

Ofcom's New Strategic Review: Lessons from the last ten years

- **Lesson 1: Focus on a few key problems and design specific solutions... but don't expect them to solve everything.**
- **Lesson 2: Identify the location of any competition problem ... which may have moved since 2005.**
- **Lesson 3: Working with, rather than against, the SMP operator is likely to be more efficient.**

Ten years after its first strategic review of telecommunications, Ofcom, the UK communications sector regulator, has announced the terms of reference for a new "Strategic Review of Digital Communications"ⁱ. In this edition of Hexagon, SPC Network considers what lessons can be taken from the last review and applied to the new one.

The Strategic Review of Telecommunications undertaken by Ofcom in 2004 – 05 resulted in a set of Undertakings signed between BT and Ofcom. Central to this agreement were the two concepts of Equivalence of Input (EOI) and functional separation. EOI required BT to use the same access products as its competitors under the same terms, and functional separation required BT to establish Openreach to provide access products to BT and competitors alike.

The purpose of these was threefold: to redefine non-discrimination; to control the

opportunities for discrimination and to alter incentives for BT, as the vertically integrated owner of the 'enduring economic bottleneck' to discriminate against its competitors in retail markets that depended on BT for access to the bottleneck.

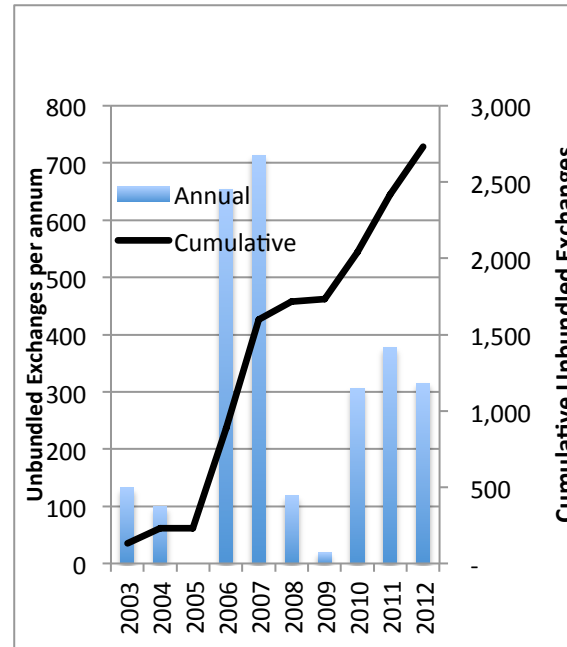
Much was written at the time that suggested that separation would not work and would even deter BT from investing in new network infrastructure. One commentator stated that the UK could end up in a technological cul-de-sac as a result of functional separationⁱⁱ.

Ofcom's 2005 Strategic Review successfully addressed the problem of non-price discrimination.

Although few would argue that all problems have been resolved, experience of the last ten years suggests that such concerns were misplaced. A few statistics illustrate this:



- i) In the two years after the Undertakings were signed, the number of unbundled exchanges increased from 230 to 1,600 as entrants' fear of discrimination reduced (see figure).
- ii) The UK has the highest level of NGA penetration and the highest proportion of access lines with speeds greater than 30Mbps amongst the five largest EU Member States. However, it does lag behind some smaller states and many countries that joined the EU in 2004ⁱⁱⁱ.
- iii) The locus of competition has moved from broadband access speed to content as the major operators concentrate on consumer benefit rather than technology.



Source: Richard Cadman

Overall, the Undertakings have worked: changing the investment environment for new entrants leading to new investment in LLU and more recently in new infrastructure by both BT and Virgin Media.

Lessons for the new Strategic Review

As Ofcom starts its new strategic review, what lessons can be carried forward from the last?

First, one of the reasons for the success of the 2005 strategic review was that it uncovered and concentrated on a specific issue: discrimination (or more accurately entrants' expectation of discrimination) by BT against its retail competitors. It established that the concept of "no undue discrimination", as enshrined in the Communications Act and as interpreted by Oftel, was insufficient to prevent that expectation. Entrants' fear that their investments would be devalued by the strategic behaviour of BT was enough to prevent meaningful investment in local loop unbundling.

Ofcom addressed this specific concern through EOI, supported by functional separation, with the positive results outlined above.

However, EOI and functional separation did not, and could not, resolve all problems in the market, as they only addressed the issue of



non-price discrimination. Other problems remained that have still not been adequately addressed. Foremost amongst these is Quality of Service (QOS).

It was expected that requiring BT's retail businesses to use the same products as competitors would mean QOS would improve: this proved not to be the case and so remains an area where direct regulatory intervention is required.

The first lesson for Ofcom in its new review is to establish and focus on a few key areas of concern: do not try to 'boil the ocean'. Ofcom should also not expect any response to be a golden ticket that resolves all problems.

Convergence and bundling may result in the economic bottleneck moving to a different level of the value chain.

Secondly, Ofcom identified the enduring economic bottleneck as local access and focussed its remedies on this one area. It was not distracted by siren voices calling for it to be concerned with issues that would not promote competition.

Since 2005, the changes in the market, specifically convergence and bundling of access and content, may have shifted the economic bottleneck to other stages in the value chain. For example, in 2005 the market was all about access to relatively simple, static content. Today the nature of competition has changed dramatically. Companies dominate the headlines today that did not even exist ten years ago. The new strategic review therefore needs to assess whether the bottleneck has moved and, if so, where to and what needs to be done to ensure competitive outcomes.

Thirdly, the solution Ofcom found to the problem of discrimination in local access had

the support of BT, as the operator with Significant Market Power. At the time BT said on a number of occasions that they were "up for it" – meaning that they supported both EOI and functional separation.

Ofcom's desire to take the industry along with it was undoubtedly one of the reasons behind the success of the Undertakings. As the old saying goes, one volunteer is better than ten pressed men.

The final lesson then is that it would be better to implement whatever ideas come out of the new review in partnership, rather than in conflict, with the affected firms.

ⁱ <http://stakeholders.ofcom.org.uk/telecoms/policy/digital-comms-review/>

ⁱⁱ Waverman, L. and Dasgupta, K. 'Mandated Functional Separation: Act in haste, repent at leisure?' Mimeo, November 2007

ⁱⁱⁱ European Commission.

