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30 June 2011

Rt. Hon Jeremy Hunt MP
Secretary of State for Culture, Olympics, Media and Sport
2-4 Cockspur Street
London SW1Y 5DH

Dear Mr Hunt

A COMMUNICATIONS REVIEW FOR THE DIGITAL AGE

Your open letter of 16 May 2011 provides a welcome opportunity to contribute to the Government's thinking towards a new regulatory regime for the communications sector and it is encouraging that the Government's stated aims and objectives are as follows:

1. To establish UK communications and media markets as amongst the most dynamic and successful in the world, with the review process culminating in a new communications framework by 2015, to support the sector for the next 10 years and beyond.
2. To put the UK on the path to sustainable, long-term economic growth.
3. To introduce a deregulatory approach to benefit consumers, citizens and industry.

These aims and objectives are exactly what they should be - <u>but the Government should recognise that we have been here before.</u> Consequently, this response provides some reflections of whether we should try to learn from previous policy iterations, which have all attempted to achieve the similar end goals but never seemingly succeeded.

What should the Review consider?

Whilst the open letter poses a range of specific questions, this response does not attempt to answer each one but focuses on whether the current mix of regulation, competition and Government intervention is right to stimulate investment in communications networks. In short, bearing in mind the apparent frustrations of the Government and consumers, the answer must be no. But, is there a better option?

As a starting point, the Government should look at whether it can draw some lessons from previous attempts at defining a policy for the communications sector. Since the early 1980s, and particularly over the past two decades, the UK policy approach has fluctuated around the midpoint between the two extremes of relying solely on market forces as opposed to a centralised command and control policy. Neither of the extremes fit the UK (nor European) political and regulatory models so getting the right mid point, and recognising that communications infrastructure investment is very capital intensive, with long-term paybacks, is critical.

The attached Annex comments on the current climate and on some key policy iterations over the past 20 years. With none of these iterations fully delivering the desired outcomes, the Government must adopt a strategic approach, with the longer-term vision implied in objective 1 above. But does the UK have the freedom to develop a national broadband plan similar to those produced in Australia and the USA because of the need for European policy alignment?

Throughout our liberalisation history, it could be argued that there has been a temptation to micro-manage the communications sector, with regular interventions aimed at fixing short-term problems. Various attempts have been made to lower barriers for new entrants in the hope that this would lead to significant new investment that is sustainable over the long term, e.g. LLU. It is questionable whether the model has created the 'ladder of investment' foreseen and, therefore, whether the desired outcome has been achieved. In reality, such an intervention could have undermined the business case for major infrastructure investments and we now have a situation where even a universal, fixed access network duopoly is not currently viable.

In summary, the current position may have been influenced by historical regulatory interventions that have had unintended consequences and their own distortionary effects on the market. In practice, the obligation to carry out impact assessments required under the Communications Act 2003 has not been widely enough applied, particularly in terms of assessing indirect, as well as direct, impacts on market players. Therefore, it may be valuable to assess the impacts on market developments of historical regulatory interventions as part of the current Review.

It could also be argued that there has been too much focus to date on demand side, rather than supply side, issues. In this respect, we regularly hear that demand for high speed broadband is "uncertain" or "take up is slow" as a reason for the supply side not investing as quickly as the Government would like. The concern must be that, if we continue to accept these arguments, our vital communications infrastructures may always lag behind, rather than get ahead of, the demand curve. Lagging behind the demand curve can only be damaging to the UK economy in the medium to long term.

There is a danger that the UK will continue to convince itself that it is a world leader and defer critical policy and regulatory decisions. Government must guard against this.

In terms of the future regulatory regime, Ofcom cannot be just an "evidence-based regulator", since this implies decisions based on historical trends, rather than the forward-looking approach needed for the current infrastructure objectives. If the core objective is to accelerate the provision of universally available, high capacity infrastructures, more may be needed in terms of a national communications infrastructure strategy than has been achieved through earlier policy iterations. Both the Government and regulator need to give close consideration to what might mitigate investment risk, for both fixed and mobile, recognising the long-term nature of payback. Political ambitions and investor horizons must align as closely as possible. If the transmission of digital bits of information (that make up visual, text and voice services) is one of the highest, if not the highest, growth sector in the world, why should investment decisions be seen as so risky?

Yours sincerely

Malcolm Taylor

ANNEX

The following comments relate to the headings used in the open letter.

1. Re: Growth, innovation and deregulation

a) The letter claims that the *"UK is already a world leader in the broadband and telecommunications market".* This may be so by some measures but it is probably a tenuous lead and, unless we get the next steps right, the UK is in danger of slipping behind. This applies to other European Member States as well as more widely.

b) It is encouraging that the letter recognises that *"in an increasingly digital world, we rely on mobile and fixed line phone services, e-mail and the internet"* and that *"efficient management of both the spectrum and broadband infrastructure supporting the effective delivery of these services underpins growth in the communications market."* It is vitally important to acknowledge that electronic communications networks are the arteries of the economy, and decisions on policy moving forward are critical to sustainable, long-term economic growth.

c) The letter refers also to the objective of UK having the best superfast broadband network in Europe by 2015 and that the government believes that a combination of policy and regulatory interventions aimed at reducing barriers to private investment in superfast broadband networks together with targeted financial support from government (e.g. £530 million available up to 2015 to support broadband rollout) will bring the desired results. Again, **this is a laudable objective but haven't we been here before?**

d) Since the first steps towards liberalisation in the early 1980s, which led to the Telecommunications and Cable & Broadcasting Acts of 1984, through the Duopoly Review in 1990/91, the changes introduced by the Labour government following the 1997 election, the further review in 2000 (A New Future for Communications) and, more recently, Digital Britain, the underlying objectives appear to have been the same.

e) Throughout this period, **infrastructure and service competition philosophies have each had their period of prominence but the lack of consistency has probably deflected from achieving the primary objective that is the delivery of a communications infrastructure that provides the foundations for growth**

Observations:

- How the UK will achieve the objective that it should have the "best superfast broadband network in Europe by 2015" is not clear. Although the UK might feel that it can reach the targets laid down in the Digital Agenda, other Member States are also moving ahead and those with significant cable network coverage will see a major part of the population having access to broadband speeds well in excess of 100Mbs by 2015. Many are there today, courtesy of the EuroDOCSIS 3.0 technology, and take up is responding to supply.

- Most importantly, Government should take a radical look at the environment for private sector infrastructure investment, notably in access networks, which are the really essential parts of any end-to-end communication.

- If the existing players are reluctant or unable to commit the levels of investment required to provide a universal high capacity infrastructure over the next five years, why should any new entrant? If the transmission of digital bits of information (that make up visual, text and voice services) is one of the highest, if not the highest, growth sector in the world, why should investment decisions be seen as so risky?

- Furthermore, the current levels of financial support from Government for 30-35 new ventures (or 5 million homes) seem very light.

2. Re: A communications infrastructure that provides the foundations for growth

a) This is the critical objective but, as has been highlighted in each of the above policy iterations, it represents a significant risk for private capital investors. Even in the **1991 White Paper 'Competition and Choice: Telecommunications Policy for the 1990s'**, it was noted (sec. 5.14) that *"cable operators maintained that BT should not be allowed to provide entertainment services in cable franchise areas for 15 years"* and that *"even without the entry of BT, their expected return on investment over 15 years was uncertain"*. At the time, the policy was not to be reviewed for at least 10 years (sec 5.19.c).

b) In the light of this policy, the UK cable industry invested over £12bn between 1992-1998, to provide hybrid fibre-coax (HFC) networks to just over 50% of the UK. It is worth remembering that the policy objective at the time, with build milestone obligations in cable licences, foresaw around 70% coverage over an 8-10 year period. On reflection, this may have been a policy that did see one access infrastructure providing capacity ahead of the demand curve (e.g., today providing 100MHz+ broadband services) although the business case was eroded as a result of subsequent policy and regulatory decisions – see below.

c) Interestingly, in 1995, a KPMG report for the European Commission estimated the costs of providing a fibre (FTTH) infrastructure across the UK at £22.1bn (and, even in 2009, an Analysys Mason study for the BSG drew similar conclusions).

d) In the event, a change of Government changed the 1991 policy and, since the late 1990s, we have seen the cable industry contract from multiple operators to the single player, Virgin Media, and we have not seen a significant increase in the size of its coverage footprint.

e) In **'A New Future for Communications'**, published in 2000, the Government said *"we want to make sure that the UK is home to the most dynamic and competitive market in the world"* and *"we want to maintain the UK's competitive advantage in the rapidly changing international market place".* At the time, the Government considered that competition alone would not deliver sufficiently universal broadband access by 2005 and it saw a potential need for intervention. It was noted that the Prime Minister supported the Government's commitment to achieving universal access to the internet by 2005 (sec. 3.8.1) and said that the Government *"will promote the availability of widespread access to higher bandwidth services and bring together public and private sector stakeholders to develop a practical broadband strategy"* and *"we will look for ways to build on public investment that is already being made"* (sec 3.9).

f) To support the achievement of these objectives, the Government established the Broadband Stakeholder Group. The BSG has produced a number of reports over the intervening period with recommendations for action but some key proposals have not been followed up by Government for various reasons. For example, in the Second BSG report in 2003, there was a recommendation for supply side stimulation because of the infrastructure investment concerns but this was rejected by Government in favour of demand side stimulation.

g) In 2007, the BSG's **'Pipe Dreams'** report commented *"currently, there seems to be little prospect for the widespread deployment of next generation broadband access networks in the UK, as commercial incentives are particularly weak. High costs, unproven business models and intense competition for revenues from value added services make it extremely difficult for UK operators to justify large-scale investments in new access networks".* It went on to say that, *"for next generation broadband to move from pipe dream to reality in the UK, steps need to be taken now. The issues are complex and there are few clear or obvious solutions at this stage. However, there is a limited window of opportunity between now and April 2009 to get this right".* **Four years on from that report, it is debatable whether we have any clearer view on 'next steps'.**

h) More recently, the **Digital Britain** report listed the Government's ambition as *"to strengthen and modernise the country's communications infrastructure equipping the UK to compete and lead in the global digital economy"* and, most pertinently, it commented that *"a sudden removal of communications would not only bring business and commerce to a halt, but also our traffic, public services, finance, energy supply and much of our personal interaction".* It goes on to state that, in relation to the copper fixed telecoms network, there may been significant upgrades in performance, *"but not the massive investment required to redevelop the fundamentals of network infrastructure. In the case of broadband, realising the full value of the copper network cost tens of millions of pounds of investment; replacing it with a fibre network will take billions. Investment of this order poses a new set of strategic challenges."* **This Communications Review must address this strategic challenge.**

i) The **Digital Britain** report went on to make the point that *"like our energy and transport infrastructures, small variations in the performance of our communications can have major ripple effects, and major economic costs. Like energy and transport, the demands upon the infrastructure are constantly growing and the challenge of coping with these demands will move from complex to critical if we fail to take the necessary action."* **So when do things become critical?**

Observations:

- The Government should reflect on previous attempts to address the same challenges that the UK faces today and try to gather some lessons from the past 20+ years of regulatory decisions.

- The rhetoric regarding the economic importance of communications infrastructures is strong but this has never really been followed through. It is notable that other 'essential infrastructures' do achieve recognition for new investment by Government but communications infrastructures seem to be side-lined, maybe because there is an on-going hope that the market will deliver, maybe as a result of them being out of sight (and out of mind) and maybe because they are generally available to meet lower bandwidth service needs. But the time of traffic jams on our communications highways is with us and this can only get worse without bold actions. Such congestion on the communications highways could come at a higher price to the economy than those on road networks.

- The EC's Digital Agenda has recognised the 'urgency' of getting appropriate infrastructure in place – both fixed and wireless. Whilst wireless is currently seen to fill an immediate void, particularly in the rural areas, it would be dangerous to ignore the need for secure and high quality fixed networks. Because of the significant role that communications networks play in the control of other utilities, as well as towards business efficiency, resilience (i.e., duplication) is also critical.

- Through the various policy reviews, it seems that the same concerns have existed and, despite the belief that the UK has been a world leader, progress with broadband supply across the UK by the private sector has been seen as too slow and, therefore, state intervention has been proposed.

- The first question we must ask is why is private sector investment not more aggressive? Is it really that demand for bandwidth is uncertain, when we are considering probably the highest growth sector in the world? Or is it that returns on investment are uncertain?

- The related question is whether, in the interests of the economy, we should just follow the demand curve or whether we should aim to move ahead of it. In the interests of sustainable long-term economic growth, the Government should aim for the latter, which means that the climate for private sector infrastructure investment must be much better than it is at the moment.

- **Perhaps the core objective should be redefined along the lines of *"to provide infrastructures that will support current, anticipated and new services as yet unforeseen".* In this scenario, broadband investment cannot be based only on forward projections of demand for today's range of services but to enable broadband provision to get ahead of the game. This implies a requirement for greater levels of speculative investment and risk than in many other industries. The regulatory framework and Government policies must create a climate for such investment.**

- The major players have significant challenges – for BT, it is to replace its old twisted pair copper access network as quickly and efficiently as possible. For Virgin Media, it is to extend its cable footprint. And the mobile operators face major challenges in terms of spectrum availability for the fast growing demand for very bandwidth hungry services.

- The Government's desire to assist the provision of infrastructure in areas where the market is not delivering is understandable. However, it is not clear that the proposals to allocate state funds have properly addressed the sustainability of the new networks that are constructed. **It should be remembered that the original cable policy was to build a 'patchwork quilt of local franchise networks'.** The current BDUK programme looks similar in intent and it has to be assumed that BDUK wishes to seed fund sustainable new networks rather than simple pilots. However, the current Delivery Model document says little about assessing commercial sustainability.

- It is understood that there is interest in the Government's regional proposals from new players (e.g. from Fujitsu initiative and PCCW) but neither these, nor the LTE option, should be seen as panaceas to the universal high capacity infrastructure conundrum.

- In summary, the Government may have to choose between either:

  - Either letting the market follow its own course – which means greater deregulation – and accept the consequences in terms of coverage, pricing, etc.

  - Or shifting the balance towards a more centrally imposed national roll out plan, with greater state funding.

- But, if the key desire is to see the acceleration of private sector investment, the Government must look to further deregulation that will encourage more risk taking to get ahead of the demand curve, either by existing players or new entrants.

Malcolm Taylor
30 June 2011