

Notice under Section 155(1) of the Enterprise Act 2002

NCC reply to consultation on undertakings offered by British Telecommunications plc in lieu of reference under Part 4 of the Enterprise Act 2002

NCC welcomes the opportunity to respond to the Office of Communications' consultation on whether it should accept undertakings offered by British Telecommunications plc (BT) in lieu of reference to the Competition Commission.

In its consultation, Ofcom makes a series of conclusions regarding telecoms markets:

- Effective competition remains the best means to deliver benefits to business and consumers;
- Competition based upon deployment of alternative infrastructure is the best mechanism to ensure wider choice, better quality and lower prices, as well as faster innovation and availability of new services;
- Competition alone cannot guarantee benefits for consumers as it may not ensure that consumers are sufficiently informed to be able to make effective choices or that the market delivers services to vulnerable groups and isolated communities;
- As a result of BT's dominant position, competition is being restricted in markets for the supply of wholesale access and backhaul network services and on directly related downstream retail markets;
- The combination of upstream market power and vertical integration provides BT with both the ability and incentive to discriminate against its downstream competitors, who are also its wholesale customers.

Ofcom believes that the present structural deficiencies and competition abuses can be remedied through a set of undertakings offered by BT and it intends to accept them.

NCC has already cautiously welcomed Ofcom's proposal to rely on BT's undertakings. We agree that this course of action is likely to be the speediest and most pragmatic means of responding to the issues that have been identified - even though its actual effectiveness of course remains to be seen.¹ However, as explained below, we believe that it is necessary to modify aspects of the proposed undertakings in order to prevent BT from using its vertical integration to distort competition in future. Our detailed comments are outlined below.

Appropriateness of undertakings

¹ "Better consumer information and mis-selling protection is vital as BT faces competition", NCC press release, 23 June 2005.

Ofcom's mentions several reasons for choosing to accept BT's undertakings rather than to follow other regulatory options:

- Ofcom's capacities as a regulator are being hampered by a significant asymmetry of information between itself and BT. In particular, Ofcom finds it hard to detect and prove individual cases of non-price discrimination, and therefore to act in a timely fashion.
- The proposed undertakings would constitute a more comprehensive solution to the identified problems than could be achieved by a series of interventions under the Competition Act.
- Accepting BT's undertakings will be more efficient than commencing separate investigations into individual products under the Communication Act or the Directives.

NCC is not entirely convinced by all of Ofcom's arguments above. On the one hand, we understand that a holistic approach to an inherent market failure is likely to be more efficient than a patchwork of individual actions. On the other hand, we are puzzled by Ofcom's assessments of its capacities as a regulator and its attitude towards regulation.

It is a well-established economic concept that regulators will often face asymmetry of information vis-à-vis the regulated entity (entities) and can therefore find it hard to detect and prove misconduct and devise appropriate remedies. This however does not prevent other regulators from striving to overcome this asymmetry and intervening when necessary. If Ofcom genuinely believed that asymmetry of information was preventing it from regulating effectively, it should propose to refer the matter to the Competition Commission.

We do not therefore believe that accepting BT's undertaking is *a priori* the only appropriate regulatory solution. However, given the extensive nature of the undertakings and the general support of the industry, we are ready to endorse them, providing that certain conditions are met.

Conditions for acceptance of BT's undertakings

We believe that BT's undertakings can only be acceptable if they ensure that BT does not have the incentive or the power to use its vertical integration to distort competition. As part of its undertakings, BT proposes to create within the BT group a separate division for infrastructure, neutrally branded as Access Services Division (ADS), with a separate management remunerated through an independent pay scheme. The Chief Executive Officer (CEO) of ADS would be accountable directly to the CEO of the entire BT group.

BT's undertakings are reasonably wide-ranging and would appear to entail a significant operational separation between its retail and wholesale activities. However, we believe that the undertakings, as currently proposed, would

still leave scope for BT to use its vertical integration to distort competition. For example, BT Group plc would have considerable power to influence the actions of the CEO of ADS, since it would have the power both to appoint and to remove the CEO, and since the CEO would be directly accountable to the Group. We therefore believe that a simple management unbundling without a proper monitoring mechanism would be insufficient to prevent BT from abusing its market power.

A truly independent monitoring body

The proposed Equal Access Board (EAB) supported by the Equal Access Office (EAO) is an attempt to ensure proper monitoring. The EAB will be composed of five members: the non-executive Director of BT Group plc, one a senior BT manager and three independent members.

However, NCC has concerns about how representative and independent the EAB and EAO are likely to be. According to BT's undertakings, the three independent members of the Board can be drawn from the following groups: employees or former employees of BT; directors or senior executives of any other communications provider; partners or senior executives of any firm, company or other organisation providing consultancy services to BT or any other communications provider; employees of Ofcom; and material shareholders in BT group or any other communications provider. There is no obligation to choose independent members from either of the groups.

NCC's concerns about these arrangements are as follows:

- We do not consider BT employees, shareholders or BT consultants to be independent from BT;
- Given the fact that BT can choose to appoint independent members from either of the groups, BT will have a strong incentive to appoint EAB board members that are sympathetic to its commercial interest;
- The undertakings do not specify how the Board members will be remunerated, leaving the possibility for perverse financial incentives;
- Even if BT proposed to appoint as independent members senior managers from competing companies, the undertakings offer no guidance about how this would be done;
- The groups from which BT can choose the independent members do not include any consumer representatives.

We therefore recommend a modification of BT's undertakings which would exclude individuals linked in any way to BT from being appointed as independent members of the EAB. In addition, there should always be an Ofcom representative and a consumer representative on the EAB. BT should reconsider establishing a larger EAB to ensure better representation of all stakeholders, including its competitors. We agree that / believe that Ofcom should make the final decision about the composition of the EAB.

Finally, the efficiency of the EAB will crucially depend on the support it receives from the EAO. As the everyday monitoring task will logically fall to the EAO, it is crucial that the EAO is staffed with independent experts. BT's undertakings state that it will supply the EAO's resources. However, the undertakings do not contain any mechanism which would ensure that the EAO's employees are independent. We therefore recommend modifying BT's undertakings to ensure that the EAO is wholly independent of BT. For example, the EAB should be responsible for appointing the EAO's staff.

Efficient and effective monitoring

NCC is concerned about the definition of the EAB's responsibilities in relation to the monitoring of BT's undertakings. BT's undertakings specify that the EAB 'may, of its own initiative, review any aspects of BT's compliance with these undertakings'² The EAB 'shall inform Ofcom, within ten working days, when it comes to its attention that there has been a non-trivial breach of these undertakings'³.

NCC is concerned that the undertakings do not place the EAB under an obligation to review BT's compliance with its undertakings, but merely mentions it as a possibility. NCC recommends modifying the wording of this undertaking by changing 'may' to 'shall'. Similarly, BT's undertakings do not specify what will happen if the EAB informs Ofcom that BT has breached its undertakings. We would like to remind Ofcom that, regardless the acceptance of these undertakings, its obligation to prosecute anti-competitive behaviour by BT remains unchanged.

Timely review

Ofcom gives no clear indication about what would happen if, following the acceptance of BT's undertakings, the relevant telecoms markets did not become more competitive. Similarly, Ofcom sets no clear deadline or evaluation criteria for the assessment of the impact of the undertakings. We also observe that the likely evaluation criteria, the KPIs, are not publicly available.

We recommend that Ofcom sets a clear deadline, preferably two years, for a rigorous evaluation of the impact of BT's undertakings. We also expect Ofcom to consult on the definitions of KPIs. We believe that meaningful KPIs should include the following indicators: the number and nature of complaints; switching levels including figures about switching away from BT; and information about investment in infrastructure and new technologies.

Finally, Ofcom should make a clear commitment that if, after two years, it finds that BT is breaching its undertakings or that the undertakings are ill-devised, it shall revoke its approval and refer the issue of BT's structural separation to the Competition Commission without delay.

² *Consultation on undertakings offered by British Telecommunications plc in lieu of a reference under Part 4 of the Enterprise Act 2002, Annex E, page 48, paragraph 10.11.6.*

³ *Op. cit.*, page 49, paragraph 10.17

The role of the undertakings in the context of the Strategic Review of Telecommunications

Ofcom explains that the acceptance of BT's undertakings follows its Strategic Review of Telecommunication. We would like to stress that the structural problems caused by BT's vertical integration were but a part of this Review and that the Review also addressed other important issues, such as consumer switching, universal service obligations, regulation of call termination charges, and so on. We are therefore looking forward to the forthcoming Phase Three of the Strategic Review of Telecommunications and hope that it will address these issues.

Moreover, Ofcom does not clearly explain what will happen to the existing regulation following the acceptance of BT's undertakings. For example, it does not make clear whether it intends to withdraw from regulating or whether it will continue to regulate a part or all previously regulated products.

We believe and expect that Ofcom's acceptance of BT's undertakings should not terminate the Review or lead to Ofcom's total withdrawal from regulation as suggested in the Review. We also expect that Ofcom will address pro-actively the remaining problems in the markets while monitoring the implementation of BT's undertakings.

Summary of NCC's recommendations

1. BT should amend its undertakings to:

- exclude individuals linked in any way to BT from being appointed as independent members of the Equal Access Board (EAB), specify that there should always be an Ofcom representative and a consumer representative on the EAB, and expand the EAB to ensure better representation of all stakeholders;
- ensure that the Equal Access Office (EAO) is totally independent of BT. The EAB should be responsible for appointing EAO staff;
- ensure that the EAB is obliged to review BT's compliance with its undertakings.

2. Ofcom should:

- specify its policy for taking action in the case that the EAB informs it that BT is not complying with its undertakings;
- assess the impact of its undertakings after two years. The undertakings should be assessed on the basis of transparent, publicly available and agreed criteria. If the assessment is unsatisfactory, Ofcom should refer the issue of BT structural separation to the Competition Commission without delay;
- clarify what will happen to the existing regulation and whether it intends to withdraw from regulating some products following the acceptance of BT's undertakings.
- pro-actively address the remaining problems in the telephone market, such as consumer substitution