

Stephen Carter
Minister for Communications
Digital Britain Team
BERR
1 Victoria Street
London
SW1H 0ET

Head Office
Inveralmond House
200 Dunkeld Road
Perth
PH1 3AQ

Telephone: 01738 456401

Facsimile: 01738 456415

Our Reference:

Your Reference:

Date: 12 March 2009

Dear Lord Carter

Digital Britain: Response to Interim Report

We welcome the opportunity to respond to the Digital Britain interim report. Following an introduction to our organisation and our interest in the communications markets, we explain the background to our thinking on a proposal for consideration by the Digital Britain team, which we believe could further the objectives of the Digital Britain project as well as bringing some coherence to the development of the market to the benefit of customers. More detailed points on elements of this proposal are contained in an appendix.

Scottish and Southern Energy (SSE)

SSE is a major energy company, with subsidiaries operating throughout the supply chain in that industry; for example in electricity generation; operation of higher and lower voltage electricity networks and gas pipelines; and delivery of retail energy services to customers. We also now provide a telephony service to our retail customers, based on the wholesale products available as well as engaging in business-to-business provision of capacity and bandwidth services on a retail and wholesale basis through code-operator subsidiary companies. It is also the case that communication services support our core businesses in energy. We therefore have significant experience of and interest in the communications markets from a number of different perspectives.

We note the references to the energy industry – and particularly to the development of the UK’s electricity networks - in the report. We agree that, like energy, the communications industry is a sector providing services on which the rest of the economy depends. It is therefore, we believe, part of “critical national infrastructure” in providing a utility type of service that is essential for both individual consumers and the rest of the economy. In both of these industries, the development of competition where feasible has led to significant innovation in the development of services and the ability of customers to “shop around” for service packages that best

suit their needs. However, it is evident to us that a degree of coordination is also necessary: both to support the smooth running of the underlying wholesale infrastructure and to allow market developments to occur in a coordinated manner. In our view, it is these elements of coordination that need to be developed further in the communications markets.

The Digital Britain Initiative

We support the Government's initiative to provide direction for the development of the sector towards meeting the demands of a modern knowledge-based economy. As our involvement in the market is concerned with communications networks and services rather than content, our comments relate principally to the first two objectives set out in the introductory section of the report:

- *Upgrading and modernising our digital networks – wired, wireless and broadcast – so that Britain has an infrastructure that enables it to remain globally competitive in the digital world; and*
- *A dynamic investment climate for UK digital content, applications and services, that makes the UK an attractive place for both domestic and inward investment in our digital economy;*

We also have some comments on how issues such as the universal service obligation or “universal connectivity”, which is covered in a separate section of the report, could be addressed. In fact, the main proposal that we would set out for consideration in response to the interim report is that **putting in place a framework for coordination and governance of market developments is a key enabler for the future success of the Digital Britain initiative**. In our view, the right type of framework for coordination would not only allow issues such as universal connectivity to be addressed by the market but it would also help to create a pro-investment climate and thereby create conditions where the market would deliver the desired developments in infrastructure, services and content - to the extent that it is judged commercially feasible.

For clarity, we have set out the key features of our proposal in an appendix to this letter but set out some high level comments on it below, followed by some observations on how coordination is addressed in other utility industries.

SSE Proposal for Developing Coordination in the Communications Markets

During our years of experience in developing our retail telephony business, we have observed and commented to Ofcom on a number of areas where a greater degree of mandated coordination between communications providers (CPs) serving the mass market would be helpful. These include:

- The initiation and development of mass-market customer switching processes;
- The coordination of numbering information and processes to allow convenient number porting and maintenance of directory information;
- Within the NGA arena, the development of technical standards and oversight of schemes to trial, roll out and migrate end customers to new technologies.

In fact, with the fast paced nature of technological change in the communications industry, we believe there is significant scope for customer detriment without inclusive and transparent arrangements to coordinate developments. For example, we believe that the technical innovations which allowed the development of competition in broadband via local loop unbundling proceeded without sufficient consideration of market processes to allow customers who took up the new competitive offerings to “switch back” economically to the pre-existing infrastructure to take up other competitive offerings. This appeared to be a contributory factor to the significant level of customer complaints about “broadband migrations” in recent years, to which Ofcom reacted by putting in place a further General Condition in this area. However, the underlying issue of lack of cross-industry coordination on such developments, in our view, remains.

We note and support the statement in the introductory section of the report about the need for cooperation in order to achieve the objectives of the Digital Britain project:

“Delivering Digital Britain will require an ambitious and clear strategic vision from Government and a new and stronger sense of co-operation between Government, regulators and industry.”

In relation to the next generation access (NGA) developments, we understand that Ofcom supports the idea of a mechanism to govern the evolution of the market and we are aware that it promoted the coordination of the implementation of technical standards for inter-operability, which is now being carried forward by a new standards body under the NICC. This is a welcome development but still, in our view, lacks two essential features: firstly, a means to establish and enforce the consensus way forward on all relevant participants; and secondly, the involvement of Ofcom, at a high level, in order to ensure that the standards and the market evolve in a manner compatible with consumer and citizen interests.

We believe that both these objectives can be achieved in relation to wider market developments if Ofcom were to set a General Condition requiring relevant CPs to belong to a co-regulatory body whose aims and objectives were set, at high level, in the Condition. Proposed changes to the “market rules” would be tested against their contribution towards better achieving these high level objectives, with Ofcom potentially having some power of veto or approval of more fundamental changes but essentially leaving the industry to develop the market arrangements within this framework. In this way, Ofcom’s involvement would be devised such that it had sufficient input to and oversight of the evolution of the market but without an ongoing need to be involved in the details.

It may be that Ofcom’s powers and duties under the Communications Act would need to be amended in order for it to be able to propose and enforce such co-regulatory arrangements. In any event, the Digital Britain project, with its stated intention to legislate where necessary to achieve the objectives, provides an opportunity to facilitate the means for coordination of the necessary parties. As discussed in the appendix, where our proposals are set out in more detail, we believe that such a framework would also assist in achieving other objectives of the Digital Britain project.

Coordination Arrangements in Other Utility Industries

Our perspective on this matter is influenced by our background in the energy markets, where SSE operates as both a provider of infrastructure and as a supplier of retail services to end customers over the regulated infrastructures of wires and pipes. In these industries, there is a clear distinction between the regulation applying to infrastructure providers (on providing access, meeting standards and supporting market mechanisms) and that applying to the suppliers of services using those infrastructures (chiefly various consumer protection requirements).

Both the infrastructure providers and the suppliers in energy also have obligations to belong to “market bodies” and to abide by their rules. These market bodies exist to maintain the rules for the day-to-day operation of the market (for example, the mechanisms for customers to switch between different suppliers) and to consider developments to these rules in a transparent manner, allowing for impact assessment, the development of consensus, voting on proposals and the management of appeals on decisions made. These bodies are independent of any individual market participant but are funded by members. The industry regulator also has a role in reviewing modifications and determining appeals. This arrangement has in our view worked well in providing a controlled set of documentation describing relevant market arrangements, against which any proposals for change can be assessed. In particular, arrangements to allow customers to switch between different energy suppliers have been established and refined over time through the market bodies to enable a smooth and trouble-free customer switching experience.

It is worth noting that the above approach to supporting competition through market bodies and switching mechanisms is also part of the emerging framework for developing competition in the water industry: national codes and switching mechanisms existed prior to the opening of the non-domestic water market in Scotland and have been advocated in the interim report by Martin Cave¹ on the prospects for competition in water in England and Wales. We therefore believe there is precedent from a variety of other utility industries, where competition in supply of services to customers exists or is contemplated, for a form of market coordination that allows for market rules to be maintained by an industry body, independent of any one market participant but working for the best interests of the market overall as the market develops.

On this theme, we note that there are a number of references in the interim report to the recent report by Francesco Cioa². This report highlights the likely development of broadband, with the NGA developments now in focus, to become “an essential digital utility” in the future. If this is the aspiration of Government and the communications industry, we submit that the time is right for serious consideration to be given to adopting some suitable elements of utility-style regulation in the developing communications markets and in particular, the elements that allow for coordination and governance of proposed developments for the ultimate benefit of citizens and consumers. If this requires changes to the legislative framework in which Ofcom

¹ “Independent Review of Competition and Innovation in Water Markets” Interim report issued in November 2008

² “The Next Phase of Broadband UK: Action now for long term competitiveness” Final Report issued in September 2008

operates, then we would urge the Government to take that step as part of the outcome of its Digital Britain project.

We hope our thoughts and proposal will be of some interest to the Digital Britain team and would be happy to discuss the ideas further with a member of the team if that would be useful.

Yours sincerely

Aileen Boyd
Regulation Manager

Detailed Elements of our Proposal

Clarity on distinction between different types of Communications Provider (CP)

1. As a starting point, we believe there should be greater clarity in the regulatory framework around the role of the different main types of CP and the regulation appropriate for each. We see a major distinction between suppliers of services (and possibly content) over communications infrastructures and the infrastructure providers (IPs) themselves. For each of these categories, it is also significant whether or not they are providing infrastructure or services to the “mass-market” of consumers and small business customers, where we believe that industrialised processes akin to those in the provision of other utility services are warranted.
2. In our view, the supplier – as the party having the direct retail relationship with a customer – brings a ready source of innovation to the market with an ability to package different wholesale offerings in different ways to meet customer demands. Suppliers can be the retail arms of large IPs but are often smaller enterprises with no ownership of infrastructure assets – the so-called “reseller” model, which covers our own activity in the retail telephony markets. To enter the market and sustain their business models, these suppliers need the support of regulated or commercially available access products to reach their customers.
3. Amongst the IPs, there is a relatively small group of those who provide communications infrastructure that serves the “mass market” of consumers and small businesses in the UK. We believe these operators should be given some distinct status in the regulatory framework so that they can be given obligations to coordinate the introduction of market changes and developments, as discussed further below.
4. There may be a case for other sets of requirements to apply to other specific groups of communications providers such as, for example, those allocating numbers. Additionally, by analogy with “system operator” role in electricity networks, which is needed in order to balance supply and demand of electricity across a constrained network in real time, we consider it may be worth considering an independent role of “connectivity manager” for the mass market, which might have a role in establishing the best means of establishing connectivity in unserved sites or in administering supplier of last resort arrangements.

Interoperability and Access to Infrastructures

5. We are in full agreement with the long term goal expressed in the interim report with respect to mobile networks.

*”The long term goal is any content...over any network ...on any handset
...anywhere”*

and would adapt this for fixed line networks as follows *“The long term goal is any service...over any network ...at any premises ...anywhere”*. We believe that this is

what customers will expect from the digital networks of the future and similarly, that they would expect to be able to continue with service from their existing supplier(s) when they move house.

6. To achieve this sort of inter-operability, such that services can be delivered technically and commercially across all types of infrastructure to any consumer, it appears that wholesale access to all types of infrastructure serving the mass markets of consumers and small business customers would have to be available to the suppliers of services in those markets. Whilst we are not convinced that access needs to be available at the low level of passive access to ducts, we do believe that the availability of more active access products across all types of infrastructure is vital to support a vibrant market in the provision of different services and content to end customers and to support the goals described above.

Regulation for Access

7. We understand that applying regulation to require wholesale access to networks might be a sensitive point within the current regulatory framework for communications. However, we believe that Ofcom, in its work on Next Generation Access (NGA) networks, has recognised the importance of infrastructure providers giving access to service providers with their emphasis on the need for wholesale products to support service competition. It could be that amendments to the legislative framework would provide Ofcom with more confidence in this respect. We note that such a development would not appear to run counter to, and arguably is consistent with the spirit of the European Access Directive.
8. The practical realities of allowing interconnection and access for traffic from one infrastructure to another is a very technical area and has naturally led, in the work that Ofcom has carried out so far on NGA, to the development of a “technical standards body” under the auspices of the NICC to develop and maintain the necessary open technical standards. This body has invited participation from relevant IPs and represents the start of “technical governance” of access. In our view, this initiative could be built upon to develop both “access governance” and “market governance” – the protocols and processes that allow the market to work efficiently and give roles, for example in the matter of house moves or switching suppliers, to both the suppliers and the IPs involved. We believe that a market governance body would also, importantly, provide a forum for suppliers with innovative ideas for new product offerings to seek to have the technical arrangements for product delivery discussed and adopted.

Development of Regulatory Requirements for Governance

9. The key element that is missing so far from the developing arrangements is a regulatory requirement for the “mass market” CPs – both suppliers and infrastructure providers – to join a relevant standards/governance body and abide by its rules, as these are developed. We strongly believe that this requirement should be embedded in the regulatory framework as, perhaps, a General Condition applying to relevant CPs. In our view, for the Government to achieve its Digital Britain objectives, there must ultimately be a mechanism by which adherence to

standards and compliance with mass-market systems and protocols can be enforced through the regulatory framework. If this does not happen, we believe the cohesion and development of this market would be undermined and Ofcom (and perhaps the Government) would continue to be involved in seeking to broker consensus for each and every market development issue amongst a diverse population of CPs who have a variety of different business models.

A Co-regulatory Market Body

10. Building on the ideas above, we propose that the standards/governance body should be run on co-regulatory lines so that Ofcom has a role in ensuring customers' interests are protected and that the direction of development of the market takes due account of other policy objectives. As discussed in the covering letter, one mechanism for this would be that high level objectives for the body are set out in a General Condition with proposed developments tested against their contribution to better achieving these high level objectives.
11. Other aspects of a governance arrangement that we consider important relate to representation and funding. It is important that all relevant market participants are given a voice in discussion and adoption of market developments and rules: for example, whereas it is clear that IPs have to discuss and agree technically how a specific development is to be implemented, suppliers may also have views on aspects of the implementation and should be allowed to be represented in discussions. Given the number of independent reselling suppliers, it may not be feasible for all to be represented directly but it should be possible to develop some form of constituency representation for this group.
12. We would anticipate funding for the administration of such a governance body to be met by the industry on a basis which recognised the relative market share of the relevant CPs. There should be no distortion to competition if funds are raised on a "per customer" basis. With independent administration, the governance body would be independent of any one market player but accountable to all and to Ofcom, as considered appropriate.

Dealing with Market Developments and Issues

13. Once established, we believe that this framework of a market body with inclusive and transparent governance arrangements could be used to help address market issues such as the arrangements for universal connectivity mentioned in the report. Such a framework would provide a transparent method of engaging the major CPs dealing in the mass communications markets and potentially could also provide a mechanism to raise a pool of funds (although this is likely to require specific legislation or regulatory action to achieve), to be used for implementing some aspects of the universal service commitment.
14. Our covering letter has set out some current areas, where we believe that a market body would have a useful role in coordinating developments which otherwise appear to have stalled - these include customer switching processes and numbering issues. There are other emerging areas and likely to be further issues in future that such a body could usefully address. For example, we are aware of

recent discussions on subjects such as minimum network security standards and supplier of last resort arrangements. In these days of recession, it may also be prudent for Government to consider whether “special administration” arrangements (as are currently in place to protect the ongoing operation of networks in other essential “utility” services such as rail, water and energy) might be appropriate for communications networks. Again, an established cross-industry market body would be in a good position to assist, in a transparent manner, in the ongoing provision of services in a situation where special administration had had to be invoked.

Contestability

15. Finally, we have supported Ofcom’s principle for contestability of NGA investment and believe this principle should extend more widely in the provision of infrastructure to support the mass market of communications products. Consistent with the Government’s vision for Digital Britain, we believe that markets should evolve to allow new networks to “plug in” to the existing mass market infrastructure. This would require mass-market IPs to provide physical connection and technical interconnection facilities to their own existing infrastructure in a way that allows potential new providers of infrastructure – for example, multi-utility providers – to satisfy their own business models. Locations where this might be applicable include new build housing developments, at network extremities or in mobile not-spots.
16. We also believe that such a framework for contestability would provide a means for local or public subsidy to be applied in a selective manner for specific projects in limited geographic areas to help the development of local infrastructure, which would be capable of integration with the “mass market infrastructure” such that a variety of suppliers could provide services to it.

If these elements that we have discussed could be put in place, we believe that the Government would have established a sustainable framework for the development of the utility “pipes” aspect of the communications industry. The governance structure would have to be carefully designed but, if successful, would provide a transparent, independently organised framework where the necessary degree of coordination of industry developments could take place. This would allow Ofcom to have sufficient input to and oversight of the evolution of the market but without an ongoing need to be involved in the details. The CPs who had a part in achieving the actions agreed by the governance body would be bound by the governance rules and the relevant General Condition to do so or enforcement action could be taken by regulator. We also consider that it should provide a forum for any market participant to raise issues for resolution.

We believe that this framework, in turn, would develop greater certainty for investment. With regulation to allow wholesale access, IPs would be clear on these expectations of access provision and tailor their investment plans accordingly. We do not believe that any mass-market IP should be bolstering their investment case by counting on ongoing revenue for retail services to which customers were “tied in” and we believe that Ofcom has already made clear that it would not tolerate this position in NGA developments. Similarly, suppliers considering investing in the market would

be clear on what levels of access to mass-market infrastructure they could expect. This factor together with the existence of a market forum, where retail innovations could be considered for adoption in the mass-market, would also create a more positive climate for retail investment than we believe exists today.

Thus, we believe the Digital Britain objectives of investment in networks, services and content would be facilitated and would take place as far as perceived to be commercially viable by the market. The Government or other public bodies could then identify the gaps in mass-market infrastructure and seek other ways, using the contestability and interoperability part of framework we have described to add local infrastructure where felt necessary.