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Strengthening Openreach's strategic and operational independence
Consultation Response from Scottish Futures Trust

1. Introduction

SFT is supporting the Scottish Government in establishing a roadmap to deliver a world class digital vision for Scotland, for which it is imperative that both consumers and enterprises in Scotland have access to enhanced digital services and mobile connectivity. A report commissioned by SFT[1] in 2015 identified that the potential impact of achieving such a world leading position would be to increase GDP in Scotland by c. £13bn (or 10% per) annum, and would require both infrastructure and devices to achieve:

- Seamless delivery across fixed and wireless platforms;
- A fibre enabled future;
- A quality of service and user experience commensurate with other leading and modern digital economies; and
- Investment into Scotland's digital infrastructure that will guarantee the country's future competitiveness, as well as its ability to provide enhanced public services and opportunity to its citizens.

This vision is similar to the Ofcom vision as captured in the recent BT Openreach consultation document. Essentially a resilient, fast fibre enabled future, which meet the expectations of all users, regardless of activity, location and device.

A key aspect to this work is to assess a wide range of potential interventions that could be considered to enhance the opportunity for public and industry investment in digital infrastructure across Scotland; these interventions include UK and Scottish Government policy and legislation and Ofcom regulatory measures. The strengthening of Openreach's strategic and operational independence is an important component of the required change, and we welcome the opportunity to be able to respond to the proposals set out by Ofcom.

2. Background and context

Openreach was created in 2005 through agreement between BT and Ofcom to address the local loop access economic bottleneck. Ofcom agreed to a series of undertakings given by BT in lieu of a referral to the Competition Authority. As part of these arrangements, governance was to be provided by the Equivalence Access Board ('EAB'), which remained an internal board, whilst The Office of the Telecommunications Adjudicator ('OTA') was created to resolve disputes between BT and other operators seeking to deliver services over local loop unbundling ('LLU'). Openreach itself, continued to manage and operate the local access network on behalf of the BT Group and the rest of the industry.

As part of the 2005 agreement, Openreach was required to ensure that it did not discriminate between an internal BT customer and other external customers – essentially Openreach operations was based

[1] The economic and social impacts of enhanced digitalisation in Scotland, July 2015

on a principle of the "equivalence of inputs". Openreach was further required to support new product and service innovation and was responsible for providing business connectivity.

In reality, it is widely felt that the performance of Openreach has not reflected the original intentions of functional separation as laid out in 2005, nor delivered the potential competitive and investment benefits that should have accompanied the original intentions. This is partly driven by the operational approach of Openreach and the underlying regulatory environment established by Ofcom. For example:

1. Openreach has been shown to have an inconsistent record of service delivery over the last ten years[2] (including quality of service and experience issues in both commercial and non-commercial areas);
2. Oversight by the EAB has not been transparent. There is therefore no real sense about how the EAB has directed and challenged current behaviours and activity;
3. The regulatory framework is driven by a price based competitive approach that is primarily targeted at the service provision layer, and has not sought to ensure that there is adequate infrastructure investment in the access layer; and
4. In a Scottish context, whilst fibre has been deployed to cabinets ('FTTC'), funded in large part by public monies, in many commercially viable urban areas, the issues identified in bullet point 1 above would indicate that there has been under investment in both maintaining and / or upgrading the access network, both in non-commercial (rural Scotland) and commercial (e.g. Edinburgh and Glasgow) residential and business areas, such that performance may fall short of expectations. For these areas considered to be commercial in nature, Ofcom deems them to be competitive and serviced, however, in reality many are not.

It is also in part driven by the way the digital infrastructure market has developed across different geographies of the UK in the period since 2005. Broadly speaking, BT Openreach is the primary provider of the access layer infrastructure in Scotland (i.e. Scotland's base telecoms infrastructure used to provide digital services) with relatively few areas of Scotland having an alternative infrastructure provider in place. There are some: for example, Virgin Media in Edinburgh, Glasgow and Dundee and other locations and emerging business providers such as CityFibre in Aberdeen and Edinburgh. Despite this additional investment by other providers, at present the vast majority of Internet Service Provider ('ISP') services in Scotland are provided on Openreach infrastructure, be that FTTC or fibre to the exchange ('FTTE'), which is subsequently delivered to the home by inadequate (in terms of future proof delivery of speed and contention rates) copper infrastructure. Much of the transmission capacity for mobile operator is also based on this type of provision.

In the recent Strategic Review of Digital Communications ('DCR) Ofcom recognised that BT Group is driven by shareholder return, which in turn influences such factors as operational and maintenance costs and capital investment into the network. BT Group's recent content strategy has made

[2] Example studies include: Ofcom: SRDC Discussion Documents, July 2015; Business Connectivity Market Review, May 2015; Ofcom Analysis of Operator Data, May 2015 (as detailed in the SRDC 16 July 2015; Communications Market Report: Scotland, August 2015; Jigsaw Research: SME experience of communications services – a research report, October 2014; Infrastructure Report 2014, December 2014; Saville Rossiter-Base: Quality of Customer Service Report, December 2014; Which?: Broadband Advertising speeds not up to speed; Broadband Services for SMEs: assessment and action plan, June 2015; Federation of Small Businesses: The fourth utility, July 2014; and Ofcom presentation: Ofcom's Strategic Review of Digital Communications, October 2015.

significant demands on its free cash flow. This has seen relatively limited recent investment in large parts of Scotland (out with the DSSB programmes in the rest of Scotland and the Highlands and Islands, where the public sector has made a significant investment), and sees the 'sweating' of its existing copper based network. Whilst Openreach has been developing its G.Fast product, there is limited evidence as yet to suggest that such a product will deliver significantly enhanced and widespread provision due to the technology's dependence on the quality of copper and the distance from the premise; there is also the question about the adequacy of such an approach going in to the future and its ability to deal with ever greater data levels and demand. Where BT has announced investment, there is limited information as regards to precisely where that investment will be delivered and when.

Whilst it is difficult to obtain a detailed understanding of the specific investment in Scotland, recent data suggests that levels of NGA and Superfast penetration are lower than the UK average[3]. It is, however, recognised that the investment needed is significant and therefore the business model and focus of Openreach should seek to enable long term infrastructure investment in addition to the requirements to support the wider BT Group. In order to secure adequate investment into the access network infrastructure to meet the digital dependency of consumers and enterprises, Ofcom is considering the current operational model of Openreach, and assessing the extent to which additional measures are required to deliver future infrastructure for the needs of the next 10 years across the UK. In establishing a future strategy, it is also necessary to consider the Openreach value chain to assess which aspects of this can and should be regulated through a competitive framework and where a more asset-based regulatory framework may be more appropriate. In addition, given the localised nature of some of the investment challenges we strongly consider that a regional and local approach is developed to understand and regulate Openreach's performance and service quality. This latter point applies at not only a Scottish level, but also a UK level.

3. The future of Openreach

As highlighted above, the next ten years will be exceptionally important for the UK in terms of preparing the ground work for a future-proofed, fit for purpose digital infrastructure which will drive productivity and economic and social benefits. In considering the options available in relation to Openreach, full structural separation is one that has generated considerable attention and detailed scrutiny. We endorse Ofcom's view that this should remain an option for them to consider, especially if the eventual structure that emerges from this consultation does not, in relatively short order, deliver the required changes in behaviour, investment, performance and user experience.

In this response therefore we have sought to identify the key areas that need to be addressed through an enhanced functional restructuring, to achieve the desired outcomes identified above. The fundamental elements of ownership, governance, regulation and investment ethos that should be applied to a restructured Openreach, can be summarised as follows:

- Separated from the rest of the BT Group as a functioning standalone operating entity. The potential for shared ownership with external parties could also be considered;

[3] Ofcom: Communications Market Review: Scotland, August 2015.

- Stand-alone governance arrangements with a separate board that contains external representation (possibly from wider industry)[4] set up to oversee the operations and performance of Openreach. Such an approach would see Openreach having its own constitution;
- Requirement to prepare and publish a rolling 5-year infrastructure investment plan that includes investment in renewals and new infrastructure; Ofcom would then monitor performance against this plan;
- Returns to be driven by and, if necessary, regulated on the basis of the long term infrastructure assets of the new standalone business. This basis of a future rate of return should also take into account the significant levels of public sector infrastructure investment made in the current fibre assets of Openreach;
- Ability to raise finance separately from BT Group to meet investment requirements;
- Ability to enter into joint venture arrangements for services and investments;
- Requirement to re-invest surpluses into infrastructure enhancement, with possible link to regulatory relief in competitive markets, based upon a regulated return;
- Requirement to invest in fibre only products to ensure a future-proof investment plan is developed;
- Introduce an enhanced regulatory and monitoring regime in relation to consumers and service providers with an increased focus on the actual end user or customer experience;
- Requirement to ensure input/output equivalence access (in relation to services, data provision and investment plans) is available to all operators; and
- Requirement to provide not only PIA to ducts and poles but also to offer dark fibre as a product at both the access and backhaul level to ECC undertakers; and
- Requirement to work with all MNOs to understand the required infrastructure to support mobile connectivity and to establish a plan to deliver on this investment.

It is recognised that some of the measures identified could have a potential impact on the relative value to BT Group of the Openreach business in that it requires Openreach to be more transparent in relation to its planned infrastructure investment plans and to operate under an enhanced regulatory and monitoring performance regime. It is also recognised that an obligation on Openreach to provide

[4] SFT has been involved in a number of initiatives which see a public interest director (a 'PID') appointed to the board of private delivery companies, especially where considerable public sector funding or support is involved. The SPVs /standalone companies created are classified to the private sector, and whilst the PID has an ultimate responsibility to act in the best interests of the SPV, it also represents the wider interests of the public and users in relation to the original aims of the SPV and the related programme. A PID can have certain discretionary although not controlling powers alongside more general rights such as representation at meetings and ensuring progress and adherence to the main contracts. Initiatives where such a role has been incorporated into the Articles of the company include the non-profit distributing ('NPD') programme and the National Housing Trust.

The precise nature of such a Director in relation to Openreach would require further detailed assessment, however the presence of such a director could have a positive impact on any revised Openreach set up. The PID would have a principal responsibility to Openreach, and to act in its best interests, however, it would also provide greater transparency and ensure that full industry and user considerations are more specifically addressed; it should be seen as complimentary to the wider industry and customer duties that the BT appointed and Ofcom approved Directors will already have.

a dark fibre product may have an impact on the levels of investment made by other operators in dark fibre infrastructure independently of Openreach. However, it is also possible that this obligation on Openreach to provide dark fibre as a product, when combined with the ability to co-invest, might reduce the overall capital and operational cost of infrastructure provision and increase the overall capital efficiency of investment; this could reduce investment risk in the Scottish market, which is often cited as having a marginal economic case without increased efficiencies being introduced. Moreover, all co-investing firms including Openreach would be in a strong position to argue for the benefit of regulatory reliefs which might arise through localised regulation, and these co-investing firms would also have an interest in the assets on their balance sheet and an influence over quality of service applied to those assets.

In order to address these or any other potential concerns regarding the impact of any Openreach restructuring, we would also suggest that reciprocity could be applied to other telecoms infrastructure companies in relation to a number of these obligations (for example the publication of rolling investment plans and introduction of enhanced performance regulation and monitoring) so that the whole industry is operating on a similar basis where it is felt to be appropriate and/or necessary.

4. Summary

It is noted and welcomed that a number of the proposals described above are, to varying, degrees outlined in the Ofcom Consultation document, however a number of them are not specifically addressed. We believe that it is the combined effect of all of the above proposals that will change the behaviours and incentives of Openreach and drive increased investment, improved performance and an enhanced user experience. Where it is not deemed appropriate or possible to enable those changes through a corporate restructuring of Openreach, then we would urge Ofcom to fully consider alternative regulatory remedies that could be explored in order to do so.

Scottish Futures Trust
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