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UK Strategic Review of Telecommunications

On 28 April 2004 Ofcom, the converged UK regulator, issued its phase 1 consultation on its strategic review of telecommunications in the UK ("Review"). Comments on the Review are invited by 22 June and given its wide impact, all companies with an interest in the telecoms sector may wish to consider responding.

This update summarises the consultation and then goes on to consider the implications. Lord Currie, chairman of Ofcom stated in the foreword: *"The Review will enable us to set out a strategic agenda for our activities in relation to telecoms, and will create a new settlement between the regulator, the companies we regulate and the citizen-consumer."* Coming after several years of ad-hoc policy making that, at times, appeared to be driven by fear of hostile headlines rather than by underlying principles of good regulation, the Review has been widely welcomed with front page coverage in the business press.

At a top level the Review asks five deceptively simple questions (described by Ofcom as the "fundamental questions"):

1. In relation to the interests of citizen-consumers, what are the key attributes of a well-functioning telecoms market?

2. Where can effective and sustainable competition be achieved in the UK telecoms market?
3. Is there any scope for a significant reduction in regulation, or is the market power of incumbents too entrenched?
4. How can Ofcom incentivise efficient and timely investment in next generation networks?
5. At varying times since 1984, the case has been made for structural or operational separation of BT, or the delivery of full functional equivalence. Are these still relevant questions?

These five questions are supplemented by 21 further questions which address specific areas raised by the fundamental questions.

An Indian fable tells of six blind men encountering an elephant - the first encountered its side and described it like a wall, the second a tusk which he described as a spear, with others encountering the leg, knee, tail and ear of the elephant which were described as trees, ropes, snakes and fans respectively. The scope of the Review is wide and initial reactions to it have been similar to those in the fable. At this stage Ofcom has neither considered what it could or should do, nor its

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constraints on action. What it has done is set out the background and invited respondents to join Ofcom in crystal-ball gazing as to how the market will develop. It appears that Ofcom has a genuinely open mind on many of the questions posed in the Review. However it is possible to discern potential outcomes from the way that Ofcom has described certain issues and asked certain questions.

As keen elephant watchers, it seems to us that the following will be among the key issues to watch as the consultation develops:

- **Strategy is not Linked to Implementation.** With Lord Currie's background as a practising and academic economist, it is no surprise that the Review takes a relatively pure economic approach to regulation. Indeed, at this stage little regard has been given to the legal systems within which Ofcom is operating: the constraints of the UK Communications Act 2003 and the EU electronic communications regulatory framework. We will watch with interest as to how Ofcom proposes to link regulatory strategy to implementation.
- **Broadband more Important than Voice.** At several points in the Review, Ofcom notes that many of the original aims of regulation (e.g. availability, price, service) have been achieved for voice telephony. Ofcom also recognises that inter-modal competition from mobile and VoIP will increasingly constrain on BT's market power even where it continues to provide access lines for voice. These comments may indicate withdrawal from voice regulation. Conversely, the market performance measures set out in Annex H indicate that Ofcom considers that for broadband the regime has delivered a relatively low level of competition and therefore of price, availability and service choice. Further, in the medium term Ofcom is concerned about how to stimulate investment in "broader"-band next generation technologies such as fibre to the kerb or home.
- **Regulation Important for Businesses as well as Consumers.** Ofcom has identified that certain segments of the market (business users) have experienced less benefit from com-

petition than others and that it will continue to address those markets, even if regulation is rolled back from consumer markets. Given the greater buying power of business customers and the focus on these customers by alternative network operators, this may mark a surprising shift from the current assumption that business markets generally require less regulation.

- **Less Mobile Regulation.** Ofcom cites the mobile market as a market where competition has delivered appropriate results. It seems likely that, with the exception of termination charges, further regulation will not be imposed and indeed may be withdrawn.
- **Network Competition rather than Services Competition?** Both the executive summary and Annex G suggest that Ofcom may shift its policies away from services to network based competition "*...fixed telecoms regulation has been characterised by trade-offs, in particular the trade-off between promoting services and network based competition...During the mid-1990s, the balance was firmly tilted in favour of infrastructure providers, but was interrupted by legal and financial developments of the late 1990s ... because infrastructure competition has been much more wide-spread in mobile telecoms, the sector has not faced the same degree of regulatory intervention*". A return to the network competition based policies of the mid 1990s, in an effort to boost investment in broadband, may positively effect BT, cable companies and network operators. Conversely it may negatively effect recent non-network based new entrants.
- **Long-term Innovation and Investment Incentives rather than Short-term Consumer Benefits?** Ofcom notes that technology is driving changes in networks and services which deliver dynamic innovation benefits, but also notes the significant capital expenditure required. Ofcom notes that retail price control, or resale based regulatory intervention, may negatively impact investment decisions by constraining the returns available to those investing in infrastructure. This may indicate the lifting of certain obligations on BT.

- **Regulation at Fewer Intermediate Levels?** Markets such as broadband access have a number of intermediate products: e.g. copper loops, wholesale access delivered over ATM, wholesale access delivered over IP as well as retail products. Ofcom raises the question of whether it is desirable and sustainable to regulate at all levels, as a regulatory mandated margin to allow competition at all levels may lead to persistently high retail prices. With Ofcom currently considering margin squeeze issues between various intermediate products, any change of policy in this area is likely to adversely affect those currently purchasing intermediate products from which regulation is removed.
- **BT Separation - a Red Herring?** The UK press has made much of fundamental question five. The Financial Times characterised it as a call for the structural separation of BT. However, much of the Review asks questions which in fact imply lifting some regulation on BT. Whilst the question is raised as a fundamental question, Ofcom does not discuss this option further or indeed ask specific questions about the advantages or disadvantages of such a move. In the light of other public comments from Ofcom, together with its lack of powers to impose such a remedy, it seems to us that the question is posed to ensure that the issue is seen to be considered, rather than as a serious option.
- **Additional Price Transparency Obligations on All Operators?** Whilst much of the consultation is aimed at looking at maximising “consumer” benefits, Ofcom indicates that it may take action to force more price transparency in the interests of “citizens” as even competitive markets seems to deliver citizen-consumer confusion. This may impose additional regulatory burdens on all operators.

Phase 1 of the Review examines the current position and prospects for the sector. Phase 2, expected in the

autumn, will identify and assess Ofcom’s options and phase 3, expected towards the end of 2004, will assess these options and set out Ofcom’s plan of action. This Review is one of three major reviews Ofcom is undertaking in its first year - the others being the public service broadcasting and spectrum reviews. Ambitiously, Ofcom is undertaking these three reviews in parallel with its day to day policy (e.g. reviews of universal service and wholesale broadband access) and case work.

In conclusion, and to mix fables somewhat, the open-ended nature of this first stage consultation is such that it is unclear whether we are dealing with an elephant or a rhino. However, we are encouraged by Ofcom’s obvious desire to take account of all stakeholders’ views. The UK regulatory framework is likely to see fundamental change in 2005. These changes will impact the business opportunities, revenues and costs of operators in different segments of the market.

For more information about the Review and/or assistance in preparing your response please contact:

Robert Bratby +44 20 7872 1620
Robert.Bratby@wilmer.com

Stephanie Liston +44 20 7872 1604
Stephanie.Liston@wilmer.com

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