



- 5.50 This list does not seek to be exhaustive but illustrates the breadth of assets that it will be necessary to consider. This is consistent with similar exercises undertaken in other jurisdictions, where this type of division has been successfully undertaken.<sup>92</sup>
- 5.51 The question of how to configure Openreach's relationship with its workforce is dealt with in the section dealing with 'Workforce independence'. This section deals with other assets at a high level, with some other assets (such as systems) dealt with separately where specific issues arise.
- 5.52 In relation to each category of asset, the Openreach Board will need to determine to what extent they will need to own or exercise control over that asset in a way that is consistent with Openreach's purpose. In doing so, they will need to consider:
- (a) Does that degree of ownership or control ensure that Openreach is able to fulfil its purpose in relation to the supply of network access?
  - (b) Does that arrangement ensure that Openreach is independent of BT?
- 5.53 Given those tests, it will be necessary for Openreach either to own the asset itself (which we think would be the norm in most cases) or, in some circumstances, to obtain rights in contract from a third-party (not BT) to use those assets that is sufficient for Openreach to fulfil its purpose. Table 2 illustrates the sort of outcome that process could produce, with some arrangements compatible with Openreach's purpose, and others being incompatible.

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<sup>92</sup> See, e.g., Telecom Corporation of New Zealand Limited 'Overview of the Asset Allocation Plan: section 37 Telecommunications (TSO, Broadband and Other Matters) Amendment Act 2011' (6 September 2011). Available here: <http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9MTA2MjU5fENoaWxkSUQ9LTF8VHlwZT0z&t=1> ('Telecom NZ Asset Allocation Plan').

Table 2: Asset classes and possible arrangements for ownership or control of those assets by Openreach

Asset class		Options compatible with Openreach being independent of BT		Not compatible
		<u>Owns directly</u>	<u>Owned by a third party</u>	<u>Owned by BT</u>
Land	Wayleave	Wayleave used to support ducts and poles held by Openreach	Wayleave held by third party (e.g. independent infrastructure provider) and access provided under contract to Openreach	Wayleave rights held by BT Group plc and delegated by contract to Openreach
	Exchange building	Exchange land/building owned by Openreach	Exchange building that has been the subject of a 'sale and lease-back' – freehold held by third party and leasehold novated from BT Group plc to Openreach	Exchange building sub-leased from or freehold remains with BT Group plc
	Office	Openreach owns freehold	Openreach leases site from third party	Openreach leases site from BT Group plc
Passive infrastructure assets		Transferred from BT Group plc to Openreach	N/A	Leased from BT Group plc
Active infrastructure assets		Owned by Openreach	Owned by third party (e.g. outsourcing provider) and provided under contract to Openreach	Owned by BT and provided under contract to Openreach
Intellectual property		Owned by Openreach	Owned by third party (e.g. software supplier) and licensed to Openreach	Owned by BT and licensed to Openreach
Supply contract (e.g. equipment supply contract)		Held by Openreach (novated from BT)	N/A	Held by BT and supplied to Openreach by BT
Vehicle fleet		Owned by Openreach	Leased from third party	Leased from BT

- 5.54 In most cases, the starting point should be that any asset currently owned by BT that is necessary for the conduct of Openreach's business will need to be transferred from BT to Openreach. There is no reason to believe that this will be an unduly difficult process (we assume that BT has an asset and contract management system in place). In almost all cases, it is reasonable to expect that sale of an asset or novation of a contract from BT to a wholly-owned subsidiary is likely to be permitted without re-opening those agreements – this is normally the case in many standard commercial contracts, including wayleaves and other relevant rights. Nor is this likely to create undue or avoidable transaction costs (in the case of transfers of interests in land, for example, stamp duty relief is available for transfers within a corporate group).<sup>93</sup>
- 5.55 It is not appropriate for assets to be provided to Openreach under contract but remain owned by BT. In those circumstances, certain rights in respect of those assets will remain with BT, and those rights are potential sources of influence. Further concerns with allowing assets to continue to be owned or controlled by BT include that:
- (a) As a matter of principle, it leaves Openreach dependent on BT for that asset. Dependence is not compatible with independence – and BT's ownership will remain a source of influence. Ownership rights are the bedrock of true economic and legal independence; while tenants have certain rights, in relation to the land they lease they are not generally considered to be able to act *independent* of their landlords.
  - (b) Critically, Ofcom's strategy for increased fibre roll-out depends on Openreach taking steps to make passive access and other forms of network access that support fibre roll-out more likely to be commercially attractive. This means that Openreach cannot be limited to reselling the forms of physical infrastructure rights offered to it contractually; it will need to undertake work that is, literally and figuratively, deeper than that. This task is inherently linked to the right to transform, re-configure and make available physical infrastructure in a range of ways, including structures that are part of the underlying asset (the land) such as ducts or poles. This is incompatible with BT continuing to own those underlying assets, since Openreach cannot achieve these tasks as a tenant.
  - (c) Equally, continued ownership of underlying assets such as property or physical infrastructure is likely to convey undue advantages on BT in giving it access to an understanding of Openreach's affairs that no other CP would enjoy. For example, it would leave BT able to veto (or even simply to have visibility of) Openreach's dealings in property, in a way that could compromise Openreach's purpose.
  - (d) Commercially, it would leave Openreach exposed to being 'sandwiched' in between BT as its landlord and BT as its customer. BT's ability to coordinate those relationships would give it an advantage that no other CP would enjoy.

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<sup>93</sup> HMRC, 'Stamp Duty Land Tax Manual', section SDLTM23010. Available here: <https://www.gov.uk/hmrc-internal-manuals/stamp-duty-land-tax-manual/sdltm23010>.

- (e) As a matter of regulatory policy, Openreach's ownership of those assets will assist various regulatory objectives – for example, it will create greater transparency in relation to costs.
- 5.56 This separation of assets will demand the establishment (for the first time) of clear boundaries between Openreach and BT assets. BT will be required to request access to the network and contract with Openreach for those services on the same terms as other CPs. Accordingly, this will allow for more transparent engagement between BTR and Openreach.
- 5.57 This proposal is also consistent with the notion that the separation between BT and Openreach should be 'divestment – minus' – that is, the only difference between the outcome we reach and structural separation is that BT owns its subsidiary, Openreach. In all other respects, the independence of Openreach and the removal of BT's influence is equivalent to that if divestment had occurred. Clearly, any divestment of Openreach would require BT to agree with the new owner what assets would be transferred in that transaction.
- 5.58 Experience in other sectors is that there is nothing inherently insurmountable in this sort of asset division.
- (a) Under competition law, divestments are a routine process. The only difference here is that the final step would be missing (the transfer of an ownership interest in the shares of the 'divested' element (Openreach)). Indeed, one of the reasons why we think that appointing an IMT to oversee this process makes sense is because this transaction looks in many respects exactly like a divestment (except in the final step).
- (b) In a regulatory context, such asset divisions are also unremarkable:
- (1) In energy, asset unbundling proceeded largely uneventfully and there is no reason to believe that the same would not be true of the BT network assets.<sup>94</sup> The European Commission's 'third energy package' which facilitated transmission system operators being unbundled (or independent) from generation, production and supply interests in the energy market, and are required to be certified as doing so (see for example sections 10A-10O of the Electricity Act 1986, and sections 8C-8Q of the Gas Act 1986). The rationale behind this package was that it should eliminate any conflict of interests between these activities and prevent network operators from favouring their own energy production and supply companies. These concerns mirror the concerns that Ofcom has regarding the level of influence that BT currently has over Openreach.
- (2) In telecoms, structural separation has been undertaken successfully in New Zealand. In order to participate in the New Zealand Government's Ultra-Fast Broadband ('UFB') initiative, which provided public funding to roll out FTTP, Telecom NZ agreed to structural separation. It entered an 'Interim Period Agreement' in May 2011, under which it agreed to undergo voluntary structural

<sup>94</sup> The third energy package consists of two Directives, one concerning common rules for the internal market in gas (2009/73/EC), one concerning common rules for the internal market in electricity (2009/72/EC) and three Regulations, one on conditions for access to the natural gas transmission networks ((EC) No 715/2009), one on conditions for access to the network for cross-border exchange of electricity ((EC) No 714/2009) and one on the establishment of the Agency for the Cooperation of Energy Regulators ACER ((EC) No 713/2009). They were adopted in July 2009.



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### Proposal 13: Openreach should employ its workforce directly

- 5.71 The obvious way to ensure that Openreach has full control over its affairs and is able to act independently of BT is to have Openreach employ its workforce directly.
- 5.72 It is outside the scope of this report to discuss the detailed mechanics of that process, although we note that the legislative framework for such transfers is very well established and – with few exceptions – there is unlikely to be any ambiguity about how it works in this case.
- 5.73 One complicating factor is that the incentives on those who work to support Openreach include incentive schemes that have not yet matured or that are still in place (e.g. workplace share purchase schemes or bonuses accrued over multiple years).
- 5.74 Provided that there is sufficient clarity that Openreach’s independence must be preserved and that the norm is to be separate arrangements, then further specific aspects of Openreach’s workforce independence will ultimately be a matter for the Openreach Board. However, a number of initial points can be made now that help illustrate what workforce independence might demand:
- (a) As is today, all incentive schemes rewarding Openreach employees (including the Openreach CEO and other senior executives) must base any organisational element of performance to Openreach performance against its objectives (or some subset of Openreach – for example, a relevant team or division of Openreach). Above all, such schemes must be entirely independent of any measure of performance by BT or BT business units (and hence must not be paid in BT shares);
  - (b) no Openreach employee ought to hold shares in BT Group (or any other CP). Clearly, there are many members of Openreach’s current workforce who do hold shares; it would be a matter for the Openreach Board whether to ask BT to purchase all such shares for cash prior to the transfer of that workforce or to offer to swap BT shares for ‘UK telecoms tracker’ shares for employees, widening the relevant financial interest to the whole of the sector;
  - (c) Openreach should maintain and update its Code of Conduct for its workforce to reflect the fact that Openreach will, in future, be independent of BT; and
  - (d) Openreach should commit to a mandatory training and compliance scheme to embed the new requirements widely and deeply amongst its workforce.
- 5.75 Equally, in relation to BT incentive schemes, it is not appropriate to reward any BT executive for Openreach performance (indeed, it would be unfair and inappropriate to do so, since if

Openreach is independent of BT, then those executives cannot control or be held accountable for Openreach's performance). This issue arises in two distinct ways:

- (a) first, in relation to the way in which performance is measured. In this case, it should be obvious that BT executives should be rewarded for the performance of 'their' part of BT (or in the case of BT Group executives, all of the divisions other than Openreach); and
- (b) secondly, in relation to the way in which incentives are paid. In particular, if reward schemes are denominated in BT shares, not (for example) cash, then they include a de facto element of reward for Openreach performance. It follows that one of the consequences of ensuring that BT is independent of Openreach is that the BT executive reward scheme should be an exclusively cash reward, not an award of BT shares.

5.76 In order to enforce such independence, Openreach (and indeed BT) would need to have in place the appropriate systems and processes. Other processes or obligations that support workforce independence include that:

- (a) other than as part of the initial transfer, any movement of staff between BT and Openreach (in either direction) should involve a 3 month period where the individual is not involved in operational work for BT and has no access to confidential information during that time. This period should be 6 months for managers and 12 months for senior executives. These are no longer than is typically required in most competitive industries where the movement of people can compromise confidentiality and there is a need to ensure that strategic information (which generally has a 'shelf-life' of 6-12 months) is protected. This requirement also recognises the need to break down the strong bonds of influence that BT enjoys over Openreach by virtue of the historic ownership of Openreach by BT. This requirement might be relaxed after a period of, say, 3-5 years; and
- (b) all current areas of shared HR management should be separated as part of the transition. That means:
  - (1) the Openreach Talent programme should be separately run and distinct from BT, with no cross-visibility or use of either list;
  - (2) job opportunities for Openreach and BT should be listed separately;
  - (3) no BT Scotland or other regional boards to include Openreach (or vice versa);
  - (4) no Openreach people on BT committees/groups;
  - (5) internal communications should be separate, with a separate Openreach intranet (not 'BT Today');
  - (6) no offering of BT retail products (voice, broadband, mobile or TV) provided to Openreach staff as a benefit, either free or at any cost not available to the public generally. If Openreach offers communications services on a subsidised basis for its workforce, that must be on the basis of vouchers that can be redeemed for the services of any participating CP; and



- (7) Openreach should maintain its own internal staff directory and the BT internal on-line people directory should not provide access to, or list, Openreach people.

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