

STRATEGIC REVIEW OF TELECOMMUNICATIONS PHASE II CONSULTATION DOCUMENT

A. Equivalence

1. The key regulatory principles which OFCOM is promoting and on which we choose to focus most of our comments below are:
 - Promotion of competition at the deepest levels of infrastructure; and
 - Delivery of equality of access beyond those levels.

In order that such competition should be established and be able to thrive, OFCOM rightly sees equality of access, or *equivalence*, as the essential foundation for this. According to OFCOM, this requires changes at the product level and in terms of BT's behaviour. In this connection OFCOM states (at 6.22) that it believes that all BT's wholesale customers should have the same ability to collaborate with BT in designing and implementing wholesale products and processes as BT Retail.

In our view, practical delivery of such a concept is going to be hard to achieve. In particular, it is unclear at what stage and to what extent a competitor to BT Retail should have the right to be informed of proposed new wholesale products in order that it may take advantage of such an opportunity. In working through the detail of this process with BT, BT will no doubt be concerned about protection of legitimate commercial confidentiality, whilst its competitors will be seeking early and informative warning. Inevitably, therefore, a compromise between these competing tensions will need to be struck. The other main problem is, as we have seen in previous market initiatives by BT, not so much the theoretical principle, but achieving *real and timely practical implementation of an appropriate and equivalent wholesale product which is fit for purpose*.

2. OFCOM believes (at para 1.43) that there is a case for what would in effect be a new regulatory contract with BT. OFCOM admits that this would not be a real contract but rather a settlement between OFCOM and the industry. If it is the intention of OFCOM that in part at least the proposed equality of access should be secured through this regulatory contract, there surely have to be some regulatory teeth to this. Unfortunately, only the existing set of dentures is available. We return to this issue later in this note (para 8).
3. OFCOM envisages a gradual withdrawal of regulation, with consumers gradually being protected by competition. However, this is dependent upon BT delivering the necessary changes to underpin real equality of access and on there being a well-functioning wholesale market which will guarantee such competition. As OFCOM points out, Oftel were not successful in policing the wholesale market and there is a real question as to whether OFCOM, which of course has only the same legal weaponry at its disposal as did Oftel latterly, is likely to be significantly more successful. Part of the answer will lie in the way in which, and the vigour with which, OFCOM uses its statutory powers.

4. Apparently OFCOM also believes (see G.15) that the equivalence of outcome model can be made to overcome many of the weaknesses of the historic regulatory approach of Oftel. In particular, OFCOM sees one of the solutions as being the setting of clearer guidelines for SMP conditions. Allied to this would be the setting of clearer definitions and guidance with regard to the objectives of equivalence, and how it would be interpreted. OFCOM would also more strictly apply the Access Guidelines to require that BT's wholesale activities do not supply BT's retail activities with any new products in markets where BT has SMP until it also is able to supply other wholesale customers with equivalent (regulated) wholesale products.

This elucidation or clarification of the SMP regime would therefore include OFCOM's interpretation as to what undue discrimination means, in particular the statement (in G.15) "that conduct that has the potential to harm competition would be prohibited without the need to wait for actual harm and clearer illustrations of discriminatory behaviour to occur".

Unfortunately, whilst from the standpoint of BT's competitors, OFCOM's ability to intervene in this way would be potentially very useful, in fact the rules as to enforcement of SMP conditions are set in the concrete of the Communications Act 2003, with all the convoluted procedures which that legislation brings in its wake. As OFCOM will be well aware, specifically it must go through a procedure of notifying the SMP operator of the suspected contravention, specifying a period for making representations, complying and remedying, followed by a further (enforcement) notification where compliance or remedy has not occurred, giving the SMP operator a further reasonable period to comply or remedy, and it is only at that stage that a legally enforceable duty arises. It is therefore difficult to see how OFCOM's stated approach can be reconciled with these statutory constraints.

5. OFCOM also envisages requiring that there be damages available as part of a remedy for breach of an SMP condition: there is of course nothing new in this. Under the Communications Act, not only may OFCOM impose a penalty on a SMP operator for failure to comply with its obligations or to remedy a contravention, but that operator will be liable to third parties for damages as a consequence of its breach of an enforcement notification. Unless OFCOM specifically consents, damages are not available under that Act with respect to the initial contravention (for which only OFCOM can exact a penalty), only for failure to comply with the subsequent enforcement notification, thus reducing the deterrent effect. OFCOM cannot of course on its own substantively improve upon this position, as it is enshrined in the statute.
6. OFCOM indicates its desire to review the scope of investigations to address the issue of *cumulative immateriality*, which might otherwise be known as 'death by a thousand cuts'. OFCOM will readily appreciate, and as the long-suffering alternative network industry well knows, allegations of patterns of behaviour which have a cumulative and deleterious effect are extremely difficult to pursue under the current regulatory framework. That framework is much more geared to specific examples of anti-competitive and/or discriminatory conduct. Again it is hard to see how OFCOM will be able to use specific sanctions for this and it seems likely to be more dependent upon achieving appropriate enforceable undertakings from BT as part of some kind of regulatory contract. Other practical remedies such as extending the use

of the Independent Telecommunications Adjudicator may be required as suggested in the Consultation Document (G.16). In actual fact, we believe that OFCOM may have to go further than this concept and actually create, say, an *Equivalence* 'Czar' whose full-time job it would be to supervise and ensure full-blooded implementation of *Equivalence*, e.g. through brokering binding commitments. Only in that way could there be a realistic hope of avoiding the old problems of differential treatment and regulatory gaming, as well as delayed availability of equivalent products leading to BT's market pre-emption.

7. OFCOM's objectives of achieving equivalence of input for all new wholesale products, processes and systems that are required by regulation is extremely laudable. It certainly is essential if BT is not to substitute its market power in its legacy networks for market power in next generation networks. The challenge for OFCOM must surely be in balancing the protection of competition against the benefits for BT of its right to innovate, for the rules under which OFCOM operates with the new EU regulatory framework clearly require that OFCOM should not discriminate between networks.

In this connection, OFCOM states (at G.25) that it will take a proactive role in identifying which new products are likely to be in markets where BT has SMP, in order to identify where equivalence of input should be built in early. Clearly there is a risk that the regulatory rules flowing from EU requirements may yet dilute the level of equivalence which OFCOM would ideally seek, in particular with regard to the level and timing of information which should be made available to BT's competitors. The Framework Directive's principle that NRAs should respect proportionality also seems to mean that the argument for full equivalence will have to be judged on a case-by-case basis.

8. In considering the behavioural and quasi-structural remedies that might be imposed on BT, it has to be recognised that these will require the full-blooded co-operation of BT. OFCOM acknowledges here that it is addressing only the options, rather than the solutions, to their implementation. It seems likely that any organisational requirements will best be embodied in some form of code of practice which can be effectively monitored but will still suffer from a lack of any enforcement mechanism.

Nonetheless, it would be of considerable practical advantage if BT can be persuaded to make the necessary organisational changes at the outset, from which point they should at least begin to become embedded in the organisation's modus operandi.

9. As mentioned above, OFCOM states (para 1.43) that it believes there is a case for a new regulatory contract with BT, a form of settlement between regulator and industry. Apparently some regulatory controls, for example regarding wholesale pricing for interconnection, might be relaxed in return for a deal on equality of access. In stick and carrot terms, if one of the sticks is the threat of a Competition Commission referral (see further Section B below), we would say that the force of this threat will be sharply reduced once the 'regulatory contract' (whatever that may be) has been struck. Thus, if BT's implementation were in any way to fall short of expectations, there would be little sanction left to ensure proper performance, other than the usual statutory enforcement mechanisms.

Summary

Equivalence is thus no 'silver bullet' solution to the problem of ensuring a fair opportunity for BT's competitors. To summarise the challenges:

- In terms of its knowledge and reach, BT holds all the cards and no amount of regulatory rule-making is likely to neutralise completely this built-in advantage;
- A high degree of co-operation will be required from BT to produce a charter for equivalence which is deliverable and enforceable;
- BT as a vertically integrated operation will have a natural tendency towards internal bias; organisational change designed to overcome this will need to be robust and structurally proof against circumvention, with defined and recognisable internal boundaries; and
- OFCOM's re-interpretation of existing rules, particularly as regards non-discrimination, is likely to push to the boundaries of legal/regulatory validity, and thus risk challenge by BT as being of itself discriminatory and/or lacking in proportionality.

In our view, therefore, just as important as OFCOM's proposed 'new way' will be its willingness to persevere with (and to ensure it has the resources for) practical ongoing implementation of the principles underlying equivalence, combined with an unflinching willingness to take timely remedial and, where appropriate, punitive action whilst accepting that on occasions it will be challenged and will have to justify itself before the CAT, sometimes unsuccessfully.

B. Competition Commission referral

We mentioned above the risk that, with the successful introduction of *Equivalence* as a practical concept, the reality of the threat of a referral to the Competition Commission will diminish. By the same token, the longer OFCOM and the industry persevere with *Equivalence*, assuming it is not a complete disaster and is even only moderately successful, realistically this threat will disappear almost entirely. After all, being a market investigation reference, the Commission would always need to be satisfied that features of the market prevent, restrict or distort competition. The height of this evidential hurdle is not to be underestimated.

Which brings us back to the central importance of a regulatory 'contract' that has teeth with real bite. Armed with its statutory powers, OFCOM must be prepared to use them speedily and forcefully.

C. 'Holistic' telecommunications policy

The Consultation Document is primarily concerned with fixed network infrastructure and voice and broadband services over them. Clearly there are other aspects to the telecommunications market which are also important for consumers and the UK economy: on the infrastructure side there are the wireless networks, both fixed and mobile; secondly there is the considerable community of service providers who rely on BT for some wholesale non-infrastructure, i.e. service, inputs.

With fixed-mobile convergence and the gradual roll-out of new fixed wireless infrastructure, the impact of the operators of these wireless networks in a competitive context is likely to become more and more significant. It is important that OFCOM as the regulator should keep a fair balance between both wireline and wireless networks so that neither is treated unfairly in comparison to the other. In this respect, OFCOM will need to bear in mind that in taking steps to promote competition at the deepest levels of (fixed) infrastructure, particularly in relation to the pricing and economics of access at such levels, it should not disadvantage wireless operators providing competing local access.

The service providers take BT's inputs on a range of regulated and less-regulated bases. Sometimes their difficulties are less well publicised than in the case of LLU or WLR for example, but the risks of cumulative immateriality are as present here as elsewhere: moreover OFCOM must remember it has an overarching obligation to ensure that providers of networks *and* services should be treated in a non-discriminatory manner. All we would therefore say is that OFCOM will need to be vigilant and responsive to concerns from service providers about service quality and delivery in this context. Otherwise, maximising the attractiveness of real choices for customers may be compromised.

All this suggests that it would best for OFCOM if it would take a universal or 'holistic' approach to the sector, so as to evaluate and take into account the impact of initiatives in one part of the sector in other parts and ensure it is acting consistently across the different segments. OFCOM should itself be promoting such 'joined-up' regulation.

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