

Sharon White
Ofcom
Riverside House
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London SE1 9HA

ENGLAND

STRENGTHENING OPENREACH'S STRATEGIC AND OPERATIONAL INDEPENDENCE

Dear Ms. White,

We are writing to you on behalf of Deutsche Telekom AG (DT), a leading telecommunications service provider with operations and investments across Europe. These investments also include significant funds directed into the UK's fixed/mobile infrastructure; firstly through T-Mobile and the subsequent merger with Orange to create the UK's largest and most advanced mobile network, EE in 2010, and secondly through our current 12% holding of BT plc (~£4.7bn in value).

Our submission is primarily motivated by our concerns in relation to the current direction of Ofcom's DCR proposals, specifically regarding the structural/legal separation of BT which we believe are unwarranted, unprecedented and could lead to detrimental results not only for BT but for the communications sector as a whole and indeed the entire UK economy. Such proposals, if implemented, would make the UK less "investable" to both domestic and foreign telecommunications and technology companies.

Deutsche Telekom shares Ofcom's ambition for promoting enhanced connectivity through greater coverage, faster speeds and improved service. There is value in any process that takes a pragmatic and evidence based approach to delivering sound recommendations for delivering such outcomes.

However, we do not understand why the DCR has resulted in such extreme policy interventions for separation being proposed by Ofcom when it is clear from your own data, and from the myriad of other international commentators, that the UK, is already among the world's leading digital markets owing to strong connectivity outcomes for consumers and citizens. Evidence shows that the UK consistently ranks at the top of the Ofcom and EU scorecards vs. other major markets for average speed, affordability, broadband take-up, competition and overall digital readiness. We note also the World Economic Forum, just last week, ranked the UK, 3rd place globally, for "Technological Readiness" with the UK's best scores relating to the category for "internet bandwidth".

This is not a story of a strong market at risk of stagnating either. Rather, it is clear that UK's current trajectory is for continued strong performance given the UK's rapid roll-out of superfast broadband to 95%+ of the country by 2017 – supported by BT, BT's plans to commence a similarly rapid deployment of ultrafast networks covering 12m homes by 2020, along with the investment plans of other infrastructure providers. Absent radical disruption, it is clear the UK's relative position should only continue to improve.

Moreover, the current framework has motivated one of the largest private investment plans in Europe, Virgin Media's Project Lightning, which aims to cover 4 million homes (15% of the UK) with additional high speed infrastructure. BT's broadband market share, at 32%, is one of the lowest amongst EU incumbents.¹

We must therefore query the basis for Ofcom's proposal for a very costly legal separation of BT and Openreach or for the even more radical structural separation as a fallback. In particular, we fail to see clear evidence that would justify such an extreme intervention considering its impact on domestic and international property rights? Where is the actual data pointing to a market failure (past or prospective), to actual cases of discrimination by BT against competitors, or that the radical proposals for separation, unseen anywhere else in Europe will actually deliver your defined objectives? Where is the evidence that such proposals would lead to more investment or better outcomes for consumers?

Ofcom's long and well-established reputation of being an evidence-based regulator is completely at odds with the current direction of the DCR proposals for separation.

The proposed interventions are particularly questionable to DT as a significant investor in the UK market and the largest investor in BT. They will only serve to introduce risk, cost, distraction and delay and ultimately undermine the very outcomes that you are seeking, namely improving the status quo.

At present, BT operates on a similar integrated model that has overwhelmingly served telecoms infrastructure investors and customers successfully across the US, Europe and Asia for over a hundred years. There is a good reason no other major economy has considered what you are proposing – it won't work. In the handful of small markets where separation in telecoms has been pursued, this has come about only with substantial Government intervention and public funding and the results have been poorer than those currently enjoyed in the UK. All the evidence suggests your proposal will diminish the incentives for investment in network infrastructure and service quality at a time the UK can least afford to discourage domestic and foreign investment.

The issue of functional/legal/structural separation of incumbents' fixed access networks that has unfortunately dominated the debate in the UK is the wrong focus. It has understandably been driven primarily by BT's competitors who have time and time again demonstrated no real intent to invest at scale themselves. Indeed, we note that Vodafone, one of the most vocal advocates of separation has a track record of investment in Germany and the UK that is put to shame by Deutsche Telekom and BT respectively. Vodafone's governance operates with a strong incentive for its management to generate and maximize free cash flow for the upcoming three-years-period. So the Vodafone management will unlikely invest into the development of the telecommunications industry. The sale of Verizon brought billions of cash flow to the Vodafone group. But less than 15% of the windfall profits have been re-invested, of which close to nothing into Germany's fixed line business. Sky has already signaled even before the DCR has closed that it has no intention of investing significantly in access networks.

¹ Media.ofcom.org.uk/facts

Unfortunately, this focus has crowded-out the real debate on more important regulatory issues for incentivizing the significant investments needed for 5G, improved service, the deployment of ultrafast broadband, delivering network resilience and reliability, and so on. It would serve everyone to bring the distraction of Openreach governance to a close and focus on these more pertinent areas.

BT will retain a crucial role in the further development of the telecommunications sector. Indeed we note that BT stands alone in setting out an ambitious investment plan designed to continue to build Britain's digital future. But the stronger separation of BT and Openreach will pose a significant threat to a wide array of aspects, which have been beneficially served by BT as an integrated company. A separate network company is unable to develop retail telecommunications services and drive innovations. It will act much slower to new developments and retail customers' demands. The integrity of the whole industry will be put at risk.

- **Slowdown in innovation:** Unlike other network industries, the driving force of progress in telecommunications lies within the networks and its link to the retail business. Innovations such as DSL itself and later stages of development with higher broadband capacities like VDSL, VDSL vectoring, G.fast and FTTP stem from innovations and improvements in telecommunications networks. These are large, long-term investments that are inherently risky and where a degree of coordination between vertically-integrated structures is vital. Moreover, the close co-operation between retail and product innovation divisions, which know the customers' demands on the one hand and network experts, who can translate such demands into concrete technological improvements on the other hand have always led to more value for the customers and competition, transforming ideas into products. If networks are completely separated from retail divisions and the group management, BT will be cut off from a core element, where the creation of the biggest part of the value takes place. Openreach will lose its connection to the retail markets, thus being much slower in taking up new ideas and product innovations.
- **Threat to network security and privacy:** Today's communications industries all over the world face severe threats from network hacks and cyber warfare. This poses a threat to essential public supply facilities connected to telecommunications networks. A network which is open to almost everybody and where no vertically integrated operator takes the full responsibility for network security and privacy could hamper the privacy of citizens and crucial national security aspects. Unlike many of its competitors, integrated operators today are playing a key role to protect privacy and network integrity. Once again, those integrated companies like BT and Deutsche Telekom are more efficient in finding solutions and reacting quickly to such challenges. Further separating BT and Openreach could fundamentally hamper national security in the UK.

We concur with your recent comments in the Daily Telegraph about the importance of considering the telecoms industry when developing the regulatory frameworks that will apply when Britain leaves the EU. Brexit means it is even more important than ever that the UK has a strong, vibrant and competitive telecoms sector that can drive economic growth and exports. We also agree that it is important that regulators should have the right powers to make changes where necessary. With power, though, must come prudence. It is important that regulators set out a clear and evidence based case of the market failure identified and the case for change that shows the benefits outweighs the costs.

We would encourage you to reassess how your otherwise commendable objectives for the UK market can be achieved without destabilizing interventions that undermine investment, and how you can avoid risking the many strengths of the UK model and critically, avoiding the creation a perception internationally of a new post-Brexit UK regulatory approach that does not appreciate the basics of good corporate governance and the property rights of others.

In our view, BT's public offer in response to the DCR reflects significant tangible movement towards Ofcom's goals of greater impartiality than would legal incorporation. We feel strongly that BT's notification to Ofcom of its plans to further enhance the governance and independence of Openreach can deliver the benefits sought by Ofcom but without crystalizing the significant costs implied by Ofcom's alternative proposals. We would caution against the pursuit of legal separation not underpinned by a rigorous cost/benefit analysis. We would encourage you to move forward to reaching a reasonable negotiated settlement. We see BT's public offer as a pragmatic and sustainable compromise.

We as Deutsche Telekom have always been proud to be such a sizable player in the UK telecommunications market. Today, we are the largest investor in BT and one of the largest therefore in the UK telecommunications sector. Our engagement was always driven by the trust in the promising perspective of the industry in the UK. The undertaking of the DCR to separate BT and Openreach further challenges our positive view on the UK market. From an international trade perspective the current DCR concept of Openreach could amount to a creeping expropriation of BT Group and its investors. In addition BT and the whole industry will suffer from a significant slowdown in innovation and growth.

We would close by saying that we admire much of the work that Ofcom has done in the past in helping to create the UK's successful telecommunications market today. We share your ambition to see the UK continue to be a leading digital economy, one that continues to attract significant investment and drive strong competition. We believe there is much to support this in your other DCR proposals and in BT's commitments to achieve this without breaking the model that has helped deliver the UK's success.

Please let us know if Ofcom would like to better understand DT's perspectives as an investor into the UK market and as an operator in the very successful German market.

Kind regards,

Thomas Dannenfeldt
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