



## **OFCOM'S CONSULTATION ON 'DELIVERING A MORE INDEPENDENT OPENREACH'<sup>1</sup>**

### **RESPONSE BY SKY**

#### **Introduction and summary**

1. Ofcom's consultation addresses the release of BT from the undertakings given in lieu of a market investigation reference in 2005. Those undertakings resulted in the establishment of Openreach as a separate division within BT, operating on an 'equivalence of input' basis. They are to be replaced by commitments given by BT to Ofcom in March 2017 ("the Commitments"), which build on the 2005 Undertakings, and are aimed at addressing a number of the problems identified in Ofcom's Digital Communications Strategic Review.
2. Sky considers that elements of the Commitments represent significant tangible improvements on the Undertakings regime, in particular the commitment by BT to consult with stakeholders on major new infrastructure investments. Similarly, there is much in the current consultation that provides comfort to stakeholders in relation to Ofcom's intention to monitor and enforce the Commitments rigorously, to review their effectiveness in the future, and to consider moving to alternatives (including structural separation) if they are found not to deliver. We welcome and endorse Ofcom's commitments in the current consultation in relation to monitoring and enforcement of the new regime, and the need for proper evaluation of its effects.
3. Sky has significant concerns about the likely long term effectiveness of the Commitments. In particular, we consider that the Commitments are overly complex, permit BT Group to retain a high degree of influence over Openreach, and continue to permit too great a level of inter-relationship between BT Group and Openreach. We continue to believe that, in the long term, there would be substantial benefits to the UK from establishing Openreach as an independent company, which is not owned by any company that also operates at the retail level of the sector.
4. Nevertheless, we consider the most appropriate approach at this point in time is to (i) implement the Commitments, (ii) ensure that they are monitored and enforced rigorously, and (iii) undertake a comprehensive review of their effectiveness in three years. We also consider that both the effectiveness of the new regime, and the ability properly to evaluate its effectiveness would be enhanced significantly if Ofcom were more specific than at present in relation to measures of its success.

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<sup>1</sup> 'Delivering a more independent Openreach, Update on BT's voluntary notification under s.89C Communications Act 2003 and consultation on releasing the BT Undertakings pursuant to section 154 Enterprise Act 2002', Ofcom, March 2017. ([https://www.ofcom.org.uk/data/assets/pdf\\_file/0035/98855/Openreach-consultation-2017.pdf](https://www.ofcom.org.uk/data/assets/pdf_file/0035/98855/Openreach-consultation-2017.pdf).) All paragraph references in this response are to this consultation document unless otherwise stated.

5. Sky is disappointed that Ofcom has chosen not to consult stakeholders on the Commitments put forward by BT. This is out of keeping with Ofcom's normal practice, and deprives Ofcom of the benefit that scrutiny of the proposals by others would bring. Ofcom's reasons for choosing not to consult in this instance are unclear.
6. Notwithstanding this point, we consider that there would be considerable value to stakeholders from Ofcom publishing a statement (as it normally does) which sets out such matters as (a) an explanation of the Commitments, the meaning and intention of key parts of which are not self-evident, (b) the issues that the Commitments are intended to address, and (c) Ofcom's reasons for believing that the Commitments adequately address those issues. This statement, which we would not expect to be lengthy, could be included as part of the statement issued at the conclusion of the current consultation.

### **Sky's comments on the Commitments**

7. Whilst, as discussed further below, Ofcom is not consulting on the Commitments, we have taken the opportunity afforded by the current consultation to provide some high level observations on them.
8. First, Sky welcomes the progress that has been made. We consider that elements of the proposals, such as the commitment by BT to consultation with Openreach's stakeholders on major new investments, and the establishment of a Board of Directors which includes independent directors, represent significant tangible improvements on the present arrangements.
9. More generally, however, it is questionable whether the new arrangements will deliver the step change in incentives for Openreach to (a) become a high performing organisation, and (b) take decisions which will deliver the optimal investment in telecommunications infrastructure that is so critical for the future economic performance of the UK.
10. This is the result of two key factors: (a) the overly complex nature of the arrangements, and (b) the extent of the scope for ongoing influence over Openreach by BT Group. We elaborate on these two concerns further below, before commenting more generally on the Commitments.

#### *The complex nature of the arrangements*

11. The more straightforward are the governance arrangements in relation to Openreach, the greater the likelihood of those arrangements delivering positive outcomes. Institutional arrangements are a key factor in determining the incentives facing those who work within them. A clear, straightforward set of institutional arrangements is likely to create better incentives for delivery of positive outcomes (for example, due to factors such as (i) setting clear goals and (ii) ease of ensuring accountability) than complex arrangements.
12. Arrangements of the type dealt with by the Commitments will always be subject to a degree of complexity given that they cover a broad range of matters, each of which potentially raises difficult issues. Nevertheless, a key objective in designing them should be to minimise that complexity. The final package of Commitments (together with the accompanying 'Governance Protocols' and 'Agency and Services Agreement' - which are key

components of the overall package)<sup>2</sup>, however, is highly complex, and puts in place a set of institutional arrangements which gives rise to a significant risk of poor outcomes.

13. Moreover, the complexity of the arrangements creates significant opportunity for BT, (should it be so minded) to undermine their effectiveness. The delivery of positive outcomes as a result of the new arrangements will depend to a very significant extent on BT (including Openreach) acting in accord with the *spirit* of the Commitments. Sky considers that Ofcom should make clear its expectation that BT will honour the spirit, not just the letter, of the Commitments, particularly given Ofcom's move to a principles rather than form-based approach.
14. Finally, the more complex are the arrangements the more difficult it is for Ofcom to monitor and enforce them effectively.

#### *The extent of the scope for substantial ongoing influence over Openreach by BT Group*

15. One of the key issues raised by BT's ownership of Openreach, which emerged clearly during Ofcom's Strategic Review, is the fact that BT is able to control Openreach to the benefit of BT Group, but to the disadvantage of other CPs who rely on Openreach inputs. Furthermore, BT ownership means that Openreach will view its own performance in terms of its contribution to the success of the BT Group – whether this is explicit (for example in relation to KPIs) or implicit (for example in relation to career progression within BT).
16. The Commitments allow BT Group to retain a substantial ongoing influence over Openreach, and there will remain a high degree of integration between Openreach and the rest of the BT Group. The inter-relationship includes: (i) extensive visibility and oversight by BT Group of Openreach financial planning and performance,<sup>3</sup> (ii) ongoing sharing of resources (e.g. HR, finance, and regulatory services) between Openreach and the rest of BT, (iii) ongoing movement of staff between BT Group and Openreach, and (iv) retention by BT of ownership of all the assets that comprise the basis for Openreach's activities. Sky understands (i) the need for a degree of financial oversight by BT of Openreach, in order that BT directors are able to meet their fiduciary duties (as long as Openreach remains owned by BT), and (ii) the potential costs of duplicating facilities and functions within BT Group. However, we consider that the extent of oversight of Openreach by BT Group, reliance on and integration between Openreach and the rest of BT, and enduring influence by BT over Openreach is excessive and we believe, poses a threat to the effectiveness of the Commitments.

#### *General observations*

17. Sky remains of the view that, ideally, Openreach should be a fully separate company, not owned by any downstream provider of telecoms services. However, in circumstances in which Ofcom reached a view that, currently, it did not regard such a step as proportionate, we consider that establishing Openreach as a fully independent company, wholly owned by BT, was both a desirable and proportionate response to the issues identified in Ofcom's Strategic Review.

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<sup>2</sup> To take just one example, whereas previously there was just one relevant entity (BT's Openreach division), the Commitments (and related documents) now refer to three different entities: Openreach Limited, the Openreach Division and the Openreach Line of Business – each of which has differing roles and responsibilities. We note that the Articles of Association for Openreach Ltd are still yet to be published.

<sup>3</sup> By way of example, we find it surprising that it is acceptable to Ofcom that Openreach is required to seek approval from the BT Group CEO and CFO for *any* variation in capex or operational expenditure that will result spending above the amounts specified in the approved Annual Operating Plan, no matter how small.

18. Whilst Sky appreciates the enormous amount of effort that Ofcom has devoted to this issue, its eventual position that 'more independence' for Openreach is sufficient to meet Ofcom's concerns (even if this falls well short of full or even substantial independence) has led to an outcome that we believe is unlikely to prove sustainable in the longer term. For example, we consider that a situation in which Openreach Ltd, which is fundamentally an infrastructure business, owns none of the assets that it manages and is required to develop is wholly counterintuitive, and we find it surprising that such an arrangement is acceptable to Ofcom. Similarly, it is unclear to Sky why Ofcom is willing to accept a situation in which something as basic as Openreach being able to contract with its customers and suppliers in its own name should be precluded by the Commitments.
19. In particular, however, the fundamental tension caused by the ongoing vertical integration of the UK's largest fixed line and mobile telecoms retailer with the operator of the UK's only ubiquitous fixed line telecoms infrastructure will, we believe, continue to give rise to skewed incentives in relation to investment and dealings with downstream customers. And, with Openreach remaining a small part of the business of the broader BT Group, we consider that the likelihood of step changes in the quality of service delivered by Openreach may be difficult to achieve.

#### *Next steps*

20. In relation to the Commitments themselves, whilst, as noted above, Sky has considerable reservations about their likely effectiveness and their long term sustainability, we consider that the most appropriate way forward at this point in time is to proceed with their implementation, to carefully monitor compliance, and to evaluate their effectiveness after a period of time.
21. In this respect, there is a great deal in the current consultation to provide comfort to stakeholders. The importance of detailed and proactive monitoring and enforcement, and evaluation of the new regime is clearly recognised by Ofcom:

*"Effective and robust monitoring will be critical to ensure that BT and Openreach Limited comply with the arrangements set out in BT's March Notification and that Openreach acts more independently in the interests of all customers.... Ofcom will take a detailed and pro-active approach to monitoring the compliance by BT and Openreach with the Commitments and Governance Protocol."*<sup>4</sup>
22. We welcome and endorse these statements, the commitment to monitoring, enforcement and evaluation of the new regime set out in the Consultation, and the measures proposed by Ofcom in Sections 6 and 7 of the Consultation. We also welcome Ofcom's confirmation that full separation of Openreach from BT remains an option in the event that the current regime is found not to be effective.<sup>5</sup>
23. Sky considers that it is important for Ofcom to be more precise in advance about the types of outcomes that it would consider to represent successful results of the Commitments in its final statement on these matters. Currently, Ofcom's statements on this issue are vague – for example:

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<sup>4</sup> Paragraphs 6.1 – 6.2.

<sup>5</sup> Paragraphs 1.31, 6.36 and 7.12.

*“Gauging the overall success of BT’s notification will depend on a broad assessment of implementation, compliance and benefits for consumers, businesses and Openreach’s communication provider customers.”<sup>6</sup>*

24. We understand Ofcom’s reluctance to be overly determinative in relation to expectations of what the new framework should deliver, given the risk that it then focuses BT’s and/or Openreach’s attention unduly on achieving particular outcomes. However, we consider that there should be a middle ground between the current position of essentially specifying very broad metrics of success, and indicators that unduly focus BT’s and/or Openreach’s efforts.
25. In particular, we consider that there must be some focus on the extent to which the new regime alters BT’s efforts in relation to the delivery of fibre to the home (“FTTH”). The importance of such investment in future, and the extent to which the UK lags other countries in the roll-out of FTTH networks, were key findings of Ofcom’s Strategic Review.<sup>7</sup> It would be highly surprising if Ofcom did not seek to evaluate the success of the new regime in terms of its impact (alongside other Ofcom initiatives) on BT’s contribution to the delivery of FTTH in the UK.
26. A further important metric that should be considered for evaluation is the extent to which Openreach incentivises non-BT CPs to sell its existing (VULA) fibre-based products. Sky considers that, if Openreach were independent of BT, it would be concerned about the relative penetration of sales of its premium products among the bases of its three key customers (BT, Sky and TalkTalk), and would have strong incentives to encourage Sky and TalkTalk to increase penetration levels. Accordingly, we consider that Openreach’s efforts in this area over the next few years provides a good litmus test of the extent to which it has, in fact, become more independent from the interests of BT Group.
27. Sky also considers that Ofcom should commit to a defined timetable for evaluation of the effectiveness of the new regime. We consider that a review in three years’ time would be appropriate.

#### **Ofcom’s decision not to consult on the commitments and the lack of a statement on them**

28. Sky is disappointed that Ofcom has decided not to consult stakeholders on the final commitments proposed by BT.
29. The issue of future governance arrangements in relation to Openreach arose out of Ofcom’s Strategic Review of Digital Communications in the UK, the first such review in ten years. Openreach supplies critical inputs to the UK telecommunications sector (both mobile and fixed line), thereby having an enormous impact on issues of fundamental importance to that sector – and the wider UK economy – such as the effectiveness of downstream competition, and the level and nature of investment in the UK’s telecommunications infrastructure. The decision on those arrangements is likely to be one of the most important facing Ofcom and the industry for a considerable period of time.

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<sup>6</sup> Paragraph 7.10.

<sup>7</sup> For example, Ofcom stated: *“We also concluded that a step change is required in the outcomes delivered to consumers and businesses. Our ambition for the future is that more homes and offices receive ‘fibre to the premises’ (FTTP). This technology, which offers average broadband speeds many times higher than those of today, is currently available to just 2% of premises in the UK, compared to 60% and higher in world-leading countries.”* (Paragraph 1.14 of ‘Strengthening Openreach’s strategic and operational independence, Proposal for comment’, Ofcom, July 2016: [https://www.ofcom.org.uk/\\_data/assets/pdf\\_file/0022/76243/strengthening-openreachs-strategic-and-operational-independence.pdf](https://www.ofcom.org.uk/_data/assets/pdf_file/0022/76243/strengthening-openreachs-strategic-and-operational-independence.pdf).)

30. The importance of this decision is heightened by the fact that – as identified in Ofcom’s strategic review - the issue of how to achieve greater investment in fibre networks in the UK, in which Openreach plays a central role, is a key strategic issue facing the UK telecoms sector.<sup>8</sup>
31. Ofcom’s review correctly identified the fact that the then current governance arrangements for Openreach were not fit for purpose, and no longer delivered the right outcomes for the sector and the UK economy generally. Ofcom indicated that while it considered that structural separation of Openreach would fully address its concerns, it considered that legal separation of Openreach from the rest of BT would be a more proportionate solution to those concerns.
32. Since July 2016 Ofcom has been following a twin-track approach of (a) preparing a notification to the European Commission of proposals to require BT to establish Openreach as a separate company on terms set by Ofcom, and (b) negotiating with BT over voluntary commitments which would address Ofcom’s concerns. Ofcom has indicated that BT has now offered voluntary commitments that meet its requirements and therefore is no longer proposing to seek to impose legal separation on BT.
33. However, despite the significance of those commitments, Ofcom does not intend to consult stakeholders on them.
34. Sky considers that the decision not to consult stakeholders is inconsistent with normal Ofcom practice<sup>9</sup>, and in principle susceptible to legal challenge.<sup>10</sup> Above all, however, Ofcom’s decision not to consult on the Commitments means that the key benefits of consultation are lost. Scrutiny of proposals by a broad range of interested parties, in particular those with direct industry experience, enables problems with those proposals to be identified and improvements to be proposed, with better final outcomes as to the likely effectiveness of the proposals.

*The reasons for not consulting are unclear*

35. Ofcom has indicated that it does not have a role in consulting on voluntary commitments proposed by BT, distinct from its duty to consult on the release of the Undertakings. Whilst Ofcom may have a formal role in relation to the release of the Undertakings, this should not have precluded Ofcom from consulting on the Commitments themselves. Indeed, Ofcom’s decision not to consult here is difficult to reconcile with its usual practice of consulting on a wide range of issues – many of significantly less importance than the issues raised by BT’s Commitments.
36. We now understand that Ofcom considers that its consultation of July 2016 made it clear that if BT addressed the remaining concerns with the commitments it proposed in March 2016 then Ofcom would accept BT’s commitments. Unfortunately, this was not clear from that consultation.

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<sup>8</sup> For example, in its February 2016 Statement Ofcom stated: “Our strategic objective in relation to fixed networks is to encourage the large scale deployment of new fibre networks over the next decade, driving the widespread availability of competing ultrafast broadband services.” (Page 32, ‘Making communications work for everyone, Initial conclusions from the Strategic Review of Digital Communications’, ([https://www.ofcom.org.uk/\\_data/assets/pdf\\_file/0016/50416/dcr-statement.pdf](https://www.ofcom.org.uk/_data/assets/pdf_file/0016/50416/dcr-statement.pdf)))

<sup>9</sup> Ofcom routinely consults stakeholders, on a broad range of issues, many of which are arguably of far less importance than the issue of the future governance arrangements in relation to Openreach.

<sup>10</sup> Given Ofcom’s long-standing practice of consulting on important decisions, stakeholders had a legitimate expectation that it would do so in this case. See: R (Bhatt Murphy) v Secretary of State for the Home Department [2008] EWCA Civ 755.

37. In Sky's view, respondents had a legitimate expectation that there would be a further consultation on any final iteration of the proposals, particularly where, as here, material changes have been made. To say that Ofcom has been consulting for some time on proposals for legal separation rather glosses over the fact that there are significantly varying forms of legal separation, each carrying its own set of trade-offs and challenges. What matters, and, in Sky's view should have been consulted on, are the specific final proposals for legal separation.

*Lack of a statement on the Commitments*

38. In a similar vein, it is unusual for Ofcom not to have published a statement concluding the final phase of its review. Currently, we have a situation in which numerous stakeholders responded to the Ofcom consultation that closed in October 2016, in relation to which Ofcom has only issued an 'update note' in November 2016. Unlike other Ofcom processes, this means that there has been no response by Ofcom to the numerous points raised by stakeholders in response to its July 2016 consultation, or proper explanation of Ofcom's reasoning in deciding to accept the Commitments.
39. Ofcom's policy statements enable stakeholders to understand why Ofcom has adopted a particular course of action. This is especially important in the current case, given (a) the complexity of the arrangements that BT has been put forward, the meaning, purpose and practical operation of which are not always self-evident, and (b) their importance, as discussed above.
40. In our recent meetings, Ofcom has provided more colour and explanation for the trade-offs made in reaching the final set of commitments put forward by BT, the issues it considers the proposals are designed to address and why it considers them likely to be effective at addressing them. It would be entirely in keeping with standard Ofcom practice at the conclusion of a policy project or inquiry to publish a statement setting out these issues.
41. Having a clear documentary record of Ofcom's reasoning in choosing to accept BT's Commitments (and not to pursue the approach of imposing legal separation on BT) is also crucial to being able to judge the effectiveness of the proposals in future.
42. Sky considers that it should be a straightforward task to draw Ofcom's existing thinking and material into a short statement, which could be incorporated into the statement setting out Ofcom's conclusions at the end of the current consultation.