

**OfTel's response to the Fourth Report of
the Culture, Media and Sport Committee,
Session 2001-02**

17 July 2002

1. In May 2002, the Culture Media & Sport Committee published its report on the UK's communication sector. One of the recommendations was:

“Ofstel, and Ofcom, when it takes over the responsibilities of Ofstel in due course, should take serious note of the criticisms of the effectiveness in establishing a competitive UK market for broadband and follow-up with remedial action, taking account of the proposal to require BT's network to stand on its own as a distinct business.”

2. This note – which follows the Government's formal response (Cm5554) published earlier this month – is Ofstel's response to this recommendation.

3. Ofstel is committed to the delivery of effective and sustainable competition in the market for broadband services. Policies to prevent anti-competitive behaviour by the incumbent, and to sustain the conditions for new players to enter the broadband market, are now in place, or where enhancements may be needed, are being put in place. The fast-developing telecoms market needs regulation that is up-to-date and proportionate.

4. Recent decisions by Ofstel on interconnection for broadband services follow a systematic policy of active regulation to create competition. The latest market data illustrates that the UK has one of the most competitive marketplaces in broadband services in Europe:

- Digital Subscriber Lines (DSL) are available from BT in 1,100 exchanges, covering 66% of UK households;
- DSL is also available from over 70 separate competitors, who consistent with regulatory requirements upon BT, are supplied by BT with a wholesale DSL service;
- 40 per cent of UK households currently have potential access to broadband using a cable modem;
- local loop unbundling, although very small in terms of lines unbundled, offers an opportunity for niche broadband players. All BT exchanges are now available for operators to order distant or co-location facilities; 130 exchanges have competitor equipment installed in situ, or at an external site; and competitors have announced further expansion plans; and
- an Ofstel direction in June allows further infrastructure competition by mandating BT to offer certain broadband services as an interconnection service.

5. Ofstel will take whatever further action is necessary in the light of an evidence-based approach to broadband issues. However, if take-up continues at the present rate of over 20,000 customers per week, it is estimated that by the end of July the UK will have 750,000 broadband end-users. That will be an increase of over 500,000 in a single year – one of the fastest ever adoption rates of new technology in the UK.

6. The latest Ofstel benchmarking data also shows that broadband prices for consumers are as cheap or cheaper than in France, Germany or the USA. Since the beginning of 2001, DSL prices have been cut by up to 39 per cent, and some

consumer packages are available for £20 per month. For some business services the UK is the cheapest country in the Oftel survey.

7. There are, of course, areas of the country where cable is not available, and BT has not yet upgraded exchanges. However, in June, BT launched a new database which allows consumers to express an interest in DSL, so that once a critical number is reached (200-500 depending on the exchange) BT will consider upgrading. In some parts of the UK (including Cornwall, Wales and Scotland) there are initiatives to aggregate demand. Trials using satellite broadband have taken place and commercial services are now available.

8. But Oftel accepts that the pressure on broadband competition has to be maintained. BT's position as a vertically integrated company – as with any incumbent – raises the potential issue of leverage of market power from its network business, and possible discrimination in providing access for its own retail business. This issue has led to a demand from some of BT's competitors that Oftel should take action to break-up BT.

9. This demand misunderstands the nature of Oftel's current powers. As is set out in the Government's response to the Select Committee, the corporate structure of BT is a matter for the Board and shareholders. Neither the Secretary of State nor Oftel has the right to break up BT. There is a power for the Secretary of State to make a reference to the Competition Commission if it is considered that there is a scale or complex monopoly. The Government response states that no such reference is currently proposed.

10. The Director General will have the power to make such a reference once the Enterprise Bill, currently before Parliament, is enacted. The Director General's view is that such a reference would not be warranted in the foreseeable future. The Director General currently considers that existing powers are sufficient to allow proportionate action to be taken in the event of potential anti-competitive behaviour.

11. The BT licence includes a legal requirement against leverage of market power. BT's network business when supplying wholesale services must not engage in undue preference or undue discrimination in favour of its retail arm. This obligation not only requires BT to provide wholesale services to its competitors on equivalent terms, but also requires BT to maintain a margin between its wholesale and retail prices.

12. Where there has been evidence of anti-competitive behaviour Oftel has intervened – for example, in a range of issues related to local loop unbundling, tough enforcement action has been taken. Oftel has also investigated a number of complaints alleging leverage of market power, most of which have been unsubstantiated.

13. It does not follow that no further action is required under the present regime. The telecoms market continues to develop quickly, and BT continues to have a dominant position in a significant part of the marketplace. Oftel will, therefore, use its powers to propose where necessary to modify and update the regulatory framework. Such proposals will be consistent with Oftel's strategic approach, which is that regulation must continue to be a proportionate response to issues.

14. First, transparent financial material will continue to be essential, where BT has market power, both for the regulator and for BT's competitors. Oftel is working on bringing greater transparency to BT's current regulatory accounts. It will continue to re-examine and where necessary strengthen the accounting rules as we review the range of separate markets. Oftel will consider whether the independent auditor in preparing the regulatory accounts should owe a duty of care to Oftel. This is a key area, on which Oftel is taking external professional advice, as well as seeking to harmonise our approach with European telecoms regulators, and other UK utility regulators.

15. Second, it is important that when introducing new retail services, including broadband, BT should offer wholesale products with service level guarantees to competitors, as well as its own retail business. In a series of market reviews, Oftel will carefully consider the nature of the obligations that should apply in each market wherever it is demonstrated that BT has significant market power, and will, in each review, consider whether there should be a requirement to supply an appropriate service level guarantee.

16. Third, Oftel will accelerate its decision process procedures on access and interconnection issues. We shall issue a consultation document on this shortly, with a view to new procedures by Q2, 2003.

17. Fourth, changes in market conditions and commercial opportunities have led to an increasing demand for BT's wholesale services. It is important to the development of competition that all parties, especially those who compete with BT retail, have a comprehensive understanding of how the rules requiring no undue discrimination are applied by BT. There must be confidence that there are internal procedures to ensure compliance with these rules. The provision of information to other operators should take place at the same time, under the same conditions and be of the same quality as that which is provided to its own subsidiaries. Oftel is, therefore, including a work programme on 'Chinese walls' and on corporate codes of conduct in a wider project on appropriate regulation.

18. Subject to Parliamentary approval, Ofcom in due course will also have the advantage of new powers contained in the Communications Bill. The Bill provides that third party operators can sue for a breach of obligations that cause loss or damage. Oftel is already reviewing dispute procedures, and will improve its processes so that all future investigations of interconnection disputes between operators are completed in four months.

19. There will be a new power to fine up to 10 per cent of turnover in the relevant market for a breach of operators' obligations. Oftel will prepare draft guidelines on fines, similar to the current Competition Act guidance.

20. In the period before Ofcom is set up, Oftel's approach will continue to focus on the promotion of competition and protecting the interests of the UK consumer. The actions taken to date, and the enhanced actions set out in this response to the CMS Committee, underline Oftel's commitment fully to support the roll-out of broadband services in the UK. But the market and market structures are dynamic. BT has in recent months reorganised its own internal structure as a response both to regulation and to market conditions. Oftel welcomes the greater transparency that flows from the wholesale/retail split. Oftel will continue to be proactive in taking action that supports

competition. Following objective market reviews over the next year, Oftel will ensure that where BT has significant market power there will be appropriate regulation.

21. For Oftel to conclude that there is a compelling argument to support a forced split of BT would require confidence that the benefits for UK consumers outweigh the disbenefits. To expose the industry – not just BT – to the uncertainties of a Competition Commission reference would be a disproportionate response especially in the light of current turbulence in financial markets.

22. Oftel will take whatever decisions are justified to support proper competition using its current powers. The enhanced approaches set out in this response indicate the seriousness with which we view the recommendations of the CMS Committee. In no sense is Oftel pulling back from proportionate and focussed regulation but it is important for competition, BT and the markets to understand that the forced break-up of BT is not on Oftel's agenda.