

South East England Development Agency

Response on behalf of the English Regional Development Agencies to Ofcom's Consultation on Undertakings offered by BT in Lieu of a Reference under Part 4 of the Enterprise Act 2002

1. Introduction

The nine English Regional Development Agencies (RDAs) submitted collaborative responses to both Phase 1 and Phase 2 of Ofcom's Strategic Review of Telecommunications. The present document is the RDAs response to the outcome of the Consultation, namely the Undertakings offered by BT in lieu of a reference under Part 4 of the Enterprise Act 2002.

2. Relevant background

In Phase 2 of the Strategic Review of Telecommunications, Ofcom proposed three options: deregulation, a reference under the Enterprise Act, and "real equality of access". Ofcom's preferred option, as stated in the Phase 2 consultation document, was

*"Option 3: Real equality of access: focus regulation on enduring economic bottlenecks, and tackle the problem of inequality of access head-on"*¹

This met with a tough response from BT which questioned both Ofcom's authority and ability to deliver such equality of access.

Three items in BT's response are particularly relevant:

*"Ofcom's Option 3 proposes a remedy that goes beyond the regulatory remedies available to it under the existing regulatory framework for which, to the best of our knowledge, there is no precedence elsewhere. In particular, BT considers Ofcom's proposed remedy to go beyond the 'no undue discrimination' regulatory obligation."*²

The point is reinforced on p. 34 of the BT response:

*"Ofcom's power to impose 'real equality of access' on BT is very limited. Although the term 'equivalent' is used in Article 10 of the Access Directive, 'equivalence' is not a defined legal term and is not included in the list of exhaustive remedies available to Ofcom under the Communications Act 2003..."*³

¹ Phase 2 consultation document, p. 59.

² BT Phase 2 response, p. 30.

³ Ibid.

BT also used a "carrot and stick" approach:

*"... we would stress that a decision by the BT Group plc Board to proceed with a full 21CN programme is dependent on Ofcom's explicit confirmation that we will be allowed to earn appropriate returns for a successful execution of 21CN."*⁴

Given that the the initial proposal to create an Access Services Division and an Equality of Access Board was also part of the BT response, BT was in effect suggesting that its commitment to proceed with its investment in its 21st Century Network (21CN) was contingent on Ofcom's acceptance of these new structures. We do not believe that pulling back from 21CN is a realistic option for BT. 21CN is straightforward commercial sense, as are similar projects for comparable telecommunications companies worldwide. We also note that 21CN does not appear to have had any impact on BT's capital expenditure, which has averaged around £3 billion per annum over at least the last five years⁵ and is projected to continue at this level.⁶

We have reviewed the proposed Undertakings in the light of the above BT statements, which strongly suggest that BT is not committed to delivering option 3 at this time.

3. The RDAs Concerns

There is a marked contrast between BT's vehement denial of any past anti-competitive practice (BT response, Section 3) and Ofcom's account.⁷ The latter officially put on record a body of evidence to supplement anecdotal stories readily found in the industry press, in evidence to Parliamentary committees and elsewhere.

Given this history, some doubts are understandable as to whether BT will deliver the spirit, as opposed to just the letter, of the proposed agreement. Ofcom's own evidence should be sufficient to persuade it that the most careful monitoring will be necessary in order to ensure that "the intent of these Undertakings" is respected.

We have been assured by Ofcom that nothing in the Undertakings either prevents them from making future references under the Enterprise Act or curtails their existing regulatory powers. This assurance, that the Undertakings do not represent a backward step, is key to this RDA response.

Our specific, as opposed to general, concerns may be considered under three main headings:

⁴ BT Phase 2 response, p. 17.

⁵ BT 2005 Annual Report, p.23

⁶ Ibid., p. 38.

⁷ Sections 4.14 to 4.23 of the consultation document, and Annexes G-K.

3.1 Access Services Division (ASD)

Firstly, we note that the ASD CEO will continue to report to the BT group CEO and that ASD will remain ultimately answerable to BT's shareholders. This must surely lead to a conflict of interest between the role of ASD as an impartial provider and the best interests of BT as the parent company. This is not addressed in the Undertakings and needs to be addressed.

Our second concern relates to the criterion used for deciding which parts of BT's activities are allocated to ASD. According to the consultation document, "The ASD would control and operate the physical network assets making up BT's local access network and backhaul network."⁸ Our understanding of this, from the definitions given in Annex E, is that "physical" is used in the sense of the ISO seven-layer model, a definition which is likely to prove confusing to non-technical readers.

Virtually all of the products currently sold by BT Wholesale incorporate elements at various layers of the seven-layer model. Consequently, we find it difficult to understand the motivation for creating a division responsible solely for supplying physical layer assets.

The difficulty of separating physical-layer assets from the higher layers when constructing a telecommunications product is encapsulated in paragraph 5.3 of the Undertakings, which refers to "those [Significant Market Power] products which are predominantly provided using the Physical Layer and/or Transmission Layer..." There is a clear opportunity for disputes to arise over which products *predominantly* use which layers.

3.2 Equality of Access Board (EAB)

Although we welcome the creation of the Equality of Access Board and of the introduction of independent members, we are concerned about several of the details.

Firstly, we consider it important that EAB should have an independent chairman, rather than "the BT Group plc non-executive director." (paragraph 10.3 of the Undertakings) We are also concerned by paragraphs 10.6 and 10.7, concerning the ability of a BT-appointed chairman of EAB to remove the independent members, and the ability of the BT Group plc chairman to remove the EAB chairman. We believe that the appointment of an independent chairman would greatly enhance EAB's credibility, to the benefit of all the parties involved. Since EAB is not an executive body, we do not consider that such an appointment would compromise BT's ability to operate competitively.

We are also concerned that there is no definition of the frequency of EAB's meetings after the first twelve months (10.8), and that there is no definition of the "reasonable time" (10.10) within which minutes of EAB meetings must be sent to Ofcom.

⁸ Consultation document, p. 5.

3.3 Timescales

Many of the timescales published in the consultation document appear to be much longer than necessary. At one extreme, “By 30 June 2006 BT will provide improved access to the engineering access books used by BT...”. At the other, fully five years away, “BT shall physically separate its Operational Support Systems such that these systems are run physically separately for the ASD and the rest of BT by 30 June 2010.” Whilst we acknowledge that changes in an organisation of BT’s size and history cannot be accomplished overnight, we are disappointed at these long timescales and the lack of urgency that they imply.

4. Conclusions and Recommendations

When Ofcom embarked on its Strategic Review of Telecommunications, it acknowledged several years of complaints from BT’s competitors and stated that “those who rely on BT to provide ... access have experienced twenty years of slow product development, inferior quality wholesale products, poor transactional processes and a general lack of transparency.”⁹ Our objective in compiling this response has been to analyse whether and to what extent this situation is likely to change with the proposed Undertakings in place, and whether any reasonable amendments to the Undertakings might result in substantial improvements.

Our concerns regarding the Undertakings may be summarised as follows:

- a) The fact that Access Services Division will remain a division within BT means that there is a fundamental conflict of interest. ASD cannot simultaneously serve the best interests of BT shareholders and the telecommunications industry as a whole.
- b) The division between ASD and the remainder of BT is imprecisely defined, resulting in a possibility for disputes to arise regarding the allocation between divisions of future products. We understand that Ofcom expects to address the issue of ASD’s boundaries more fully in its forthcoming consultation on Next Generation Networks, to which we intend to respond in due course.
- c) The Equality of Access Board seems to be unduly tightly controlled by BT, with a consequent risk to its credibility. Furthermore, the frequency of its meetings is not defined beyond the first year.
- d) Many of the timescales for implementation published in the Undertakings are disappointingly conservative.

When Ofcom initiated Phase 2 of its Strategic Review of Telecommunications in November 2004, it proposed three options for the future of the industry: deregulation; reference under the Enterprise Act; and real equality of access. Ofcom made it clear

⁹ Phase 2 consultation document, p. 11.

at the time that its own preferred option was the last one, and a clear majority of the responses received to the consultation endorsed this view.

BT's offer to create an Access Services Division and an Equality of Access Board do not constitute a commitment to "real equality of access". BT made it clear in its response to the Phase 2 consultation that "real equality of access" is something that it feels neither obliged nor inclined to provide. Ofcom has not secured a commitment to its preferred option as set out in its Phase 2 consultation document. Consequently, we must question whether the Undertakings will address the concerns summarised by Ofcom in the quotation at the beginning of this section.

We specifically recommend the following amendments to the Undertakings:

- that the Equality of Access Board be chaired by an independent Ofcom appointee - we believe that this would enhance the credibility and effectiveness of EAB, without compromising BT's ability to carry on its business in a competitive environment.
- that changes to EAB membership be made only with Ofcom's assent.

We are encouraged that the Undertakings apparently do not remove Ofcom's ability to revert to Option 2 (a reference under the Enterprise Act) nor do they apparently curtail any of Ofcom's regulatory powers. Consequently, the proposed agreement does not theoretically represent a backward step. However, we caution that the presence of a written agreement between BT and Ofcom might in reality reduce Ofcom's inclination to pursue these remedies should they be needed.

Ofcom's own evidence, presented within the consultation document, should be sufficient to assure it of the need for continued review as the new arrangements come into play.