Digital Communications Infrastructure Strategy Consultation
TalkTalk Response

About TalkTalk
TalkTalk is the UK's leading value provider of broadband, television, fixed-line telephony and mobile services, serving a customer base of over 4 million. We sell services to consumers through the TalkTalk brand and to businesses via TalkTalk Business.

Introduction
TalkTalk welcomes the opportunity to respond to the Digital Communications Infrastructure Strategy consultation. Ensuring businesses and consumers have the digital infrastructure they need is essential to Britain's future prosperity. At a time of slowed growth in other sectors, the internet economy in the UK is growing at 10% a year and will account for 10% of GDP by 2016[1]. In the period the consultation considers, 2025-2030, connectivity will underpin virtually every sector of the economy and will be the fourth essential utility. This presents an enormous economic opportunity; Booz and Co identified a potential £63 billion uplift in GDP if Britain maximises the digital potential[2]. Achieving this will require much more than just infrastructure investment. It also requires vibrant competition at the retail level (to drive investment and innovation in services and customer acquisition); empowered consumers able to make informed decisions; and a significant improvement in Britain's digital skills. TalkTalk therefore welcomes the Government's focus on digital infrastructure, but believes it should be considered in this wider context, as one element of the policy response required to ensure Britain can compete economically.

In responding to this consultation, we have focussed on a limited number of questions directly relevant to TalkTalk and grouped answers to reduce duplication.

Q1 Views are sought on:
a) Is this an appropriate role for Government?
b) What other high level principles the Government might adopt?
c) What resources do you consider the Government should aim to deploy to effectively manage its role?

- **Market-based innovation –** Government is right to prefer market-based innovation to meet Britain's digital communications infrastructure needs. Private sector

[1] http://raconteur.net/business/uks-position-in-the-digital-economy
[2] http://www.strategyand.pwc.com/media/uploads/Strategyand_This-Is-for-Everyone.pdf?utm_source=boozcom&utm_medium=text&utm_campaign=reports-studies&_ga=1.91697882.1576467578.1410769179

investment is more agile and better able to respond to consumer and business demand and at a lower cost. It also removes risk for the taxpayer and protects against infrastructure investment becoming a partisan political issue. The role for Government is in creating the policy and regulatory environment that supports investment and intervening to address market failure, such as where the consumer interest is threatened by a lack of competition. There will be some issues where the market alone is not able to meet demand, such as infrastructure provision in remote locations and where Government will need to play a more active role in financing investment that is not commercially viable. Wherever possible, however, Government should be focussed on stimulating innovation and investment from the private sector, whilst ensuring via the market or price regulation that there are strong incentives to reduce costs and prices to consumers. In the cases that it does intervene Government must design its interventions carefully to ensure value for money and avoid diminishing competition.

- **Flexible policy frameworks** - The pace of technology innovation makes it difficult to predict future demand with certainty, particularly to 2030. Government policy based on demand forecasts also risks being inflexible to market innovation, unable to adapt as technology and consumer behaviour evolves in unforeseen ways. Rather than predicating policy on particular demand forecasts, Government policy should instead be robust to different demand outcomes. It can do this by establishing a policy framework that defines the characteristics of a successful market and the principles on which Government will intervene to shape it, but is sufficiently flexible to allow for unforeseen changes in demand, innovation and technology. This allows policy to evolve over time rather than having to be re-written as unforeseen changes render it obsolete. Principles would include ensuring markets remained competitive, prices are accessible, service standards meet consumer demands, markets support innovation, services are reliable; and that informed consumers are able to make sovereign choices about the services they require. Within these principles, Governments should be agnostic about the specific details of product offerings and how they evolve to meet consumer demand.

Q7 – What metrics do you think should or will become relevant in comparing network performance in different countries? What metrics should most appropriately be used as the basis to set objectives for Government policy?

- **Holistic measures –** It is imperative that infrastructure is viewed in the context of the wider market. Section 1.29 of the consultation notes that BT's superfast broadband network currently reaches 19 million homes, but just 2 million customers take the service. Whilst there is an understandable – and welcome – political focus on infrastructure, viewed in a silo it won't deliver the market that consumers, businesses and the economy need, take-up will continue to lag behind what is expected and Britain will fail to maximise the economic uplift possible. An effective market has to deliver for consumers on choice, price, service levels, innovation, reliability and take-up. Infrastructure underpins that, but infrastructure is meaningless unless consumer and businesses are able to access the products and services they need, at a price they can afford. Accordingly, the objectives should reflect this wider and more holistic set of desired outcomes.

Q23 – Are there factors, for example technical or unrelated to the regulatory framework, that could create bottlenecks and delay future infrastructure deployment in the UK in this timeframe, that would result in demand not being met or the UK not being seen as a leading digital nation?

- **Digital Skills –** Britain's digital skills deficit risks jeopardising its ability to maximise the economic benefits possible from improved digital infrastructure. 9.5 million UK adults lack the basic digital skills to get online[3], undermining Britain's ability to attract high-skilled digital jobs that might otherwise be lost to competing economies. Only half of UK businesses have a website, and of those who do, only one in five use it sell products and services.[4]

  Britain also risks excluding specific social groups from the economic benefits of embracing digital. Just under a third of those with disabilities do not use the internet and over half of those without basic digital skills are over 65.[5] As digital skills become increasingly essential in the workplace, those without them risk being excluded from the jobs market, or confined to low-paid sectors. The Government's commitment to digital infrastructure is welcome, but a concerted effort to address the skills challenge is required to ensure people are able to maximise the opportunities improved infrastructure provides.

Q27 – How might efficient investment in communications infrastructure be supported, for example by changes in the regulatory framework?

- **Investment through competitive markets:** Striking the right relationship between investment and competition is the most important challenge facing Government and the regulator. Incumbents such as BT often argue that infrastructure investment can only be secured by reducing or removing regulation that supports retail competition. Indeed, Section 4.6 of the consultation notes that Ofcom's decision not to set prices for active wholesale access to BT's superfast broadband network was partly influenced by a desire not to undermine the investment case for rolling out fibre. Similar arguments are advanced about market consolidation, in the UK and at a European level. Incumbents continue to suggest that mergers which reduce consumer choice and undermine competition are a necessary price to pay for infrastructure

[3] http://www.go-on.co.uk/about/
[4] http://www.go-on.co.uk/opportunity/
[5] P4, Digital Skills for Tomorrow's World, UK Digital Skills Taskforce

investment. This is a false dichotomy. Significant infrastructure investment and vibrant retail competition can co-exist though it requires adapted regulation which allows investors fair returns but simultaneously allows rivals to compete. Companies in intensively competitive sectors undertake investment, and getting this balance right is an important part of the competitive strategy of most businesses. In competitive markets, companies do not rely on monopoly profits to fund investment and innovation: neither should regulated incumbents. The present fibre market, with no margin squeeze regulation, fails to achieve the appropriate balance, with too much emphasis on stimulating investment and too little on the incentive to compete. The answer is to redress the regulatory balance in the short-term, before addressing the structural issues (such as the full separation of BT Openreach) in the medium-term.

A regulatory approach that promotes competition, rather than market consolidation, will drive increased infrastructure investment in two ways:

1. More vibrant retail competition will increase consumer and business demand, thereby increasing demand for new infrastructure and making faster and wider infrastructure roll-out more viable. Instead of funding investment from high prices, the UK could do so with lower prices and higher volumes. Strong retail competition also makes the market more directly and rapidly responsive to consumer demand, ensuring that investment continues to be focused on the areas where it adds the greatest value.

2. More vibrant retail competition can create competition for infrastructure investment which is the surest way of driving efficient infrastructure investment. For instance in April TalkTalk announced a joint venture with Sky and City Fibre Holdings to build Britain's first city-wide fibre-to-the-premise (FTTP) network in York. Using innovative micro-trenching techniques, the network will offer speeds of 1 Gigabit to residential and business customers. This is a major milestone in the development of digital communications infrastructure in the UK and if successful, we see the potential to scale it nationally. This is only possible, however, because TalkTalk and Sky are able to leverage large existing customer bases to support the investment. Without robust regulation to create a level playing field, rival providers will not be able to develop the scale customer bases required to finance alternative infrastructure investments.

The existing superfast broadband market demonstrates the need to protect competition from the outset. In contrast to the copper market, where Ofcom's pro-competition interventions have created a vibrant market, with high degrees of choice and low prices, the UK's superfast broadband market is far less competitive and this is arguably slowing down its development. TalkTalk, Sky and smaller resellers are forced to rely on the sole monopoly infrastructure provider, BT, to set a fair wholesale price for the GEA (consumer fibre/FTTC connections) product. BT is able to exploit this to margin squeeze competitors, overcharging at a wholesale level and undercutting at a retail level. This undermines competition in the market and has allowed BT to rebuild its former retail monopoly. For instance, whereas in the copper market BT Consumer/Plusnet accounts for 39% of all Openreach connections, it accounts for 76% of Openreach connections in superfast broadband. Ofcom recognises this risk and proposes to introduce a margin squeeze test to prevent BT from acting anti-competitively. TalkTalk welcomes this as an essential step towards creating a level playing field, but had such measures been in place earlier the problem could have been avoided. It is far easier to support competition from the outset with a level playing field as new markets develop as opposed to retrospectively unpicking entrenched monopolies. For instance, the current requirement to introduce a fibre margin squeeze test could have been prevented if BT had been fully separated a decade ago, with a standalone infrastructure provider providing wholesale access to BT Retail. Given BT retains its unique role, it is vital Government and Ofcom replicate the robust pro-competition regulatory architecture for next generation networks.

- **Focus on efficient infrastructure investment** - The Government is correct that policy and regulation should focus not just on achieving any investment but rather only <u>efficient</u> investment that is demanded by the market or necessary to meet a well specified social or economic need. As countries increasingly seek to benchmark their digital infrastructure, Britain should avoid the temptation to drawn into a 'digital arms race', setting ever more ambitious targets for the sake of it. Britain absolutely should be ambitious, but targets and infrastructure commitments should reflect real consumer and business needs.

Q34 – How can the regulatory framework keep up to date with new business models and changes in technology?

- **Ofcom powers and market structure –** We think that Ofcom has the right powers (through the Framework Directives and Communications Act 2003) and that these do not need either expanding or reducing. The current regime has generally worked well, is well understood and provides the certainty operators need to continue investment in the sector. Obviously, the specific implementation of regulation will differ for certain investments (e.g. initially margin squeeze regulation rather than wholesale price caps) but the regulatory framework is sound.

  Supporting competition in the market is a continual process, however. BT's unique position means that as the market evolves so too must the regulation underpinning it. In the short term, this requires a robust regulator, able to introduce measures such as a fibre margin squeeze. In the medium-term, structural reform is required to remove the conditions that give BT a natural monopoly. This would involve separating BT Openreach as a standalone infrastructure provider. This would create a more level playing in the market and would reduce the regulatory burden on Ofcom to continually counter-balance BT's natural monopoly. A standalone infrastructure provider would also make more efficient infrastructure investment decisions. It could consider future infrastructure investment based objectively on consumer demand, rather than having to balance that against the interests of one particular provider.

- **Appeals reform –** The current appeals regime is a barrier to effective regulation. An effective appeals regime must allow for challenges to regulatory decision making when the regulator has made a bad decision or a mistake but, crucially, it should also deter litigation aimed solely at slowing the regulatory process. The current regime fails to meet that standard. It has allowed Ofcom's decisions to be delayed by incumbent operators opposed to meaningful change, through technical, legalistic and substantive challenges that ignore the substance of the regulator's judgments and game the system to commercial advantage. Attempts to reform the appeals regime have been consistently frustrated by incumbent operators which benefit from the status quo. Government should prioritise the interests of consumers and competition, with meaningful appeals reform that empowers, rather than undermines, the ability of Ofcom to regulate effectively.

- **Switching reform** – A vibrant market requires well-informed consumers being able to easily switch providers to secure the best deals. However, attempts to simplify the switching process have been persistently frustrated by providers who benefit from the status quo.

  The UK mobile switching process is almost unique in Europe in requiring consumers who have chosen to switch to deal with their existing provider as well as their new provider. This complicates the process, undermines competition and causes consumer harm. Of the 9 million UK mobile customers who enter the switching process each year, as many as 1.2 million end up being double billed or losing service.

  Switching in the fixed market can be even worse. At present, there are several different processes depending on the wholesale products used and the gaining and losing providers. This causes confusion amongst consumers and ensures that switching rates are far lower than in other sectors. The car insurance market, for instance, has a switching level of 38%, compared to 9% in the broadband market and just 3% in digital television. This leaves consumers paying more than they need to.

  The current switching system also enables providers to 'hide' their best deals until customers enter the retention process, reserved only for those who threaten to leave. This means the vast majority of UK consumers (including the inactive, the out of contract and the vulnerable) face higher prices while only a minority of savvy customers, willing or able to 'work' the system, get the best deals.

  Ofcom's powers need to keep pace with changes in consumer behaviour. Consumers are increasingly purchasing landline, broadband, TV and mobile products together as one bundle to save money. By 2025, we expect triple and quad-play packages to be the norm. At present, consumers seeking to take advantage of a triple or quad-play package have to negotiate out of 3 or 4 separate contracts, each with different contract lengths and break clauses. This makes it too complex for consumers to secure the best value deals. At present, Ofcom does not have the power to enforce simplified switching processes across product bundles. It is crucial Ofcom's powers are extended to reflect changes in consumer behaviour, with a Gaining Provider Led switching process applying across landline, broadband, TV and mobile bundles.

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