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Evidence-based, light-touch regulation?

A reaction to Ofcom's Initial conclusions from the Strategic Review of Digital Communications

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Note: This response represents the view of the authors only, and does not represent a corporate view of Communications Chambers

Introduction

Ofcom published their initial conclusions of the Digital Communications Review yesterday.¹ On its face, it's not as radical as some hoped (no structural separation), but nonetheless it could have some radical consequences, intended or otherwise. In this note we consider the evidence for Ofcom's recommendations and their implications.

Before diving into the detail though, a note on the title – this is not, in fact, a *Digital* Communications Review. Rather attention is focussed further down the stack on ducts, poles and fibre. Software is eating the world, but this is a report about plumbing. Perhaps that's OK, but without thinking about services it's hard to assess future demand, or even the significance of any current broadband problems. As Ed Vaizey has commented: "If broadband is so terrible, why are we the leading ecommerce nation in the world?"² Indeed, on a host of output measures, the UK is in fact performing very well.³

Evidence based?

One of Ofcom's principles is to "strive to ensure its interventions will be evidence-based". The DCR (and the preceding Discussion Document⁴) could have done with a bit more striving.

Ofcom asserts a requirement for ultrafast, but offers very little evidence for its benefits. Indeed, the only forecast of bandwidth-demand Ofcom cites (in the Discussion Document) is Communications Chambers' work for the BSG⁵, which found requirements for tens of Mbps, not hundreds or thousands. Of course opinions differ on future needs and we don't claim ours is indisputable, but surely we should know the basis for Ofcom's sudden confidence that we need a massive new wave of investment in FTTP? As recently as December, Ofcom didn't feel FTTP deployment was a metric even worth including in an assessment of international broadband performance.⁶

Ofcom also suggests that higher bandwidths result in higher usage. However, their source is their own Connected Nations Report⁷, which

¹ Ofcom, [Making communications work for everyone - Initial conclusions from the Strategic Review of Digital Communications](#), 25 February 2016

² *Financial Times*, ["Ed Vaizey delivers blow to rivals' hopes of BT broadband split"](#), 30 September 2015

³ Brian Williamson & Sam Wood, [This connect'd Isle: building on success in digital communications](#), September 2015

⁴ Ofcom, [Strategic Review of Digital Communications - Discussion document](#), 16 July 2015

⁵ Communications Chambers (for BSG), [Domestic Demand for bandwidth](#), 5 November 2013

⁶ Ofcom, [The European Broadband Scorecard](#), 1 December 2015

⁷ Ofcom, [Connected Nations 2015](#), 1 December 2015

makes the rather different claim that heavier users are more likely to switch to higher bandwidths – the opposite cause and effect.

Another area where the evidence seems to be lacking is Ofcom's view that Virgin simply doesn't count for effective competition. The Review refers to "areas where network competition occurs but does not give rise to effective competition (for example, in areas where there are only two network competitors)". However, the Discussion Document quite rightly pointed out that "As Virgin Media extends its network further and offers faster speeds, BT is likely to come under greater competitive pressure to offer ultrafast broadband"

Ofcom's setting aside of Virgin leads to their puzzling statement that "a good outcome in the long term would be to achieve network competition of around 40% of households". If you don't assume away Virgin, *we have this right now*.

Competitiveness, a dangerous obsession⁸

Another Ofcom assertion is that we should be wary of falling behind other countries in FTTP deployment. However, league tables can be a trap, setting up a race to see who can over-invest most.⁹

Moreover, many FTTP deployment decisions around the world were made before innovations such as VDSL and G.Fast. It isn't obvious that FTTP-deployers would necessarily make the same decision today, nor do they have much to show for their early fibre investment. Spain, Korea and Japan are not the centre of the digital universe, and lag the UK on many measures. Australia followed the competitiveness logic and opted for a national FTTP strategy, but the main effect to date has been to foreclose deployment of much quicker-to-implement copper-based superfast. In light of new technologies they recently switched away from FTTP to use copper wherever possible.

Possible consequences, intended and otherwise

So, Ofcom's Review is on some shaky evidential and conceptual foundations. How about their recommendations?

Ofcom focuses on duct and pole access as a means to enable greater infrastructure competition. Ofcom also float the prospect of dark fibre access (forthcoming report on the business market) and the possibility of moving to cost orientation for VDSL. They also propose tighter

⁸ Paul Krugman, "[Competitiveness: A Dangerous Obsession](#)", *Foreign Affairs*, March 1994

⁹ Robert Kenny, "[Tilting at windmills – latest scores](#)", 24 April 2014

controls on Openreach (a belt-and-braces approach, since more infrastructure competition might have achieved the same thing).

So what is proposed in the near terms is more intrusive regulation at multiple levels, not less (though Ofcom suggest deregulation as infrastructure competition develops). Ofcom also discuss future regulatory options for VDSL, including the possibility of moving to cost orientation or to a modified anchor product (which could be decoupled from any particular technology). Only the latter option would continue to allow pricing freedom for other service levels, thereby supporting ongoing innovation in terms of service-price differentiation.

Whether the impact of the Ofcom proposals and signals would be more investment overall is unclear. It may deter Virgin's coverage extension or BT's planned G.Fast upgrade. If access revenues are to be divided amongst three (or more) fixed access providers, this may weaken business cases. The risk of deterred investment certainly deserves more attention than Ofcom seem to have given it thus far.

BT has suggested that duct and pole access is not a big deal since ducts are already available. However, let's assume Ofcom's right, and it unleashes third party fibre deployment. This sets up some very complex decisions for operators. Being first into the ducts both gives first mover advantage, and may also block the second mover if duct capacity is limited.

There are also implications for Openreach's pricing. If access seekers are buying duct instead of copper or active products, Openreach's total costs don't change much. But the number of lines carrying those costs will fall. Thus today's regulatory accounting would increase the price of unbundled loops. This could mean that infrastructure competition for city dwellers would drive up the price for customers in less dense areas.

The proposals may also impact on a promising development elsewhere in Europe where cable competition is present, namely the negotiation of voluntary long-term access contracts between access seekers and providers (in the Netherlands and Germany).

At minimum, managing these interlocking layers of regulation is going to create some challenges, as New Zealand has found to its cost – a change to wholesale copper prices there threatened to derail the business case and funding of their FTTP deployment.

Dogs that didn't bark

So what Ofcom has said raises a number of questions. But so do some of the things Ofcom hasn't said – there are several dogs that didn't bark.

Firstly, Ofcom rightly mention cost reduction in the context of investment incentives, but have nothing to say about allowing the closure of existing services and networks. Ofcom have resisted legacy service closure in the past, and the UK is behind European peers in terms of “All-IP” transition. The question becomes more pressing given the emphasis on facilitating greater fibre to the premise investment. The proposed 10 Mbps USO also needs to be designed in a way that is compatible with the opportunity to close legacy network.

Secondly, there is nothing in the way of cost-benefit analysis. For example, Ofcom rightly say that consumers are increasingly dependent on broadband, but simply assume the best response is to increase the reliability of fixed broadband connections. In practice many people already rely on mobile broadband as a fall back – might this network diversity be a more efficient solution than investing even more in fixed reliability?

Thirdly, the proposals would, over time, turn Openreach into a provider of inputs (duct and poles) to itself (VDSL, G.Fast and FTTP). Have we got the right split¹⁰, and what mechanism assures non-discrimination within Openreach? This is an acute issue if some ducts are nearly full, and Openreach itself is one potential user of the scarce remaining capacity. This shift in focus also highlights the importance of flexibility in the boundary of separation – something for Ofcom to consider as it seeks to more deeply cleave Openreach from the rest of BT.

Fourthly, Ofcom doesn't appear to have considered that given Openreach's customers greater influence may actually *reduce* investment. Certainly the non-BT ISPs were not big fans of VDSL deployment, which threatened their sunk costs in ADSL. If anything this problem may get worse, since Ofcom is setting up a situation where Openreach's customers will also be its direct competitors, with all sorts of incentives for game-playing.

Fifthly, Europe is also carrying out a fundamental review of telecoms regulation and is expected to report after the summer. How the Ofcom and EC reviews play out against one another is not entirely clear. However, what is clear is the position the UK has taken in

¹⁰ Richard Feasey, [Why the UK should think about splitting Openreach and not BT](#), February 2016

relation to the EC review.¹¹ The Government position is characterised by strong advocacy of technology neutrality, some scepticism about the demand for ever faster broadband and support for reducing regulation. Ofcom are making policy, but is it joined up?

Conclusions

The ambition of promoting both competition and investment is laudable. However, it isn't clear that the Ofcom proposals, and indications of future direction, will deliver. That is a question that will be debated. What is perhaps more concerning about this paper is what it tells us about Ofcom's thinking and methodology. In particular:

- For such a major piece of work, the provided evidence for some of the conclusions is thin, and Ofcom has relied on simple assertion for some fundamental points
- The precept of technology neutrality is greatly weakened
- There is an enormous focus on the fixed access network in isolation, with almost nothing on converged networks or the applications and content riding on them
- Overall the tone is more dirigiste than we are used to

For a document designed to take us into the 2020s, it is surprisingly redolent of regulation in the 1990s.

¹¹ DCMS, [Review of the EU Electronic Communications Regulatory Framework - The UK government's response to Commission Consultation: "Public consultation on the evaluation and the review of the regulatory framework for electronic communications networks and services"](#), December 2015