

**France Telecom companies in the UK submission:
Notice under Section 155(1) of the Enterprise Act 2002**

Executive Summary

The France Télécom group of companies in the UK appreciates Ofcom's efforts to date in its strategic review of telecommunications and broadly supports the conclusions reached by Ofcom. In particular, we welcome:

- Ofcom's recognition of BT's ability and incentives to discriminate against its downstream competitors due to its upstream market power and vertical integration.
- Ofcom's view that significant action needs to be taken to enhance competition in the market, particularly given what we consider to have been BT's anti-competitive behaviour and/or market/regulatory failure to date.
- The proposed acceptance of undertakings since they represent the most appropriate course of action for the regulation of the UK telecommunications industry.
- Given the historic unsatisfactory state of development of competition in the UK, the introduction of the notion of Equivalence of Inputs by the undertakings, a concept which if implemented by BT and rigorously enforced by Ofcom should be of major benefit to the competitive process in general.
- The fact that "broadband dialtone" issues are addressed in relation to the application of the principle of Equivalence of Inputs to next generation networks.

However, we have some comments and suggestions that Ofcom should take into account:

- The undertakings should not be perceived as a replacement for Ofcom's existing sectoral regulatory and / or competition law powers.
- In our opinion, the evidence gathered by Ofcom to date establishes that BT has in fact already abused a dominant position on a number of occasions. Ofcom should take infringement proceedings in this regard to send a signal to BT, both as punishment and as a deterrent.
- For the undertakings to be effective, Ofcom will need to monitor and enforce them strictly. We do not currently have any confidence that BT has the ability (assuming it has the willingness) to ensure compliance. Ofcom will have to adopt an extremely sceptical stance with respect to BT's actions and behaviour going forward. We consider that it is clear from the consultation that BT has been willing and able to delay implementation and compliance with a number of regulatory directions and requirements to its advantage, and to the disadvantage of its competitors and ultimately consumers, even where the regulator had been seeking to take enforcement action. Such examples arise, *inter alia*, due to the asymmetry of information. Ofcom should be exceedingly wary of permitting similar scenarios to arise with respect to the undertakings. Agreeing to the undertakings should not be a way of BT avoiding effective regulation.
- A number of provisions in the undertakings may be seen as unduly fettering Ofcom's ability to carry out its monitoring and enforcement tasks. Such provisions may even be unlawful since they interfere with Ofcom's statutory duty under the Enterprise Act 2002.

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Introduction

1. This document represents the collective response of the France Télécom group of companies in the UK (Orange, Wanadoo and Equant). We represent the second largest player in the UK communications sector, with a share of approximately 14% of the communications sector by revenue. We are the largest truly converged communications company in the UK.
2. We welcome the opportunity to respond to Ofcom's consultation on undertakings offered by BT *in lieu* of a reference to the Competition Commission pursuant to Part 4 of the Enterprise Act 2002.

Acceptance of Undertakings

3. We believe that accepting these undertakings represents the most appropriate course of action for UK telecommunications regulation, given (i) the uncertainty, cost, delays and risks associated with a reference to the Competition Commission; and (ii) the historic failure of both sectoral regulation and competition law to act as a material constraint on behaviour by BT that we consider to have been abusive, as shown by the evidence presented by Ofcom in the annexes to this consultation.
4. Were it not for this failure, it is quite possible that these undertakings, and the principle of Equivalence of Input which underpins them, would not be required to ensure an effectively competitive market. In a country such as France, where there is an effectively competitive broadband market (as evidenced by the fact that there are now over 2.3 million unbundled lines), such measures would be neither required nor proportionate. Such undertakings are therefore to be considered appropriate only for suitably extreme cases of market abuse and / or market failure, such as in the UK. The principle of non-discrimination (what Ofcom terms "Equivalence of Outcomes") should still remain an important weapon in the arsenal of national regulatory authorities, including Ofcom.
5. The undertakings however should not be perceived as a replacement for application by Ofcom of its existing sectoral regulatory and / or competition law powers. In particular, Ofcom must press ahead with issuing BT with an infringement decision for unlawful margin squeeze in the retail broadband market contrary to both Article 82 EC and Chapter II of the Competition Act 1998 and, for both punishment and deterrent purposes, impose a significant financial penalty on BT commensurate to the effect on competition of its continued, and to-date unfettered, unlawful activities in this market.
6. Ofcom has indicated that the undertakings presented in this consultation are subject to a binary "yes" / "no" choice. While we understand the deadlines to which Ofcom is working – for the ultimate benefit of industry as well as citizen-consumers – we respectfully submit that such a binary choice limits the openness and transparency of this consultation process. We therefore comment on matters of substance and will, where we think it appropriate, suggest necessary clarifications to the undertakings.¹

¹ As a preliminary point, we invite Ofcom to clarify how the undertakings relate to general competition law and the EU regulatory framework. Clarification of the legal basis for the adoption of the

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Market Failure and Market Abuse

7. We welcome Ofcom's recognition of BT's ability and incentives to discriminate against its downstream competitors due to its upstream market power and vertical integration. We agree with the view, that we think is implicit in Ofcom's consultation, that BT only remains dominant in key downstream markets by virtue of discriminatory access to upstream monopoly assets (such as the local access network), and that in the absence of such discriminatory access, effective competition would naturally develop over time.
8. We support Ofcom's views that ultimately some markets may be suitable for deregulation once this discriminatory access has been removed. However, we would urge Ofcom to be cautious in considering deregulating any markets until such time as the fruits of BT's compliance with these undertakings have been unquestionably received by its competitors, rather than deregulating markets once BT has merely implemented the building blocks for what will one day hopefully turn out to be effective competition. The latter risks further entrenching BT's dominant (or superdominant) position and rewarding it today for behaviour which it will be disincentivised to deliver tomorrow. BT's persistently high market share in the wholesale local access market, which is indicative of a superdominant position, imposes a degree of even greater special responsibility going beyond the duties usually incumbent on dominant undertakings.
9. We also welcome Ofcom's view that significant action needs to be taken to enhance competition in the market, particularly given BT's anti-competitive behaviour and / or market / regulatory failure to date. In fact, given the evidence gathered by Ofcom (as set out in the annexes to this consultation) we believe that BT has in fact already abused its dominant position on numerous occasions. If the settlement does not turn out to be as successful as desired, Ofcom should initiate infringement proceedings in this regard to send a signal to BT, both as punishment and as a deterrent. We believe that the evidence provided by Ofcom in the annexes to this consultation will clearly satisfy the s25 Competition Act 1998 threshold for investigation. As Ofcom itself notes, BT's discriminatory conduct has had the effect of deterring investment by competitors.² We further believe that BT's willingness to accept the undertakings is tacit acceptance of this fact (notwithstanding BT's response to Ofcom's consultation on phase 2 of the strategic review of telecommunications in which it attempted at great length to rebut each of the accusations of abusive behaviour).

Local Loop Unbundling

10. Separate from its (ultimately) legally-binding undertakings, BT also agreed not to decrease the margin between LLU products and wholesale broadband until such time as there are 1.5 million unbundled lines. However, we understand that this promise does

undertakings would remove any uncertainty and avoid possible arguments and challenges in the future.

² Paragraph 4.25 of the consultation states that, "[t]he ability of alternative communications providers to offer new, innovative products and services in downstream markets may have been hampered. Ultimately, end consumers are likely to suffer as a consequence of reduced choice, delayed introduction of services and potentially higher prices. The costs in terms of dynamic efficiency ... are likely to be especially pronounced in rapidly evolving telecoms markets".

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not constitute a lawfully binding *in lieu* undertaking as part of this settlement. We do not understand why Ofcom has not sought such a binding undertaking from BT.

11. We urge Ofcom to reconsider this as a matter of priority to prevent BT from renegeing on (or circumventing) its non-binding statement without any legal ramifications, particularly given the doubts as to whether new 21CN wholesale broadband products would be subject to such margin stability. Specifically, we believe that the margin undertaking should encompass both 21CN bitstream and IP broadband products. We do not believe that the risk of diminished corporate credibility by a company which has engaged in margin squeeze for close to 3½ years will act as a significant deterrent.

Equivalence of Inputs

12. Given the current situation in the UK, we regard the introduction of the principle of Equivalence of Inputs as the most important and necessary step towards a truly competitive fixed-line communications sector.
13. Enforcement of this aspect of the undertakings must be robust in order to bring any and all ongoing abuses and their significant anti-competitive effects to an end as well as to avoid similar situations arising in the future.
14. We agree with the list of products and services which should benefit from Equivalence of Inputs as set out in section 3.1 of the draft undertakings. We also agree with the dates for delivery of Equivalence of Inputs, as set out in annex 1 to the consultation. BT remains persistently dominant in various key wholesale markets and its ability to abuse its position is not limited to its dominant position in the wholesale local access market. This is a significant improvement to BT's original proposals as set out in its response to the second phase of Ofcom's strategic review of telecommunications, which advocated limiting the application of the principle of Equivalence of Inputs to LLU products and in a conceptually weaker form than exists today.
15. The timeframe for implementation must be closely monitored by Ofcom to ensure that it does not slip (see below). Clear milestones are required to track delivery of this activity. Currently we are concerned by the lack of measurable success criteria for the application of the principle of Equivalence of Inputs for each product and would encourage Ofcom to clarify this with BT and publish amended undertakings.
16. We are already seeing significant push-back from BT on delivery dates for other regulated products (such as Basic Copper Access), which BT has said is as a result of its work to implement the undertakings. We urge Ofcom to ensure that BT does not use this settlement as an excuse to delay delivery of other mandatory regulated products.
17. We are concerned about the extensive derogations from the principle of Equivalence of Inputs particularly in relation to 21CN (we refer to a number of these directly below).

Next Generation Networks

18. We welcome the recognition by Ofcom that BT has every incentive to design its 21CN in a manner that favours its own operations to the detriment of downstream competitors. It

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is positive that steps are being taken to ensure that BT will design its 21CN in a non-discriminatory and non-abusive manner from now on.

19. However, we do have concerns about specific undertakings in relation to BT's 21CN. While this main response does not intend to identify every concern, we mention some of these concerns to support a point of principle. For a more comprehensive analysis, please refer to Wanadoo UK's response to Ofcom's consultation on Next Generation Networks.
20. Furthermore, we are concerned that certain decisions may have already been taken (for example, in relation to whether BT's retail operations are entitled to sit within certain "firewalls" while downstream competitors require separate gateways) which may frustrate the application of the principle of Equivalence of Inputs to 21CN. We encourage Ofcom to appoint a member of its senior management team to lead a review of BT's existing decisions concerning its 21CN to ensure that they are compliant with this settlement. Furthermore, Ofcom will need to monitor the process closely to ensure that the market is not distorted on a long-term basis and should not hesitate to take enforcement action to prevent such market distortion.
21. We have concerns that the procedural rules which apply to the design process for 21CN might have unforeseen substantive consequences. In particular, we would be worried if application of the consultation process in section 11.3 of the undertakings were to represent a substantive *get out* from the principle that charges must be based on efficient network design.
22. We particularly welcome the spirit of the proposed undertakings in relation to the introduction of "broadband dialtone", although we feel that the current wording gives BT the ability to claim that any discrimination and its anti-competitive effects are immaterial. The wording suggests that the obligation not to discriminate may be considered a weaker form of Equivalence of Outcomes rather than as true Equivalence of Inputs. If this is the case, we invite Ofcom to explain why this compromise was reached given the theoretical ability of "broadband dialtone" to undermine materially the business plans of LLU operators. For further information, please refer to the section on "broadband dialtone" in Wanadoo UK's response to Ofcom's consultation on Next Generation Networks.
23. We are concerned that the balance of compensation is weighted towards operators that interconnect with BT and does not pay sufficient attention towards broadband and LLU Communications Providers, resulting in compensation not being available for some important categories of costs incurred by those Communications Providers. We believe that the compensation arrangements are not compliant with the Ofcom's own draft non-discrimination guidelines.
24. We are also concerned about how obligations which sit outside section 11 of the draft undertakings will apply to 21CN. Paragraph 11.20 seems to say that **no** undertakings outside section 11 can affect the "development or deployment" of 21CN. In some respects this seems to contradict the explicit wording in some of the undertakings; in

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others, it seems to restrict the application dramatically. For example, we would expect Equivalence of Inputs to apply to migrations from today's broadband to next-generation broadband. Draft undertaking 3.7 seems to say that, but it seems to be disapplied by 11.20. Clarity is needed here, but as a matter of principle we would be deeply concerned if the effect of 11.20 is as sweeping as we fear.

25. Another area of potential concern once again relates to section 11 of the undertakings. Under section 11.6, "BT shall build its NGN and associated systems in such a manner as to ensure that other Communications Providers can purchase from BT Network Access on an Equivalence of Inputs basis." Section 11.7 further provides that where "BT provides Network Access using its NGN, it shall do so on an Equivalence of Inputs basis." However, under section 11.9, "[s]ections 11.6 and 11.7 shall not apply where it would not be reasonably practicable to provide Network Access on an Equivalence of Inputs basis. For BT not to have to provide access on the basis of Equivalence of Inputs where it would not be "reasonably practicable" creates a potentially significant loophole. In the likelihood that this section will remain within the final set of undertakings, we consider that Ofcom should keep a tight control on BT's use/exploitation of this carve out.

Access Services

26. We are sceptical as to whether Access Services will alter either the competitive landscape or BT's economic incentives. Given past experiences, we doubt whether the establishment and operation of this business unit will effectively change the culture within BT. We will continue to regard BT as a single economic entity, including for the purposes of competition and regulatory law.
27. Whatever the success of Access Services, Ofcom should bear in mind that its creation does not in itself ensure that Equivalence of Inputs will be achieved. Notwithstanding the "separation" of Access Services from the remainder of the BT Group, it will be difficult to ensure that a full and effective Chinese wall will operate as between the two parts of BT from the commencement date of the undertakings.
28. Furthermore, it is possible that Access Services, by virtue of it owning more than just the local access network, may compete with alternative operators (for example, in the provision of backhaul to LLU providers). It is therefore imperative for BT to understand that a product or network element sitting within Access Services does not in itself abrogate BT from its duty to comply with any of its current sectoral regulatory or competition law non-discrimination obligations. There may be a requirement for Chinese walls to exist within Access Services itself.
29. We are concerned that there is nothing currently preventing Access Services from entering downstream markets. We would like to see BT undertake that this will not occur, as it would undermine the entire rationale for accepting these undertakings.
30. We are unsure what, if any, impact these undertakings will have on current regulatory finance obligations. We would welcome clarification from Ofcom on this point.

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Equality of Access Board

31. We welcome the establishment of the Equality of Access Board as a potentially useful mechanism to help ensure BT's compliance with the terms of the undertakings.
32. We note that it is envisaged that board members will be appointed by BT with some Ofcom involvement. This position and the constitution of the board will need to be regularly reviewed to assess its effectiveness. It is essential that board members have both the skills and, crucially, the personality to carry out their tasks effectively and robustly. We are concerned that the board directors will only work for a few days a year.
33. In any event, as we are sure that Ofcom would agree, the creation of the Equality of Access Board does not abrogate Ofcom of its statutory duty to keep under review BT's compliance with these undertakings, nor does it relieve BT of compliance with its obligations as a dominant (or even superdominant) undertaking to ensure that it does not abuse that position.

Monitoring and Enforcement

34. While we appreciate that accepting the undertakings may ultimately be an effective remedy going forward, we consider that BT's past behaviour and the former sectoral regulator's past inability to address such behaviour in a timely manner (or at all on some occasions) should make Ofcom wary and sceptical about BT's likely actions going forward. While BT may well be offering the undertakings in good faith (and we have no cause to doubt that), they must be strictly enforced.
35. In this context, we are concerned about discussions separating the "spirit" of the undertakings from the "letter". We do not believe it will necessarily be open to BT, which has a duty to shareholders, to offer more than is contained in the letter of the undertakings. Given this, we think it is important that all stakeholders focus on what the undertakings actually say, rather than relying on implementation of their spirit at a later date.
36. Ofcom will need to strictly monitor and enforce the undertakings, in particular, in relation to Equivalence of Inputs if real progress in the market is to be achieved. The undertakings will only achieve their objectives if they are effectively monitored and enforced by Ofcom. In terms of the substance, effective monitoring is important in order to ensure, for example, non-discrimination by BT in relation to non-price conditions. As Ofcom is aware, non-price discrimination is particularly hard to detect, especially given the asymmetry of information. The analyses pulled together by Ofcom regarding past behaviour, as set out in the annexes to the consultation, show how BT has been willing and able to delay implementation and compliance with a number of regulatory directions and requirements.
37. We are concerned that a number of the provisions in the undertakings are both immeasurable and require BT in the most part to regulate itself. We believe that BT's history of regulatory compliance is at best poor. We do not currently have any confidence that BT has the ability (assuming it has the willingness) to ensure compliance with these undertakings.

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38. We are also concerned that a number of the provisions in the undertakings may be seen as unduly fettering Ofcom's ability to carry out its monitoring task (for example, the provisions on Ofcom requesting information from BT in relation to its compliance with the undertakings). This is particularly important given the widely-acknowledged asymmetry of information which (together with the high costs of direct legal action) calls into question the practicality of private enforcement for breach of these undertakings. It is open to Ofcom to remedy this asymmetry of information by using its wide-ranging competition law powers.
39. By way of example, sections 12 and 14 of the undertakings give cause for some concern. We fear that they are indicative of BT's general dilatory approach to compliance, as described by Ofcom in its consultation. We note that, under section 12.1 of the undertakings, Ofcom may request information from BT in order to assist Ofcom to monitor compliance with the undertakings but only provided that (i) Ofcom consults with BT on the draft of the request prior to making the request; (ii) the request is proportionate; and (iii) the request is reasonably necessary for Ofcom to monitor the undertakings. This provision unduly fetters Ofcom's ability to carry out its monitoring task. In light of this, the provision may be unlawful since it interferes with Ofcom's statutory duty under the Enterprise Act 2002. This is a source of significant concern, especially in so far as it gives a possible advance taste of how BT intends to approach compliance.
40. In terms of section 14, BT has a minimum of one month to make representations on any compliance direction. We are concerned that there may be no 'interim remedy' available and that BT could seek to exploit this. We note, however, that Ofcom has the power to obtain injunctions under the primary legislation and would urge Ofcom to utilise this power where appropriate. This is the case notwithstanding the wording in section 14.1 which seems to give BT the unilateral ability to reject directions.
41. Finally, there are numerous references within the undertakings to KPIs (see, for example, section 10). The KPIs will clearly play a key part in assessing BT's compliance with the undertakings. However, it is unclear who will be responsible for defining the KPIs and how they will be defined. Clearly, KPIs must be objectively defined in order to serve any useful purpose. It would clearly be beneficial for Ofcom to have significant input into the process of setting such KPIs.
42. An action which represents a breach of the undertakings may well also constitute an abuse of a dominant position, contrary to Article 82 EC and / or the Chapter II prohibition of the Competition Act 1998. Utilising competition law, including the ability to impose financial penalties, may be a necessary deterrent if, for example, issues are regularly arising. It should be noted that in its investigations to date, the regulator's unwillingness to make an infringement decision and fine BT for anti-competitive behaviour, far from having the necessary deterrent effect on BT, has sent the opposite message that BT can essentially risk breaching fundamental competition law obligations without the fear of facing any punishment. Currently the retail broadband margin squeeze investigation represents the most obvious and appropriate occasion to show BT that Ofcom is serious

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about enforcement. If Ofcom wants to show the sector that it is serious about enforcing the undertakings, it needs to reverse this negative signal.

43. We therefore urge Ofcom to consider how they will measure BT's compliance with the principle of Equivalence of Inputs. This is particularly important in the context of Equivalence of Inputs between LLU and IPStream and more generally on BT's 21CN programme. We recommend that Ofcom creates a new function, led by a member of its senior management team, to assess compliance with the undertakings in a proactive manner and be the main interface with the Director of Equivalence and industry on this matter.

Conclusion

44. While we consider the undertakings to be a step forward in terms of ensuring competition in the market develops more effectively, there are a number of risks and uncertainties relating to the interpretation and enforcement of the undertakings. The past record suggests that BT will exploit any such uncertainties / loopholes. Ofcom will have to be vigilant to ensure the effectiveness of the undertakings, in particular in relation to Equivalence of Inputs if the undertakings are to alter the current position which, as analysed and recognised by Ofcom, has been one of regulatory failure.