 10% of BT's total rural investment as identified by the NAO and PAC

believe they can compete directly against BT and Virgin Media on quality of service, not just because they are the only game in town.

e. *Future-proof products:* none of INCA's members owns a phone network. No company setting out to build a new communications infrastructure today would build a copper network; it would only build a fibre and/or wireless/satellite network. This means that these networks are built to last and represent a long-term solution to the UK's connectivity needs.

14. These characteristics demonstrate that INCA members and the wider altnet community are increasingly behaving as competitors to BT and Virgin - for the 95% as well as the rural 5% - even in a regulatory environment that in our view is sub-optimal.

15. We welcome Ofcom's increased recognition of this sector in recent years, for example by including a section on "non-major NGA providers" in the 2014 Infrastructure Report, which revealed that "in aggregate [they] provide coverage to around 1% of UK households." The Strategic Review Discussion Document also notes that "...in recent months a number of smaller providers [...] have begun deploying their own localised fibre-to-the premises (FTTP) networks" but concedes that "it is still early days to assess these initiatives' long term footprint and commercial model."

16. The sector is changing rapidly, however, and these figures and assessments already underestimate the capacity of the sector. We are keen to continue to work with Ofcom to capture not just an accurate picture of today's sector, but more importantly both its trajectory and its potential in a more competitive regulatory environment. Indeed, the Discussion Document reveals the scale of non-incumbent fibre deployment in other countries, which underlines what could be possible in the UK given the right conditions. We argue that now is the time to create those conditions and to place the independent sector at the heart of policy decisions about the UK's future digital infrastructure.

**Principles for future UK communications market regulation**

17. We believe that to realise a world-class digital infrastructure for the UK, and maximise the contribution of the independent sector, we require a policy and regulatory environment that:

a. *Promotes open and vigorous competition - and curbs anti-competitive behaviour - at both the service and infrastructure level*: competition is the primary driver of investment, quality of service, choice and value for money for both consumers and UK plc. It's worth noting that opening up a market to competition not only favours challenger companies, in this case INCA members, but benefits consumers, through increased choice and lower pricing, and the incumbent, by creating the right incentives for them to invest.

b. *Encourages investment in next generation networks from all players, not just the incumbent*: independent players are already investing, despite a regulatory framework that is tilted towards the incumbent and focused on the legacy network. A truly level-playing field would lower the barriers to altnet investment and maximise the impact of the sector.

c. *Is technology and platform neutral*: what users can do with connectivity is more important than the platform or technology used, be it fixed or mobile, wired or wireless, fibre or satellite – with the caveat that they are future-proof technologies and platforms (see below).

d. *Is future proof*: Today's data needs are beyond what most envisaged ten years ago[4] and growth of internet traffic is rising year on year[5]. A regulatory framework based on a conservative approach to future needs will inevitably result in having to revisit the design of that framework all too soon, massively disadvantaging the UK against its competitors. The framework that emerges from this Review needs to build in the headroom for the unforeseen. This means orienting regulation around future networks that can deliver and exceed our greatest predictions, rather than attempting to prolong the life of the old phone network with its inherent practical limitations.

e. *Values ubiquity, reliability, resilience and quality of service as much as speed*: the success of the UK's digital infrastructure should be measured not by headline speeds, but simply by whether it does what it needs to do, whenever and wherever it is needed.

f. *Makes the most efficient use of public funding and publicly funded infrastructure:* Some level of public subsidy will be required to ensure that all

[4] See https://web-assets.domo.com/blog/wp-content/uploads/2013/07/DataNeverSleeps.jpeg

[5] See http://blogs.cisco.com/sp/the-history-and-future-of-internet-traffic

UK citizens are able to benefit from a world-class digital infrastructure. In an age of austerity, it is therefore vitally important that this public funding, and the infrastructure that is built with it, is worked as hard as possible. The best way to do this is to ensure that it is open to competition.

Box 1: Efficient and competitive use of existing infrastructure

A smarter, more competitive approach to passive infrastructure is needed to maximise the potential of private investment.

1. One of the greatest barriers to private investment in rural areas is access to affordable backhaul. Significant opportunities for investment in FTTH are being missed because suitable backhaul is not available.

2. Access to other infrastructure can significantly reduce the deployment costs of new networks. Passive Infrastructure Access (PIA) sought to bring some of BT's assets into play. However, the PIA approach is demonstrably inadequate, with only a handful of INCA members making use of it. Tackling the challenges of backhaul and reducing deployment costs will unlock significant private investment in rural broadband, reducing the need for public subsidy.

3. Away from BT's network, the pervasive fibre networks that are owned by public bodies, such as the Highways Agency (managed by NRTS), Network Rail Telecom, local authorities and others could also be opened up to commercial providers. Making smarter use of these publicly funded networks can help solve some of the current bottlenecks in provision and provide a return to the public purse.

g. *Is truly converged*: consumers are using fixed and mobile networks interchangeably. Mobile and FWA networks often need high bandwidth fixed line connections to deliver high quality services to consumers. Many fixed line networks terminate in a wireless connection in the home or business. However, the regulatory framework still approaches fixed and mobile as separate markets. We should instead simply be addressing "the digital communications market".

18. We think that Ofcom will find much to support in these principles, given that they echo the objectives it sets out for this Review:

- "delivering widespread high-speed digital infrastructure through investment and innovation;
- delivering choice, quality and affordability through competition;
- empowering consumers through competitive markets;
- deregulating, except where targeted regulation is required."

**Delivering the optimal policy and regulatory environment**

The current framework has led to suboptimal competition in the market

19. Against the backdrop of INCA's principles for future regulation, the current framework falls short, principally because it is resulting in suboptimal competition in the market:

    a. *Poor quality of service from Openreach*: As Ofcom identifies in its Discussion Document, "at the wholesale level, the quality of service that Openreach delivers to downstream providers, including BT, has been unsatisfactory". This is demonstrated through:

        i. unacceptable delays in new line installations;
        ii. frequently missed and changed installation appointments;
        iii. increased fault rates;
        iv. failure to meet targets to fix faults.

    These failings are experienced by INCA members and other communications providers - and a number have publicly documented them in detail[6]. This repeated under-performance has a negative impact on wholesale, residential and SME customers, and has the effect of dampening competition and strengthening BT's position by discouraging switching.

    b. *Stagnant investment from BT in Openreach*. Opinion is divided about the extent of BT's historic investment in the Openreach network, but its recent statement on its future plans[7] makes clear that it does not intend to significantly increase investment under the current structure. In fact, over the next three years, BT will invest more in football rights than it does in new network access equipment at Openreach.

[6] See Sky's Initial response to this Review. A recent FCS blog refers to a long running litany of complaints about poor service quality from Openreach experience by b2b service providers
[7] 22 September press release by BT

c. *Anti-competitive behaviour from BT*: BT has repeatedly exploited its position in the market by failing to cooperate with its competitors as it is required to in its Undertakings. This is hampering competitors' ability to invest and innovate, thereby dampening competition:

   i. Openreach is reluctant to engage with non-BT wholesale customers to take forward innovations, and slow to drive them through once agreed;
   ii. Openreach does not readily share data, such as from PQTs, with wholesale customers, which could be used to improve consumer experience.
   iii. BT repeatedly overbuilds using public subsidy in areas that are already being served, or in the process of being served, by independent providers.

d. *Risk of re-monopolisation and insufficient competition on next generation networks*: The UK is moving away from the copper network and towards fibre, but the limitations that exist on competitors' ability to access and offer differentiated services using BT's fibre infrastructure, combined with the vertical integration of BT, means that there is a strong risk that BT will re-monopolise this new market unless sufficient infrastructure competition is created.

20. These features of the market are either caused by or exacerbated by the current structure of the market, and in particular the vertical integration of BT within it. As Ofcom observes "the current ownership structure of BT means that it still has the incentive to discriminate against competing providers". It is resulting in a diminished opportunity for alternative providers to compete effectively and invest confidently, and poor outcomes for individual customers and UK plc.

<u>Ofcom must swiftly refer the market to the Competition and Markets Authority</u>

21. A digital communications market structure that limits competition as described above will not be able to deliver the investment and innovation needed to fulfil the UK's connectivity goals. We believe that bold regulatory moves will be required to fix it, starting with a referral by Ofcom of the market to the Competition and Markets Authority. This is the principal point that INCA wishes to make in response to this

Discussion Document, and reflects the widespread[8] opinion of the industry and its customers.

22. According to the Enterprise Act 2002, Ofcom is entitled to refer a market to the CMA if it has "reasonable grounds for suspecting that any feature, or combination of features [...]prevents, restricts or distorts competition". As listed above, there is ample evidence to indicate that the market has passed that threshold.

23. The decision about whether or not to refer needs to be taken quickly, to avoid even the question of it negatively impacting investment. We argue that Ofcom should refer as part of its proposed second phase document in January 2016.

24. INCA appreciates that three out of the four courses of action that Ofcom has listed in the Discussion Document do include measures - some radical - to address these market failings and we do not underestimate Ofcom's willingness to act radically and decisively if required. However, we do not believe that Ofcom has sufficient powers to follow through on at least one of those potential outcomes - structural separation; the CMA, with its far-reaching powers, does. In addition, given the scale of the inefficiencies in the market and the size of the prize at stake, we believe that the situation warrants a fresh pair of eyes; a referral to the CMA would allow a full and proper debate to take place about the correct market structure required to enable sufficient competition.

Looking ahead: Phase 2 of Ofcom's Strategic Review and a possible CMA Market Investigation

25. While many industry players, including some INCA members, have already called for structural separation as the end result of any referral, INCA's position is that any potential investigation must result in a market that supports the principles outlined above, principally by maximising competition and investment from all players. Whether this outcome is achieved through structural separation (or by any of the other options listed by Ofcom) is a second order question that cannot be answered without further work to understand the market and the ramifications of possible new structures. One of the primary roles of any investigation would be to undertake this work so that a fully informed decision can be taken.

[8] INCA - along with the Institute of Directors, Sky, Vodafone, TalkTalk, Federation of Communication Services and Association of Independent Professionals and the Self Employed - has publicly called for Ofcom to refer the fixed line communications market to the CMA under the Enterprise Act 2002.

26. We believe it is useful to begin to outline some of the questions that will need to be answered during this next phase of work - whether it is Ofcom or the CMA that undertakes it. For example:

    a. What does structural separation really mean?
    b. Who would the new owners of a structurally separated infrastructure company be?
    c. What incentives would new owners have to behave differently from the current BT-owned Openreach?
    d. What other measures could achieve the same end?
    e. What would the impact on all players be?
    f. What are the benefits and risks of each scenario?
    g. What would "bad separation" look like?
    h. Which of the upsides of the current structure would be lost?
    i. What regulations would still be applicable to a separated Openreach?

27. INCA is keen to enable debate between Ofcom, its members and other relevant stakeholders to fully understand the extent to which the different regulatory scenarios on the table would deliver the principles we have set out - and importantly, which will allow the independent sector to fulfil its potential to the benefit of UK plc.

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