



Ofcom Strategic Review of Digital Communications

TalkTalk response to Ofcom's July 2016 separation proposals

October 2016

1 Summary

- 1.1 This document responds to Ofcom's consultation on '*Strengthening Openreach's strategic and operational independence*'¹.
- 1.2 TalkTalk is firmer than ever in its conviction that only full structural separation of Openreach will give consumers and businesses the investment, value, and quality of service they need and deserve. Anything short of this will leave unchanged BT's incentive to use Openreach to distort and weaken competition in the retail market. Without structural separation BT will continue to have the ability to game and evade whatever behavioural rules Ofcom to try to curb discrimination and increase competition. These facts have been acknowledged by Ofcom during the course of recent discussions. And, as set out in the rest of this paper, there is no meaningful argument as to why the structural separation of Openreach would be harmful to the consumers and businesses of Britain.
- 1.3 Ofcom also agrees that structural separation is the "*cleanest and most clear-cut long-term solution*", but faced with strong and sustained resistance from BT it has instead proposed to tweak the current functional separation model by adopting 'legal separation'. This merely rearranges the deck-chairs such that Openreach will become a company 100% owned by BT Group, rather than a division of BT. Also TalkTalk does not think that 'trying out' legal separation for a few years is likely to provide the 'smoking gun' evidence that Ofcom seems to think it needs before imposes structural separation.
- 1.4 While legal separation may have some marginal benefits in transparency, and is therefore preferable to the situation over the last decade which has been wholly unacceptable, Ofcom has acknowledged that it will not materially change the ability or incentive for BT and Openreach to:
- Charge high prices to non-BT wholesale customers;
 - Provide a low quality of service;
 - Make investment decisions that benefit BT and 'BT Retail'² at the expense of consumers;
 - Transfer funds internally from Openreach to BT Group to be used for the benefit of the rest of Group;
 - Frustrate retail and network competition and innovation.
- 1.5 However, if Ofcom remains resolute in its decision not to take the opportunity to structurally separate now, it is possible to partly mitigate the harmful effects of continued vertical integration by completely overhauling both the effectiveness of existing regulation including the approach to enforcement and penalties. This means Ofcom robustly regulating BT's wholesale FTTC products, and greatly increasing

¹ Strengthening Openreach's strategic and operational independence July 2016 ("**DCR Consultation July 2016**") §4.9

² We use the total 'BT Retail' to refer to the part of BT in the UK that excludes Openreach but relies on Openreach inputs. This would principally be: BT Consumer; BT Business; BT Wholesale; some of BT Global Services; and the part of TSO that supports these divisions.

both its willingness and ability to identify and penalise breaches of both existing SMP regulation as well as of the legal separation model. Based on past experience TalkTalk is extremely sceptical about Ofcom's capability to transform itself and genuinely hold BT to account.

- 1.6 BT appears to be using its pensions scheme and its pensions deficit as a shield, claiming there would be serious consequences should Openreach be separated, in particular the loss of the Crown Guarantee and weakening of the pension covenant. TalkTalk (and a number of pensions experts) treats such claims with a high degree of scepticism. We have included in this response a report by Mercer, a firm of actuarial and covenant specialists, who conclude that the pension issues caused by legal separation can be mitigated using commonplace tools. For example, insurance costing around £1m per year could replace any loss of Crown Guarantee benefits. More importantly though, as a matter of principle the nation's broadband cannot be held perpetually to ransom because BT may or may not have underfunded and mismanaged its pensions scheme. Solutions are found every day in the commercial world for such situations, and we see nothing unique to BT's situation.
- 1.7 BT's own proposal of a divisional separation model is even less desirable than Ofcom's proposal. By BT's own admission it is designed to allow continued 'integrated decision making', which is precisely what Ofcom should be trying to eradicate. BT's proposal should not be treated as a serious offer to remedy the problems in the market, but rather as an attempted smokescreen to deflect Ofcom from solving the real problems inherent in the current market structure.