

BT's comments on the summary responses published by Sky and TalkTalk to Ofcom's 26 July 2016 document "Strengthening Openreach's strategic and operational independence"

1. On 4 October, BT submitted its response, supported by a series of reports by external experts, to Ofcom's 26 July 2016 proposals for making Openreach more independent from BT and its proposed future model for Openreach. Sky and TalkTalk have published executive summaries of their comments on these issues. Both companies continue to argue that Ofcom should seek to impose either full structural separation or, at a minimum, a form of full legal separation that goes beyond Ofcom's own, in our view flawed, proposals and envisages Openreach operating with an extreme level of autonomy from its owners.
2. We have reviewed the evidence and arguments put forward by the companies. In large part Sky and TalkTalk simply repeat arguments previously made which are addressed in our response (and specifically in Annex I). Below, however, we set out brief comments on some of the assertions made as the overall impression created is seriously misleading.
3. Sky's executive summary starts with unsupported assertions, and facts adduced without any reference to the relevant context. For example, an assertion is made that the "status quo is not working" when in terms of NGA coverage, internet speeds and take-up of NGA services the UK performs better than any other EU-5 country.
4. In its Digital Progress Report 2016, regarding its Connectivity measure, the European Commission stated that across the EU:
"On the fixed side, Luxembourg, the Netherlands and the UK are the strongest".¹
5. Analysys Mason has considered the performance of the UK against a number of benchmark countries namely, the largest European countries, countries where duct and pole access has been used by competitors to deploy their own fibre and countries where there has been a government policy push for fibre (i.e. Australia, France, Germany, Italy, New Zealand, Portugal, Spain and Sweden). It concludes that the UK leads the benchmarks in terms of NGA broadband coverage; ranks first on availability of 10 Mbit/s; second on average broadband speeds (number one when compared to the big five European countries); third on NGA take up (again, number one of the European big five) and is expected to be number one on all benchmarks by 2020 due to the availability of NGA infrastructure and highly competitive nature of the UK market.²
6. The UK has an excellent investment record, and more infrastructure investment is in the pipeline which will preserve the UK's position near the top of international "league tables". The UK is recognised in independent studies as having a strong e-economy and one that is well placed to take advantage of future opportunities. The suggestion

¹ Europe's Digital Progress Report 2016, page 5

² Analysys Mason "Comparative analysis of outcomes in the UK broadband market; coverage, connections and competition", 3 October 2016, page 1.

by Sky that there has been a decline in the UK's "fixed broadband competitiveness" is, therefore, completely false.

7. Sky then holds out the prospect that Openreach independence from BT "could unlock" fixed broadband investment in particular, investment in fibre to the premise ("FTTP") networks in the UK. BT is committed to providing the national infrastructure that the UK needs. Full separation, however, would give rise to substantial costs including the loss of efficiencies from vertical integration which would have detrimental effects on investment and therefore directly undermine BT and Ofcom's investment objectives. In particular, crucial business cases would be much more difficult without the ability to factor in end-to-end margins and without the commitment of an anchor tenant to drive sales. Sky does not, and cannot, point to a single example of separation working to increase commercial investment in communications infrastructure.
8. Much of Sky's description of the alleged failings of the UK regime, and of BT and Openreach, amounts to the fact that the UK, like Germany and many other comparable countries, has not (to date) seen a large-scale FTTP deployment. This has nothing to do with BT "holding back" any such investment. BT's labs were the original fibre pioneers and BT has continued to be a key innovator in driving fibre technology. BT's fibre footprint is the largest in the UK, passing 330,000 homes. We are also conscious of the need to connect people quickly and cost effectively, goals that pose a challenge to FTTP as a universal solution in the near term given its higher costs and longer timescales for deployment, and the lack of willingness to pay a significant price premium over other options for broadband.
9. FTTC was the right technology for Britain when BT first began to deploy NGA. It has put superfast broadband into the maximum number of homes in the minimum time. As of today, superfast broadband coverage in the UK is approaching 91% and we are on track to meet the Government's target of 95% by the end of 2017. As we now gear up for the shift to ultrafast broadband (with speeds of 100 Mbit/s plus), we expect the FTTP footprint to grow rapidly, alongside the deployment of G.Fast technology to bring customers the speeds they want at prices they are willing to pay.
10. In this context, Sky mentions the FTTP network in New Zealand which aims to cover 80% of the population by 2022. Although held up as an exemplar, New Zealand has not, however, delivered market outcomes as favourable as those seen in the UK. FTTP take-up in New Zealand is circa 12% of all households whereas fibre take-up in the UK is three times *higher*. Average download speeds are 40% *higher* in the UK than in New Zealand. This is all despite the fact that the FTTP programme in New Zealand is heavily subsidised – costing nearly ten times more, proportionate to GDP, than the BDUK programme. Even in New Zealand, FTTP will not reach 20% of the population and thus does not address concerns relating to an urban/rural divide.
11. Sky points to Portugal and Spain as FTTP flag-bearers, but fails to recognise the factors which are specific to these countries and which explain why FTTP has been more extensively deployed in these countries than elsewhere. The main reasons are:
 - there is no regulatory obligation to wholesale fibre access services (ie VULA), allowing the incumbent to keep the service for its exclusive commercial use without facing competition at the retail level from access takers;

- the high levels of MDUs, lower labour costs than the UK and the availability of new duct, which reduces the cost of deployment significantly;
 - Portugal and Spain have long had specific regulation for shared fibre access to the final connection to the customer.
12. The difference in outcomes has nothing to do with Openreach, and its “lack of independence” but, as a number of analysts have recognised, reflects different country-specific factors. Both Portugal and Spain have integrated suppliers, and neither have seen the need to carve out a separate access business to encourage investment. Further, the absence of a VULA remedy means access seekers wishing to compete in the provision of NGA services have no choice but to deploy their own network infrastructure.
13. Sky does not recognise the high levels of competition in the UK at all; it ignores the fact that competition is sustainable and growing at all levels of the industry including the infrastructure level. Regulatory policies over the past ten years have helped to create the economic conditions in which competitors to Openreach have been investing, particularly Virgin Media’s commitment to rollout to another 4 million homes taking its coverage to over 60%, and also commitments by CityFibre Holdings, Gigaclear and Hyperoptic. In this context, BT has strong incentives to invest and innovate to ensure that the needs of consumers and businesses (both customers of BT and those of CPs) are met, given existing and prospective competition from Virgin Media and other competitors.
14. Sky also highlights the fact that average speeds in the UK are behind those in the Czech Republic, Bulgaria and Romania. Sky omits to mention that the UK has much better superfast broadband coverage than the countries it mentions, meaning that there is not the same urban/rural divide (and which BDUK is continuing to address). For example, the European Commission has estimated:³
- rural coverage in the Czech Republic at about 5%, with the UK ten times this level;
 - Bulgaria has the second lowest level of fixed broadband take-up in the EU, and Romania the sixth *lowest*.
15. The suggestion that the UK, with world leading coverage and take-up, as well as internet usage, is getting left behind by these countries is a complete distortion of the actual position.
16. In any event, none of Sky’s assertions have any causal link to the “independence” of the access business. Separation has only been imposed when governments have taken a technology choice and provided the necessary financial support for FTTP. Whether these governments would all make the same choice now is doubtful given that innovation has delivered extraordinary advances in technology which means that speeds over copper are much higher than they were ten years ago, and are about to increase further still, whilst fixed wireless technologies promise speeds that can match

³ Op. cit. page 13 (rural coverage) and page 18 (take-up).

FTTP and will form part of the technology mix going forward as the technology evolves.

17. More generally, private operators are better placed to determine appropriate technology solutions including the path to these solutions in the context of highly uncertain market conditions. BT's past choices (for example the choice of FTTC in 2008) have allowed demand to be met in a timely fashion and for high levels of coverage and take up to be achieved. To the extent FTTP becomes a greater part of the technology mix going forward, this will be at lower cost than would have been available in 2008 and allowing BT to build an FTTP footprint covering 2 million premises by 2020.
18. TalkTalk also makes unsubstantiated contentions which expose the vacuity of its case for structural separation. The bullets from their paragraph 1.4 attempt to summarise the "wholly unacceptable" situation and allege that:
 - *BT and Openreach can charge high prices to non-BT customers - **in fact*** where Openreach has SMP its services are subject to the imposition of direct price controls (where Ofcom deem appropriate), and prices always have to be *exactly* the same prices to both internal and external customers;
 - *Openreach has the incentive to provide a low quality of service - **even if*** this contention were true, which it is not, this can be remedied by standard regulation as applied in utilities where separation is in place, and which Ofcom has now introduced following Market Reviews;
 - *Openreach makes investment decisions that are at the expense of competitors and customers – **yet*** TalkTalk cannot give a single example of investment that has been detrimental to customers or competition;
 - *BT can transfer funds to benefit the rest of the Group – **yet*** (again) no single example is given by TalkTalk and certainly BT Consumer funds all costs associated with premium TV content from its own free cash flow;
 - *BT frustrates retail and network competition and innovation - **in fact***, BT has the lowest incumbent retail share of any benchmark country (as found by Analysis Mason).⁴
19. Regarding innovation, BT has an outstanding heritage of innovation which we maintain to this day, investing some £470m annually in R&D making us one of the largest investors in R&D of any company in the UK, and globally in the telecoms. BT's Adastral Park technology headquarters is shared with around 70 high-tech companies, and a workplace for around 3,700 people. In 2015/16 BT filed patent applications for 97 inventions, has been leading in the development of ultrafast broadband, whilst our new Ultra HD Sports broadcasts have been the first of their kind in Europe.
20. Nor can the package of full legal separation and the additional measures proposed by Sky be made "at minimal cost". As BT has exhaustively set out in its Response and

⁴ Analysys Mason "Comparative analysis of outcomes in the UK broadband market; coverage, connections and competition", 3 October 2016, page 6.

associated Expert Reports, Ofcom's proposals (even without the additional measures proposed by Sky) would load BT with disproportionate costs and hamper its ability to control, and deliver value from, its key assets with a range of adverse consequences. Whilst, as we have explained, this is not solely a matter of the implications for BT's pension scheme, advice that TalkTalk may have received that insurance for around £1m a year could replace any loss Crown Guarantee is completely contrary to the expert advice from top tier pension advisers KPMG and PwC. Whilst this is a decision for the Trustees, it is likely that the Crown Guarantee could only be replicated by over £30bn of coverage for the unlikely event of BT's insolvency. BT notes that even if the issues around the Crown Guarantee could somehow be fixed, this does not address the adverse impacts Ofcom's proposals would have on the strength of BT's covenant to its pension scheme. TalkTalk also fails to address the points on this issue made in the BT Pension Scheme Trustee's response to Ofcom's July 2015 DCR discussion document.

21. BT is also aware that Sky were asked by Mercer to change their Press Release, so that it more accurately reflected their conclusions, these being that there would be a negative impact from full separation (as opposed to this being positioned as a possibility); that there are mitigation measures (although that such measures are not "straightforward"); and that the Government could extend the Crown Guarantee to a new Openreach pension scheme (although that this was not "simple and straightforward"). Unfortunately, many media outlets used the erroneous original Press Release.
22. Rather than substantiate or summarise the case for separation or "quasi separation", the executive summaries published by Sky and TalkTalk highlight that these parties have not provided any evidence or facts supporting Ofcom's intervention, or for a more extreme version of Ofcom's proposal. Sky's demands that "*the Ofcom proposals must go further and not be weakened*" are predicated on a case it has been completely unable to substantiate. Similarly TalkTalk's demand that "*...anything short of this will leave unchanged BT's incentive to use Openreach to distort and weaken competition in the retail market*" is not supported by any evidence that BT has distorted competition or that market outcomes have been adversely affected.