



House of Commons
Trade and Industry Committee

**Ofcom's Strategic
Review of
Telecommunications:
Ofcom Response to the
Committee's
Thirteenth Report of
Session 2004–05**

**Ninth Special Report of
Session 2005–06**

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The Trade and Industry Committee

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Committee staff

The current staff of the Committee are Elizabeth Flood (Clerk), David Bates (Second Clerk), Grahame Allen (Inquiry Manager), Clare Genis (Committee Assistant) and Joanne Larcombe (Secretary).

Contacts

All correspondence should be addressed to the Clerks of the Trade and Industry Committee, House of Commons, 7 Millbank, London SW1P 3JA. The telephone number for general enquiries is 020 7219 5777; the Committee's email address is tradeindcom@parliament.uk.

Ninth Special Report

The previous Committee published its Thirteenth Report¹ of Session 2004-05 on 5 April 2005. Ofcom's (the Office of Communications) response to this Report was received in August 2005 and is published as an Appendix to this Special Report.

Government Response

Introduction

Ofcom welcomes the interest shown by the Committee in the Strategic Review and the support shown by the Committee for Ofcom's approach.

This response provides an opportunity to update the Committee on the progress of the Review and to comment on the specific conclusions and recommendations set out by the Committee.

Developments since April

There has been significant progress since the Committee published its report on 5 April. On 23 June, Ofcom published a statement setting out the next steps in the Review process. The statement explained that, in response to the issues raised by Ofcom in the Phase II consultation document and subsequent industry discussions, BT has now put forward a comprehensive set of draft undertakings designed to address Ofcom and wider industry concerns.

BT is offering these undertakings under the Enterprise Act 2002 in lieu of a reference by Ofcom to the Competition Commission under that Act. This means, if the undertakings are accepted by Ofcom they will be legally binding. The undertakings were published in full by Ofcom for consultation on 30 June. The consultation will run until 12 August. Ofcom intends to then publish its final conclusions in a statement concluding the Telecommunications Review in early autumn. That statement will also set out Ofcom's conclusions in relation to other policy questions raised during the review.

More detail of the undertakings is set out in the annex. Ofcom's view is that, taken together with our existing regulatory powers under the EU Framework and the Communications Act 2003, these undertakings do provide the basis for a comprehensive solution to the competition problems identified by Ofcom in the Strategic Review.

¹ Thirteenth Report from the Trade and Industry Committee, Session 2004-05, *Ofcom's Strategic Review of Telecommunications*, HC 407-I

The Committee's conclusions and recommendations

Broadband availability and speed

We agree with the Committee's conclusions. Ofcom's latest annual Communications Market report² highlights that not only has the problem of availability of current generation broadband been largely addressed, but that take-up is now accelerating very rapidly indeed with over 7.5m broadband homes by May 2005. The market is delivering both higher speeds and lower prices to consumers. This success strongly supports a market-led regulatory strategy for broadband for the present.

We welcome the Committee's clear recommendation in relation to next generation broadband access. Following on from the Strategic Review, Ofcom intends to examine next generation broadband access in more detail. This will enable us to build a comprehensive understanding of the demand and supply factors affecting the transition to this next generation of technology, to address any regulatory factors which are retarding investment in such technology, and will allow us to look in particular at the critical question of what are the compelling broadband content applications that might drive the business case for this new technology.

Local loop unbundling

We agree with the Committee that significant additional investment in end-to-end infrastructure competition remains unlikely in the foreseeable future and therefore local loop unbundling should continue to be the focus in seeking to create infrastructure-based competition in the broadband market.

Market participants seeking to make use of Local Loop Unbundling (LLU) will now benefit from improvements in five critical areas. First, BT is committing that LLU will be supplied from the new 'Access Services Division' (ASD), which will create the business incentives within BT to supply LLU on a fair and fit-for-purpose basis.

Second, BT's undertakings include commitments in relation to equivalence of input, both in relation to LLU itself and in relation to possible successor products. This means that there will be equality of treatment for LLU operators and—critically—that this equality will not be bypassed through the introduction of 'non-equivalent' replacement products.

Third, BT is committing to a period of price stability in relation to IPStream, the product with which LLU operators are effectively competing. The Committee noted that a previous price adjustment to IPStream prices had unsettled some LLU providers. BT has now said that it will provide stability of IPStream prices for up to two years to provide greater certainty and clarity of pricing during the key build up phase on LLU.

Fourth, LLU operators who wish to pursue 'full LLU' (where the operator takes over the line in its entirety, rather than for broadband only) will benefit from significant improvements in the price for that service. BT's has announced a full-LLU price reduction from £105 to £80 a year, meaning that the UK will now have full LLU prices which are very much at the better end of the range of European prices.

Fifth, BT is continuing to work within the processes set out by the Office of the Telecommunications Adjudicator to address ongoing process problems associated with the provision of LLU.

The Committee also raised the issue of geographically de-averaged pricing. It may be that over time, as the Committee suggests, the process of competition will vary significantly between different parts of the country. Ofcom will address any issues that arise from this as required, but we do not envisage the need for any immediate regulatory action.

Equality of access

The Committee clearly considered carefully the merits of the argument for full, structural separation of BT's business. We note the conclusion drawn by the committee that such an intervention—which could be imposed by the Competition Commission following an investigation under the Enterprise Act—should be pursued only if achieving real equality of access by other means proved unworkable. In our view, the undertakings offered by BT, taken together with the other powers available to Ofcom, should make real equality of access a viable and achievable proposition, provided they are implemented in full.

The Committee noted industry concerns about the enforceability of a regulatory 'settlement' with BT. Accepting undertakings in lieu of an Enterprise Act will mean that the commitments BT makes are legally enforceable and binding. If the undertakings were breached, Ofcom would be able to seek enforcement in court against BT. BT's Board would be responsible for ensuring that BT complied with the court's decision. Third parties affected by a breach could also seek damages via the court to recover losses incurred as a result of any breach of the undertakings.

Like the Committee, Ofcom believes questions of BT's long-term structure are matters for BT and its shareholders. But it may be worth noting that Ofcom's policy approach explicitly recognises that there are some legitimate benefits from BT's vertical integration. BT will, for instance, be able to take capital expenditure decisions relating to the 21st Century Network which reflect the interests of BT Group as a whole.

Annex: The BT undertakings

The principal features of the undertakings are as follows:

Access Services Division

The establishment of a new 'Access Services Division' by BT. This new entity will include some 30,000 BT staff and nearly all its access infrastructure and facilities, including the copper local loop, local exchanges, and associated ducts and other civil infrastructure. It will deliver a comprehensive suite of the access products on which wholesale customers rely including:

- All forms of Wholesale Line Rental (WLR);
- local loop unbundling (LLU) products incorporating both full and shared;
- fibre access products including Wholesale Ethernet Service (WES) and Partial Private Circuit access products;
- Ethernet and SDH backhaul products and sub-loops specific wholesale backhaul services which are critical to effective competition including Ethernet backhaul.

The ASD will be organised as a separate business unit with its own management structure and substantial operational independence. The management board of ASD will have a clear remit to deliver Equality of Access and will establish an annual operating plan including plans and targets for adhering to the undertakings. BT has agreed that the ASD headquarters management team staff will be moved to a separate physical location to other BT staff, and BT will develop separate operating and trading systems used by ASD from those used by other parts of BT. Remuneration will be based solely on ASD's performance. BT will develop a revised long term incentive plan (LTIP) for use within the Access Services Division as soon as reasonably practicable, which will sever the link between the triggering of an award and the performance of BT Group plc's shares.

BT has also agreed that the ASD should have its own distinctive brand (name and format to be confirmed) which reflects its operationally separate status from other BT business units.

Equivalence of Input

BT commits to deliver equivalence of input for the following products to the following timescales:

- LLU – ready for service June 2006;
- WLR on the PSTN – ready for service mid 2007, migration complete June 2010;
- WLR on ISDN2 - ready for service September 2007, migration complete end-March 2009;

- WLR on ISDN30 – ready for service December 2007, migration complete December 2009;
- IPStream – ready for service end-December 2005, migration complete end-December 2006;
- Wholesale Ethernet Service (WES), and Backhaul Ethernet Service (BES) – ready for service September 2006, migration complete March 2007.

In addition, if BT does not have WLR equivalence of input ready for service by the end of 2006, with a financial rebate to operators of 25p per month per line for any month beyond December 2006. The same financial rebate applies in the event that the June 2006 ready for service date for LLU is not met.

Obligations for other products

BT's undertakings also give commitments to resolve outstanding issues in relation to Partial Private Circuits, Carrier Pre-selection and ATM interconnection.

Other issues of governance and compliance

The undertakings also address the question of the relationship between BT Wholesale and BT Retail, providing greater clarity on the organisational separation of governance of these business units.

BT will separate out those product management teams in BT wholesale which provide SMP services from non-SMP services. Similar remuneration and incentive changes as those within ASD will apply to the teams responsible for product management of SMP products.

The Equality of Access Board's remit will cover compliance with the undertakings across the whole waterfront of SMP products. It will have five members, three of whom will be independent, and a BT non-executive board director who will chair the EAB – providing a direct link in terms of accountability to the BT Group Board. It will have independence, resources, powers and teeth. The EAB will also have a legal duty to inform Ofcom of any non-trivial breaches of the undertakings. Any trivial breaches will be recorded in the EAB's minutes which are sent to Ofcom.

21st Century Network

BT's undertakings set out some clear principles on which BT will base its future design, procurement and roll-out decisions for the 21st Century Network. These include:

- BT to ensure that the 21CN design supports competition, by allowing other operators unbundled network access;
- BT to design the 21CN in a way which will support Equivalence of Input;
- BT's charges to reflect a network that is efficiently designed for the above purposes;
- BT to launch retail products only when equivalent wholesale products are available.

These principles are underpinned by a commitment by BT to work in a transparent and multi-lateral process with other operators and service providers to manage the transition to NGNs, and to participate in a new adjudication process for disputes that may arise.