A Communications Review for the Digital Age: BT's response

Introduction

BT is pleased to be able to contribute to the Government's early thinking in this Communications Review. The measured timescales of the review provide a much-needed opportunity to consider properly the underlying questions about the scope and purpose of regulation in an era of convergence.

Communications sectors are key enablers of economic progress. The UK has the advantage of one of the most competitive, efficient and dynamic sectors in the world. BT endorses the government's objectives to promote the health of these sectors going forward.

In BT's view, the key contribution that this review could make to the achievement of those objectives is to ensure that there is an even-handed, objective and light touch regulatory regime that applies to all parts of the communications industry clearly and consistently. Such a regime would provide the foundation for fair competition and the encouragement of investment across converging communications markets for the benefit of the citizen / consumer.

The Communications Act combines a highly structured and intrusive regime for the regulation of telecommunications (and spectrum) under the EU Framework with a very heterogeneous ad hoc set of regimes for media sectors. At the same time there are a number of omissions related to activities that have emerged in importance since the Communications Act was propounded, particularly as regards the internet. What the review should aspire to achieve is a consistent ex-ante regulatory regime to promote competition and protect consumers all media and communications sectors. The regulator should be vested with powers to act if markets require this, rather than an obligation to act. It should recognise the reality of convergence of markets which have superseded the narrow definitions enshrined in European Directives. And it should sweep away panoply of legacy regulations that have outlived their relevance.

Commentary

The value of this sector for future economic growth across the globe is well recognised. It featured highly for example in the recent report by McKinsey for the eG8 summit in May.[1] This shows that internet related activities exert "a strong influence on economic dynamics" both directly and indirectly, because of "the productivity gains… offered to economic agents in all industries and sectors, both private and public." The strength of the UK is highlighted in this report and particularly the strength and performance of its telecom operators. This suggests that on many fronts the UK is getting it right.

[1] *Internet matters: the Net's sweeping impact on growth, jobs and prosperity*. May, 2011.

Investment in the next generation of broadband infrastructure will be crucial in enabling further internet-related growth and innovation, and Government is rightly considering how it can provide a supportive, enabling framework. With BT's investment and the BDUK initiative, we believe the UK is on track to achieve the Government's ambition to have the best superfast broadband in the EU before 2020.

Given the pace of technological change and market developments since the Communications Act 2003, it is clearly important to consider whether the existing legislation, and the resulting institutional and regulatory framework, will remain fit-for-purpose. We should however recognise the difficulties of accurately predicting the future and hence the risk of unintended consequences, particularly with legislation that may well last beyond 2020. We therefore believe the focus of the Government's review should be on carefully setting the scope and purpose of regulation, ensuring there is an enabling framework that allows markets to deliver economic outcomes wherever possible, with legislation / regulation limited to areas of market failure and essential consumer protection.

Some overarching questions

We therefore suggest there are three core issues to be addressed as part of this review:

1. Setting the scope of 'communications' to be regulated

The review should encompass all media and communications markets together. Prior to the 2003 Act, communications-industry regulation was confined to the services of telecommunications companies. This was separate from the regulation of broadcasting (of content itself and the systems for distributing it) and spectrum. The Office of Communications Act 2002, which created Ofcom, and the 2003 Act brought the separate regimes together under a single regulator and by inference 'Communications' was expanded to cover all these areas, although in practice they have continued to be regulated differently and separate arrangements apply to the BBC. The scope of the 2003 regime has been subsequently extended again, culminating most recently with additions from the Digital Economy Act, which brought the protection of copyright into 'Communications' regulation for the first time. The Open Letter seeking views on a new Communications Act potentially draws the scope still wider, referring to "media markets", "online publishing", "video games", "other digital industries" and "other creative industries". In BT's view a coherent set of communications and media markets can be defined which include many of these activities, and in particular include content rights and content distribution markets.

2. Clarity of regulatory purposes

The questions asked in the Open Letter demonstrate the importance of being clear and focused on core regulatory purposes. As indicated in BT's responses to the questions (set out in the attached annex), the issues the Government is considering are undoubtedly important but many are not best answered by legislation, though they may warrant other forms of intervention (in education and skills, or in public funding for certain kinds of content services or in infrastructure).

We suggest that the overarching purpose of regulation in this sector – once the sector is defined – should be *to enable markets to serve and empower citizens/consumers***.** Regulation should generally be designed to enhance citizen/consumer outcomes, by enabling markets to serve the dynamic needs of citizens/consumers and by encouraging investment through a clear, fair and predictable regime which will drive the innovation that flows from increased competition, enhanced by essential consumer protection measures.

However, it is important to understand that shifts in consumer behaviour occur very rapidly in the digital age. The world has moved away from one where established industry players hand down products and services for consumers passively to consume. It will become increasingly difficult to legislate for consumer outcomes going forward through rigid interventions. What is essential is that a well-equipped regulator should have the ability to apply its powers in a manner that recognises rapidly changing markets, to define markets as they converge and change and to analyse market behaviour to ensure that it supports citizen/consumer benefit, and allows it to intervene if required and if the risks of intervention are outweighed by the likely benefits.

In particular, although the internet does undoubtedly bring new challenges and potential concerns, we believe that the emphasis needs to be on enabling outcomes through encouraging competition and enabling consumer choice to drive market outcomes. Intervention should only be contemplated when there is clear evidence of market failure or other citizen/consumer detriment. This approach needs to recognise that there could be a wide variety of bottlenecks to free market processes, not just those that have been identified in sectors that have been regulated for a long time. Dealing with bottlenecks should come together with an emphasis on encouraging greater education, information, transparency etc. This approach will, in our view, better safeguard consumer interests than would the introduction of new formal rules and regulations, which are likely to be cumbersome and expensive to implement, and may become rapidly out of date.

3. Regulatory coherence

We strongly endorse the principle set out in the *Principles for Economic Regulation* published by BIS in April 2011 that there should be a clear separation between the government's overarching policy role and the independent regulator who should undertake its duties according to its legislative powers. It is essential that the regulator is able to pursue its objectives on the basis of rigorous analysis of the evidence of what is actually happening in these markets and sectors, founded on sound economics, without interference from Whitehall.

BT believes that Ofcom is most likely the best authority for dealing with the complexities of interconnected regulations in the communications and media sectors, so long as it is given enabling powers rather than obligations to act. Ofcom should only use its powers to regulate where intervention is necessary and beneficial.

Ofcom was vested with a large range of powers, duties and functions under the 2003 Act, which has been added to since, including by the Digital Economy Act (DEA). Even though BT believes that some provisions in the DEA are unbalanced and at odds with European law, we nevertheless believe that the issues that it seeks to deal with are fit subjects for appropriate intervention if a suitable light touch, balanced approach is adopted. Consideration needs to be given to how any such additional duties fit with Ofcom's overall objectives and how any potential conflicts should be resolved. Ofcom can only operate successfully in the context of clear boundaries and a coherent remit. So the boundaries between Ofcom and other authorities in the area of, for example, copyright need to be well defined. Here, Ofcom should have the powers to regulate media rights markets if that is necessary to promote effective competition, but should not be responsible for the regulation of copyright law or its enforcement.

Priorities for the Digital Age

Having set the boundaries and objectives of the regulatory framework, we believe Government should then be in a position to articulate its priorities from this review of communications. From BT's perspective as a telecommunications company operating in an increasingly competitive market, we would like to see the following areas prioritised for consideration:

1. Create a level-playing field

It is essential to recognise that communications and media markets are rapidly converging and have already moved well beyond the bounds of narrow economic markets defined in the EU framework. Consumers are buying products together that they used to buy separately. It is essential that the regulatory regime reflects this reality so that the conditions of free market processes can operate in an unbiased fashion. A regime that deals with bottlenecks in only one part of the market – fixed line telecommunications – is systematically biased in favour of the owners of bottleneck assets in other parts of the market – mobile and content.

Therefore it is important to have a consistent approach to economic regulation and the analysis of market power across the broader communications sector, as advocated in the BIS *Principles for Economic Regulation*. It is important that the scope of communications-sector regulation properly recognises convergence, given that an asymmetric approach will not adequately deal with all sources of market power. Telecoms regulation is dictated in a highly prescriptive regime by the EU Framework. Nevertheless a new Communications Act could propound a similar regime in media markets and could provide for Ofcom to consider the convergence between the two.

2. Deregulate wherever possible

The UK fixed line telecoms market is the most regulated in the world: no other country requires the level of operational separation of the access network business and the provision of exactly the same products to all downstream communications providers that BT delivers in the UK. We believe that deregulation of telecoms should be a prime objective of this review: the market is best placed to deliver benefits to consumers, innovation and growth. There is always likely to be a role for some sectoral regulation focused on enduring economic bottlenecks, in telecoms and in media sectors, and indeed in some areas there may be a need to address new bottlenecks to ensure a level playing field. So where regulation to achieve consistency is introduced, it should give Ofcom the power to act rather than the obligation to act. And, as discussed above, it is important generally to avoid the temptation of introducing unnecessary specific regulation into new areas, since it could harm emerging business models and will not be adaptable to change. There should therefore be a rigorous regulatory impact assessment carried out before any new regulation is introduced.

3. An intelligent approach to internet regulation

Consideration of the whys, wherefores and consequences of internet regulation needs to be based on a detailed understanding of the functioning of the internet; of the role played by device manufacturers, access providers, search engines, social network platforms, services and applications; and of user behaviour. It is not appropriate to consider 'internet regulation' under a single heading. If regulation is deemed necessary, it should apply to all players at the same level in the value chain so that it does not unduly distort the market or provide perverse signals to consumers. Government should also assess the experience of limited forays into editorial regulation of the internet, e.g. rules on VOD services. They should not assume that the right response to an internet-related 'problem' is to regulate it.

4. Recognising the value of telecoms

It is important to recognise that the telecoms sector can deliver growth and innovation across many different economic sectors: it is much more than just 'pipes' supporting the creative media industries. The McKinsey report emphasises this and it is important to remember, in particular, the key contribution to economic growth made by ICT. There is considerable scope for innovation in new ICT technology areas such as cloud computing and 'machine to machine' applications, driven by investment in telecommunications networks. To encourage investment, particularly in major communications infrastructure, the regime needs to allow operators reasonable returns from which to invest and reasonable certainty to support investment. Providing and maintaining the networks underpinning the internet is not cost free – as traffic increases, so does the need for investment. Any new regulation needs to factor that in and avoid discouraging investment in the internet by infrastructure owners and service providers.

Annex : BT's response to the Government's questions

Our views in relation to the specific questions posed are set out below. As indicated above, although the issues the Government is considering are all important, we do not believe that all are necessarily best answered by changes to legislation, though they may warrant other forms of intervention.

Growth, innovation and deregulation

Q1. What could a healthier communications market look like? How can the right balance be achieved between investment, competition and services in a changing technological environment?

In our view, a *healthier* communications market would be one that builds on the foundations of recent years, recognising the regulatory, market and technology developments that have produced probably the most competitive communications market in the world. Government and Ofcom can do more, by taking a properly convergent approach to policy interventions to create a truly level playing field. This entails a consistent approach to regulating economic bottlenecks and a presumption of deregulation elsewhere in the value chain on the basis that healthy competition based on free markets is the best way of ensuring optimal consumer and business outcomes.

Plurality in media markets is a prerequisite for healthy competition and we support Ofcom's view that the Government should consider undertaking a wider review of the statutory framework to ensure plurality in the public interest in the longer term, including where plurality concerns arise in the absence of a specific corporate transaction involving media enterprises, for example as a result of organic growth.

Q2. What action can be taken to facilitate greater innovation and growth across the wider competition regime, and how can deregulation help achieve this?

Innovation and growth generally depend on investors being able to earn a fair return that recognises risk. In general, free markets are best-placed to deliver innovation and growth but where regulation is required to help promote competition, it should be focused where it is needed and where it can be effective. Given the relatively long pay-back periods of telecoms infrastructure investment, it is particularly important that there is policy certainty here.

Q3. Is regulatory convergence across different platforms desirable and, if so, what are the potential issues to implementation?

We believe regulatory convergence across different platforms is essential given the extent of the development of converged offerings in the sector. The majority of consumers already buy bundles of services covering fixed and mobile telephony, broadband and TV, while businesses do not differentiate between telecoms and ICT solutions. A level playing field is vital in order to allow all market players to offer converged offerings in adjacent markets; there should be fair access to market entrants to all economic bottlenecks, whether it is fixed copper/fibre networks, mobile spectrum or premium TV content (including movie and sports rights). Although Ofcom was established as a 'converged' regulator, it has never really regulated in a converged way across fixed telecoms, mobile, TV and cable. There is currently asymmetry within telecoms between the regulatory treatment of fixed and mobile players and between telecoms and cable/satellite.

Some constraints do exist to the extent that the EU telecoms framework limits national discretion but we believe that Ofcom can already take a broader view of market definition and market power within the existing rules and can make greater use of other instruments, such as the new power (recently transposed into UK law) allowing them to mandate access to operators' infrastructure without a finding of market power. However, to properly ensure there is a level playing-field, we would like to see the Communications Act amended to give Ofcom the power to introduce ex ante regulation into markets such as pay TV following the same process as they currently follow in telecoms market reviews - defining markets, assessing market power and proposing remedies.

Q4. What barriers can be removed to facilitate greater exports and inward investment and make the UK more globally competitive in digital communications?

BT's focus outside the UK is serving multi-site businesses with high quality, featured ICT and connectivity services. BT believes that the EU Framework needs to be applied more effectively in a number of countries, in order to provide effective wholesale access. The UK market is rightly the most open in the world but a priority for the UK must be to seek more open access elsewhere, including in key markets outside the EU such as the US and Asia Pacific.

We also need to address the very different rules globally on areas such as foreign ownership, public procurement processes, licensing rules and security regulations, all of which make it difficult for communications providers to serve businesses operating in more than one country. Common norms in these areas – at least in G8 or G20 – would go a long way to helping UK business in these areas.

The UK has great attractiveness for inward investment as a function of its open, competitive ICT market. BT's investment in a fibre network open to all users underpins that further. The UK also has a chance to become a global leader in emerging ICT technologies, notably cloud computing, e-health solutions, IT security solutions and 'green/smart ICT solutions'. UK industry collectively might market this capability in an even more coordinated way with government assistance via UKTI.

A communications infrastructure that provides the foundations for growth

Q5. What further market and regulatory developments would lead to widespread take-up of superfast broadband? What regulatory action would government need to take to make superfast broadband more readily available in a) urban areas; and, b) rural areas?

With BT's investment and the BDUK initiative, we believe the UK is on track to achieve the Government's ambition to have the best superfast broadband in the EU before 2020.

The formal regulatory framework for superfast broadband was established in 2010 with the conclusion of Ofcom's Wholesale Local Access market review following extensive industry and stakeholder consultation and consistent with the EU NGA Recommendation. We believe that the WLA market review reached reasonable and pragmatic outcomes with the Openreach 'active' VULA product seen as the main basis for scale NGA delivery and wholesale competition and ‘passive’ remedies seen as complementary. The economics of passives are challenging compared to VULA but they do have a possible, complementary role to play outside BT’s footprint. We have made clear our commitment to opening up our ducts and poles and believe other providers should be prepared to do the same with their own infrastructure; through the recent transposition of the revised EU Directives, Ofcom now has the power to mandate this from others, but it may be necessary to strengthen this legislation.

Although the commercial case for fibre remains challenging, this regulatory framework should help to enable the roll-out of superfast broadband on a commercial basis to most of the UK, and particularly to urban areas. The situation in rural areas differs from urban areas in that they are generally less economic to serve and hence are likely to be outside commercial roll-out plans. If there is such demonstrable market failure, then there is clearly a case for public funding along the lines of the ‘Final Third’ procurement exercise currently being driven by BDUK. In these instances, we believe it is crucial that all recipients of state aid funding offer wholesale access on the same basis as BT – and that any other outcome would be both unfair and legally questionable**.** Where government can make a difference is in ensuring that there is an efficient procurement process that targets public money in the most cost-effective way and ensures competition and consumer choice.

Outside of regulation, we believe market and technological developments will continue to drive SFBB forward, with faster speeds available from both FTTC and FTTP and emerging applications to drive up take-up and end-users’ willingness to pay . However, it has to be acknowledged within government that IPTV has helped to drive broadband investment and take-up elsewhere in the world – and that this process could be inhibited in the UK unless issues relating to pay TV content are addressed. Regulatory action to ensure premium TV content is available on a fair wholesale basis is required and, as indicated elsewhere in this response, this can be best enabled through a change to the Communications Act, giving Ofcom the power to introduce ex ante regulation in media markets. Outside of legislation, any initiatives to generally increase broadband take-up and stimulate demand, where we believe government can play a vital part, will also be important.

Consumers increasingly demand ever greater amounts of data for smart phones and other laptops/tablets and portable devices. They want to be able to use fixed superfast broadband in their homes with mobile connectivity to these devices**.** Spectrum policy should ensure that suitable and sufficient licensed and license-exempt spectrum remains available in the future to ensure that, as superfast broadband speeds increase, the wireless connectivity does not become a bottleneck to the speeds and performance that are delivered. The proposed Ofcom award of low power 2.6GHz spectrum is helpful in this regard.

We see wireless as a useful means to distribute superfast broadband on a localised basis, but because of the very high speeds and the required network capacity (assuming typical take-up and usage) we do not believe that wireless is an effective alternative means to deliver superfast broadband speeds over wide areas. However, high speed mobile broadband will of course be needed as a complementary service in both urban and rural areas and will require access to adequate spectrum in a range of available bands. Ofcom’s auction of 800/2600MHz spectrum next year will be important in this regard.

Licence-exempt spectrum may also have a role to play in broadband delivery and we encourage the Government to support and encourage Ofcom in their efforts to put in place a system that will enable spare capacity in the TV spectrum (the 'white spaces') to be utilised more efficiently.

Q6. What are the competing demands for spectrum, how is the market changing and how can a regulatory framework best accommodate any rapidly changing demands on spectrum and market development?

BT considers that the current EU regulatory framework on spectrum is appropriate. This already has considerable flexibility that the UK can exploit if needed. For example, although Ofcom generally uses auctions to award spectrum where demand exceeds supply, it is not prohibited from other approaches such as a beauty contests. That said, BT does in general favour the use of market mechanisms for spectrum assignment and supports the use of auctions and trading/liberalisation as spectrum management tools. We note that trading has only recently been applied to high value mobile spectrum. This, together with market value based pricing that Government has applied in some instances and the fact that there is still much cleared spectrum still to be awarded, might mean that more time is needed to see how the secondary spectrum market in the UK will ultimately operate. It may therefore be premature to change policy significantly before the market based approach has had time to become established.

The competing demands of spectrum are many and varied and attention needs to be given to both licensed and licence-exempt spectrum availability. The market cannot fully resolve the balance of spectrum available for competing uses, for example, the proportion of spectrum used for government versus civil use or the balance between mobile and broadcasting. Ofcom can, to some extent, set policy for the spectrum within its remit, following consultation with stakeholders, but it does not have the ability to set policy or have responsibility for spectrum as a whole. For example, the Government is consulting on releasing certain MOD spectrum at 2.3-2.4GHz and 3.4 – 3.6 GHz, but that award is disconnected from the auction of similar spectrum at 2.6GHz by Ofcom and it is not yet clear to us how the processes for releases of MOD spectrum will compare with those that Ofcom would use to award new spectrum rights. Closer coordination between Ofcom and Government on spectrum management policy is therefore needed.

Q7. How should spectrum be managed to deliver our growth objectives whilst also meeting our policy objectives of furthering the interests of citizens and consumers in relation to communications matters?

BT supports the prompt release of spectrum to the market where possible, efforts to make additional licence-exempt spectrum available and the promotion of greater spectrum sharing where technically feasible. The release of Government spectrum is an important component of this and requires coordination and cooperation with Ofcom and alignment of award plans and methods where possible. It is crucial that any spectrum auctions and awards are designed to ensure a level playing-field and encourage new entrants in order to maximise innovation and end-user choice.

Q8. How should the UK engage on an EU/International level in relation to spectrum?

We would encourage the UK to play a full role in international spectrum management discussions within the Europe (e.g. CEPT/ECC, RSPG, RSC, Council) and globally via the ITU. Close coordination should be maintained between Ofcom (where it is representing UK under direction of the government) and government (where officials participate directly). Close consultation with UK industry is important and involvement of UK industry in relevant meetings where appropriate will bring added value. No fundamental change is proposed by BT, but we would encourage the UK to work to secure the approval of the draft Radio Spectrum Policy Programme (as recently agreed at first reading in the EU Parliament) and to pursue its implementation.

Q9. Is the current mix of regulation, competition and Government intervention right to stimulate investment in communications networks?

Competition is more effective than regulation in promoting investment and innovation. Where there is regulation, it should promote competition, ease economic bottlenecks and tackle abuses of market power. To date, regulation has been successful in addressing these issues in fixed telecoms markets, but we believe much more could have been done to promote competition in related sectors where an asymmetric approach to regulating mobile, cable and pay TV markets has denied consumers effective choice and lower prices and restricted the ability of new entrants to innovate. A new Communications Act affords the opportunity to address these issues and it is also important that this pro-competition, pro-consumer approach underpins forthcoming BDUK procurements.

Creating the right environment for the content industry to thrive

Q10. Are there disproportionate regulatory barriers to investment in content? If so, what are they and how can increased investment in UK content production be encouraged?

The recent Hargreaves report has highlighted some areas of copyright regulation and licensing practice which warrant reform in order to stimulate new business models for content creation and distribution. We agree with Professor Hargreaves that policy in this area needs to be more evidence-based going forward than it has been in the recent past. To this end the Government should continue to be vigilant against established content producers seeking regulatory protection from the effects of technology developments and changing consumer preferences.

Q11. Should the core focus of public service broadcasting be on original UK content?

Undoubtedly the principal focus of public service broadcasting provided by the BBC, Channel 4 and Channel 3 licensees should be on original UK content, though this should not necessarily be primarily distributed on linear broadcasting platforms. The economics of video on-demand means it should be possible for the PSBs to continue to invest in high-quality UK content of appeal to relatively narrow segments of the population without incurring the high costs of linear broadcasting.

Q12. What barriers are there to innovation in new digital media sectors, including video games, telemedicine, local television and education?

The principal enablers of innovation in any sector are demanding consumers, a highly-skilled workforce, the availability of risk capital, the absence of barriers to entry (and therefore vibrant market competition) and an entrepreneurial culture. By contrast the ‘enemies’ of innovation are therefore low consumer demand, low skills, a risk-averse finance sector, unregulated economic bottlenecks leading to inefficient markets and an anti-business culture.

Looking across these factors, the UK inevitably has some strengths and weaknesses. We believe the principal role for government in respect of the communications industry lies in addressing media literacy, skills deficits and ensuring that enduring economic bottlenecks are targeted for regulation to produce a technology-neutral, level-playing field in which competition can thrive.

Q13. Where has self- and co-regulation worked successfully and what can be learnt from specific approaches? Where specific approaches haven't worked, how can the framework of content regulation be made sufficiently coherent and not create barriers to growth, but at the same time protect citizens and enable consumer confidence?

BT's direct experience of content 'regulation' is three-fold: as a major advertiser; as a provider of VOD services; and as an ISP offering parental controls to its subscribers. The first of these regimes is of long-standing and largely developed with only light-touch intervention by Government. The second of these regimes – co-regulation by Ofcom and ATVOD – is nascent and needs to be given time to prove its legitimacy and value. Therefore it is important that the legislative framework around it is relatively flexible and permissive. The final area is currently unregulated yet self-regulatory dynamics are beginning to come together in the wake of the Byron report and the work of UKCCIS. In our view, it would be unhelpful for the Government to consider direct regulation of this space until self-regulation has been given an opportunity to demonstrate its effectiveness.

As indicated above, we note that in recent years there has been a shift towards more formal regulatory intervention and we would suggest that the government should always look in the first instance to industry-led self or co-regulatory models.