

# **Ofcom Strategic Review of Telecommunications**

## **Consultation on undertakings offered by British Telecommunications plc in lieu of a reference under Part 4 of the Enterprise Act 2002**

### **Response submitted by Tiscali UK Ltd – 12th August 2005**

#### **Introduction**

Ofcom has published details of the undertakings it proposes to accept from BT, which it believes are sufficient to avoid the need to make a reference to the Competition Commission under the Enterprise Act. Stakeholders in industry and society are invited to submit written views and comments on the undertakings as part of the consultation on the effectiveness of the undertakings to address competition issues identified and to agree or disagree with the proposal to accept.

Tiscali believes that Ofcom should be able to accept undertakings offered by BT but has significant concerns with potential problem issues and missing or unclear details, which necessitate a review of the undertakings in their current form. Tiscali's major concern is that the undertakings may not be effective in the long run, because things are missing or inadequately dealt with, even though they are appropriate in form and intent.

In making this response, Tiscali suggests that Ofcom consider areas for review as covered below, especially concepts of making the undertakings subject to continuing review so that confidence in comprehensiveness, linkage to detailed plans and monitoring of achievement is possible. Key points in this text cover the following subjects:

- Linking undertakings to implementation plans and updating
- The legal basis and existing powers and actions
- Policing and monitoring of undertakings and activity
- Product equivalence
- BT Wholesale structure
- BT internal trading and transactional transparency
- BT-Ofcom-Industry engagement ongoing

The aim of all parties must be to ensure that the undertakings are as good as they can be, in view of the fact that any review by the Competition Commission may be more restricted and less effective than the current proposal for change and that it would be costly in time and resources for the UK telecommunications industry.

Risks that need to be acknowledged at this point include that of BT never receiving the trade-offs it expects from making these undertakings, the potential for industry to have to rely on existing regulatory powers and dispute mechanisms to protect the competitive environment and that Ofcom will be judged a failure if the proposals do not achieve significant and lasting change.

## The Basis of the Undertakings

The undertakings offered by BT include, amongst other things, changes to the BT organisational structure, new layers and types of governance and radical changes to products, systems and processes. For such significant alterations to occur and if there is to be confidence in BT's commitment to achieve change, the undertakings must have a legal basis that is effective and enforceable. Although the final sanction, for failure to deliver on undertakings, would theoretically be a reference to the Competition Commission (after a period of at least a year), that course of action would be no more desirable than it is now. It is essential that the solution to market problems now devised is backed up by legal and regulatory mechanisms that are effective, otherwise the industry is likely to have to rely on existing Communications Act and Competition Act powers and dispute processes that should be inferior to the new solution. It should not be the case that all the important changes introduced by the undertakings rely solely on the good intentions of current BT employees for their realisation.

Sections 14 to 18 of the undertakings document (Annex E to the consultation) are of interest in respect of the basis and enforceability of the undertakings.

- Section 14 describes how Ofcom may issue a direction to deal with a breach of undertakings, along with BT's ability to decline to accept the direction, in which case the direction is of no effect. Section 14.2 says that BT's failure to comply with an accepted direction constitutes a further breach of undertakings. The provisions in section 14 are weak, if not meaningless. There would appear to be an incentive for BT never to accept a direction, thereby avoiding guilt regardless of whether corrective action is taken in fact. If BT is in breach for failure to comply, does Ofcom respond by issuing another direction?
- Section 17 makes provision for the variation of the undertakings, in exactly sixteen words: 'BT and Ofcom may, from time to time, vary and amend these Undertakings by mutual agreement.' There is nothing to describe further the circumstances that may lead to such review or how the parties would negotiate a change. Again, the provision appears to carry no weight at all for Ofcom; BT need never agree to a variation and would not suffer any particular consequences of adopting that policy.
- Section 18 describes conditions that would lead to termination of the undertakings. Section 18.4 says that BT can ask for a review to determine whether to cease undertakings, but there is no equal and opposite provision for Ofcom to initiate a review to add to or increase the depth of undertakings.

Tiscali is concerned that Ofcom will have no real ability to enforce or review the undertakings that are proposed and accepted. Sections 10.16 and 10.17 set out, very briefly, that 'BT shall inform the EAB (Equality of Access Board) of any breaches of these Undertakings that it identifies' and that EAB will inform Ofcom of anything that it decides is 'non-trivial'. Again, there is a lack of depth and strength to these provisions. What does 'BT' represent in this example where a form of reporting to EAB is taking place? What is the definition of 'non-trivial'? Indeed, how can such a fine judgement be made when undertakings often begin with words such as 'as soon as reasonably practicable' or 'BT shall establish' or 'BT shall maintain' or 'BT shall ensure'? If undertakings are, by their form and nature, not measurable or enforceable then surely they are not worth making.

It may be that undertakings of this type must be relatively lacking in detail in places, because the achievement of the overall goal (for example, to set up a new division) will depend on activities that will develop over time. One would not wish to restrict the exercise of improvement and change, but BT's undertakings must be formally linked to detailed plans in some way for them to impress stakeholders as potentially effective and comprehensive. Such plans must exist, otherwise parties to them will have nothing to go on as the work of implementation begins. What is currently proposed should be strengthened by an undertaken ability for the updating of the undertakings set out so far to reflect the 'blueprints' for change, be it to products, processes or organisational units. The provision for this strengthening should be added to Section 17 in a logical way, setting out the means by which regular reviews occur and are agreed by BT and Ofcom. In this way, the undertakings are 'live' in a sense that does not apply to the current version. Stakeholders will be able to see that BT's commitments are being followed through in detail and enshrined in something to which it can be held accountable. Further comments on the kind of 'blueprints' that may be developed for changing BT are included in subsequent sections of this response.

The above suggestion does not address the fact that BT's undertakings are potentially unenforceable. Ofcom cannot impose penalties for breach and, has been shown, may not be able to do anything at all about breach, once undertakings are accepted. Theoretically, Ofcom or affected third parties may take a case to the High Court where BT is accused of breaching undertakings and such action could lead to a case for third party damages. Third party legal action of this type is as unlikely as it would be prohibitively risky and expensive. To pursue such a course would entail a telecoms operator proving loss on an individual case, referring to undertakings that are lacking in detail in the way that has been described above. Ofcom legal action would be preferable, of course, but not necessarily any easier to prove. It may be that some form of 'class action' would be needed to test new arrangements, but to anticipate that is to anticipate major failure to deliver what is promised on BT's part. It appears that the only real enforcement tool at Ofcom's disposal is reference to the Competition Commission, after more than a year from acceptance of undertakings has passed. Such action would signify failure and may result in a lengthy and costly process that promises less in the end than what is promised or hoped for today. If the proposed undertakings suffer from this lack of enforceability, then the expansion of them to include development and implementation detail and the introduction of the living, formal review method mentioned above is required.

## **Product Equivalence**

The annexes to the consultation document contain analyses of specific product issues that support Ofcom's case for action, based on identification of discriminatory BT behaviour that has damaged and continues to damage competition in the UK market. Equality of access has been central to Ofcom's thinking for a considerable time and input equivalence is a key part of undertakings proposed, applying to a set of wholesale products that may be described as 'enduring bottleneck' inputs. Input equivalence should mean that BT supplies the relevant wholesale product to internal and external customers on exactly equal terms, thereby eliminating anti-competitive advantages of vertical integration and market power. The need for constant review of undertakings and 'blueprint' plans for implementation has been mentioned above. This is especially the case for input equivalence plans applying to the products named

in Section 3 of the undertakings. The main concern of the undertakings and Annex 1 is with timetable commitments (ready for service and completed migration targets) for input equivalence, rather than what will have to happen to product, process and system designs to achieve the goal and how BT will trade products with itself in an equivalent manner. These matters are discussed further below. BT has begun discussion of detailed plans that should be revealed as back up to the undertakings and stakeholders will expect to engage on those plans. Tiscali suggests that they should constitute a major part of the possible review mechanism discussed above, thereby installing a far greater level of detail and depth of real commitment into the undertakings themselves.

Access Services Division (ASD) will supply, amongst other things, LLU as an equivalent input to downstream parts of BT and the outside world. This undertaking is desirable, because local access (access to the end user over the local part of the network) is an enduring bottleneck that is likely to remain so for the foreseeable future. Section 3 of the undertakings and other parts of the document deal with the application of equivalence of inputs and broad timescale commitments, but do not describe the manner in which downstream BT will purchase and use LLU inputs supplied by ASD. This absence of detail may be interpreted as evidence of the 'hypothetical' nature of input equivalence, whereas the undertakings should demonstrate exactly how equivalent inputs will be traded and what steps will be taken to make that a reality. As Wholesale Line Rental (WLR) is to be sold by ASD, LLU will be an input only to IPStream, a product managed by the new BTS part of BT Wholesale. Detail must be provided of how the IPStream product will be constructed using LLU as an input. Will BTS be unbundling, in the same way that Tiscali is? Will it be installing its own racks and DSLAMs in exchanges, or simply assuming control of those already present? What changes must happen to the LLU product and processes to render them fit for input equivalence? Questions arise concerning the ability of the BTS unit described to trade in the required manner at all and the detail of the transactions that will take place, which should be reflecting transactions with external organisations.

Section 4 of the undertakings deals with transparency requirements for products not qualifying for input equivalence that are subject to regulatory obligations. Previously, Tiscali has argued that DataStream should be part of a chain of equivalence between LLU and retail broadband and it is not clear why the undertakings do not include this. Instead, DataStream will not use LLU as an input or be an input to IPStream, the downstream product with which companies such as Tiscali compete. The section referred to contains only two paragraphs, promising 'sufficient transparency' by 'reasonable endeavours'. As equivalence for DataStream is as important as equivalence for IPStream to Tiscali, it is essential that much more detail and commitment is given to the plans to explain what internal trading creates the DataStream product and prove that a DataStream-based operator is not disadvantaged in comparison to an IPStream operator, whether BT or otherwise. Similar points could, of course, be made for the other products covered by section 4. Informally, Ofcom and BT might say that the development of 21<sup>st</sup> Century Network (21CN) versions of products will ensure full chains of input equivalence; thus, LLU would input to 21CN DataStream, which would input to 21CN IPStream and so on. This may fix the issue raised with DataStream, but only if obligations to supply remain and a truly distinguishable intermediate wholesale product is maintained for areas that are not viable for LLU. If 21CN DataStream will qualify for input equivalence, how can

one argue that the current product does not? The overriding concern is that the uncertainty, discrimination and lack of support that have plagued DataStream since inception (refer to Annex J to the consultation) will not be addressed by current or future proposals despite the clear competitive need.

Tiscali would like to know which part of BT will be selling interconnect products (circuits and minutes) to operators and what sort of equivalence will apply to those products. It should be the case that equivalence of supply and transactions applies and that this will be demonstrated by externally available accounting proof, but the undertakings are not clear on the subject. Tiscali also questions the fact that WLR is to be sold by ASD, as it is surely downstream of LLU. Such a plan will render ASD a vertically integrated organisation benefiting from SMP upstream and downstream, with all the risks that are implied. If WLR has to be located within ASD because of the assets it uses and the fact that it is an enduring bottleneck product, shouldn't it at least use LLU as an equivalent input that can be demonstrated and monitored by the governance mechanisms in place? If 'naked DSL' is required as a wholesale product at some future point (used by operators to take voice and data frequencies under control and thereby cease the need for end users to pay BT line rental), would that product not lead to the definition of the input required from ASD to WLR?

Much of the above makes reference to the detail and evidence needed on internal BT transactions, to prove that equivalence commitments are met and that disallowed competitive disadvantages are removed. The BT undertakings, in a version that answers the need for detailed backing information and continuous review, should contain descriptions of how a trade will work in every instance, along with detail on the transparency of the transaction that will occur. This should not be unduly onerous, because a commitment to the internal trading has already been made. The example situation of BTS buying an LLU input mentioned above demonstrates how important this demand is. BTS will be a product management function, not a fully resourced operational unit. This calls into question the adequacy of the separation achieved, as well as the ability for BTS to truly purchase any input product from ASD. If it can't, then BT Wholesale will be buying LLU from ASD as an input to IPStream, as well as any inputs required for DataStream, when the two products should be managed separately. A sufficient level of detail on proposed transactions and terms of trade is needed to address such concerns and this detail should form an integral part of the living BT undertakings. More discussion of issues with BT Wholesale organisation follows.

## **Organisation and Governance**

During the Strategic Review, Tiscali has expressed the view that the access or loop part of BT needs to be separated into a subsidiary company. The undertakings currently offered by BT fall short of this and commit to the separation of ASD into a new division within BT. It is understandable that, in undertakings of this nature, BT has not offered to split companies and such a solution was always going to be very complex to implement and manage. The risk remains that the simple creation of a new division will not create sufficient cultural and behavioural differences to produce the change that current proposals rely on. BT has created and renamed divisions and shifted payroll many times in its history. In recent memory, BT has also created a separate company from existing resource and then reversed that decision. Setting up ASD will not be a revolution within BT; indeed, a significant amount of work towards

the creation of ASD has already taken place, in advance of acceptance of the undertakings. BT sets out its detailed commitments relating to ASD in section 5 of the undertakings document. It will be essential that an effective means of demonstrating implementation and change is established very soon, to ensure that Ofcom, industry and other stakeholders know that BT is driving through the measures that should produce the benefits to the market that are expected.

Three other aspects of the creation of ASD are also worthy of separate mention: branding of ASD, limitations on the markets that ASD sells to and from where ASD products are sold. Section 5.42 deals briefly with plans to partially separate a new ASD brand from the rest of BT Group. This is a very important and welcome commitment, but the timescales suggested for completion are too long. Efforts should be made to improve the plan to achieve full deployment on buildings and stationery down from 16 months and Tiscali suggests that a target of less than a year should be set. Dealing with the branding of clothing and vehicles only on replacement of assets and over a period of five years is not acceptable. These two elements are probably the most visible to the UK public and Tiscali believes they should be actively changed within 18 months of the establishment of ASD.

The undertakings refer to the fact that the business of ASD will be ‘network access’ and ‘upstream’ products, but there is no positive prohibition on ASD attempting to sell into downstream markets in future periods. It may be considered inappropriate for undertakings to contain such a prohibition and BT has acknowledged in discussion that it is committed by intention and spirit to restrict the scope of ASD away from downstream markets. It is obvious that if ASD entered downstream markets in competition with the suppliers using its upstream products as inputs to the competing products, the basis of the undertakings and settlement between BT and Ofcom would be undermined. Consideration should be given to attaching current informal or verbal commitments to the undertakings in some way, or at least making them clear to stakeholders in such a way that any incentive for BT to subvert the undertakings in future is drastically reduced.

A similar point must be made in respect of BT downstream divisions selling ASD products. If BT plans to allow BT Wholesale to sell ASD products such as LLU – and the undertakings are silent on this – it is surely the case that the regulatory principles of the undertakings will be undermined. The creation of ASD, the application of equivalence of inputs and the behavioural and incentives changes are key to this settlement. If current BT Wholesale customers continue to buy products such as LLU from that division, all of these things will be at risk. There may be very good commercial and operational reasons for wholesale customers to prefer a single sales relationship with BT, but none of them should be getting a better deal on input equivalence products. BT Wholesale selling ASD products will perpetuate a vertically integrated BT and this should be explicitly prohibited in the undertakings.

In section 6 of the undertakings document, BT makes proposals on the separation of product management functions within BT Wholesale. Questions have been raised in the text above concerning the product and trading implications of the planned BTWS/BTS split. Tiscali’s position has been that meaningful separation between upstream and downstream parts of BT Wholesale must take place, entailing the creation of at least two new divisions under two CEOs. What is proposed by BT in the undertakings may be a reflection of what is considered proportionate and realistic for

actual implementation, but it is nevertheless inadequate and insufficient to engender confidence that behavioural and incentives change will be effective. This is not to say that the stated aims within section 6 are invalid; equality of access, non-discrimination and incentives are all addressed. The problem is that organisational proposals are not bold enough to support those aims.

The above points should be linked to those made already concerning internal trading of equivalence products within BT. The undertakings do not give confidence that meaningful internal transactions will be possible. If BTS, which will purchase LLU as an input to IPStream, is actually no more than a small group of BT Wholesale product management staff, then it cannot possibly purchase any input in a meaningful way. The trading of LLU from ASD must, presumably, be to a BT Wholesale platform or network management function. As this function would be serving BTWS, BTS and BT Wholesale product groups, how can the application of input equivalence or organisational separation be perceived as at all material? If such an issue can undermine the principles behind the theory of BTS, can it (and other similar issues) not undermine the principles of the undertakings overall?

Similar problems to the above arise when one considers how the undertakings deal with support functions across BT Group. Annex 2 to the undertakings lists BT functions, the employee members of which are to be excluded from prohibitions on cross-boundary commercial and customer information disclosure. Many of the functions listed have a strategic influence that could impact the running of BT, after the re-organisation, in an anti-equivalent manner. For example, how could BT Wholesale regulatory and finance teams that support both BTWS and BTS be expected to provide advice that is ignorant of one when dealing with the other? Again, the risk in this area undermines the aims of the undertakings. At the very least, much more explanation should be given in the undertakings themselves of how support activities are divided in this respect and the 'BT Group view' benefits of common functions ended.

Reference has been made to the role of EAB above, in relation to aspects of enforceability that give Tiscali cause for concern. In terms of constitution and scope, Tiscali supports the plans for the creation and implementation of EAB and the operational activities that go with it. However, EAB should be part of a system of engagement and review that enables BT to demonstrate the success of the undertakings to all stakeholders for the future. The concept of a code of practice for BT staff is covered by section 9 of the undertakings. It will be essential that such a code or set of codes adequately deals with the parts of the undertakings that are mixed up with potentially unenforceable 'intentions' or the 'spirit of' the undertakings. In the past, some stakeholders have perceived BT compliance training poorly and new codes of practice must avoid old pitfalls and help ensure that cultural change within BT is nurtured. The BT staffing of EAB and EAO must demonstrate commitment to independence and engagement with the external industry community. EAB members chosen from BT ranks should not experience conflict between 'day job' and EAB responsibilities and EAO should be clearly separate from and different to existing internal audit and compliance functions.

## **Conclusion**

Ofcom would like a straightforward yes or no answer to the question it poses on the BT undertakings. The stakes for the UK telecommunications industry and its customers are so high that such a simple approach will not work. Tiscali believes that Ofcom should be able to accept undertakings offered by BT, but that those proposed should be subject to a review dealing with all the concerns and issues raised during the consultation before that happens.

Many weaknesses in the undertakings proposed have been identified in the content of this response. These cover questions of clarity and understanding, detail missing and fundamental disagreements with proposals. In Tiscali's view, weaknesses allowed to remain at this stage will lead to unacceptable risks in the regulatory environment in future periods. The overarching risk is that the proposal does not address competition concerns and that, in the absence of any other solution, industry turns to established ways of dispute under existing regulatory regimes. The undertakings and changes made by BT would become meaningless in this eventuality. Repeated consideration of Enterprise Act referral would be as unattractive as it is today.

Therefore, Tiscali believes that all the issues identified with the undertakings should be addressed and that a mechanism should be put in place that allows continuous review and update into the future. This suggested change could address the issues of implementation, monitoring and enforceability and produce a new era of competition in UK telecommunications.

More detailed planning of implementation is required, setting out how stakeholders will engage with BT and Ofcom as changes are made and ensuring that progress may be monitored into the future. Most importantly, the resolution of this phase of review and the transition into the next will depend on good faith and flexibility throughout the industry. Tiscali believes that an opportunity for significant change has presented itself and sustained effort and commitment is now essential to achieve extraordinarily valuable gains.