SHEPHERD+ WEDDERBURN

# TELECOMS INSIGHT

## Welcome to the Telecoms Quarterly Newsletter

*The convergence of advancing technologies in the telecoms sector makes it particularly important for those in the industry to keep abreast of new developments wherever and whenever they occur. However, when time is at a premium it can be a challenge to keep up with the breadth and pace of change.*

*To try and help, Shepherd and Wedderburn is producing this new quarterly newsletter, "Telecoms Insight". In it you will find summaries of the key developments taking place around the UK and the wider world, pulled together by our specialist lawyers.*

*In this second issue we focus on (i) the recent Business Connectivity Market Review in the UK and the dark fibre obligations; (ii) the EU Commission's decision to block the o2/3 merger; and (iii) the release of the UK Government's White Paper on the BBC.*

## Business Connectivity Market Review – Supporting infrastructure investment or just investment on BT's network? Is the ladder of investment dead?

On 28 April, Ofcom released its final statement on the Business Connectivity Market Review ("BCMR"). At over 1500 pages in length Ofcom's review makes the case for some far reaching interventions in the markets for wholesale high quality access at fixed locations and for wholesale trunk segments of leased lines in the UK, as well as the market for retail leased lines.

These include imposing a new requirement on BT to make available dark fibre in the 'London Periphery' and in the 'Rest of the UK' from 2017 onwards, and benchmarking the pricing of that fibre to BT's 1 Gbps Ethernet product. The result of this will be a price for dark fibre that is well below the current commercial price.

Ofcom's public justification for the introduction of a dark fibre remedy is that this will allow alternative operators to be more innovative, and to offer services constructed to their own specifications. This is intended to assist them in becoming more effective competitors to BT. Ofcom has also indicated that it believes the introduction of dark fibre is a stepping stone towards an end state where active remedies are gradually withdrawn and replaced with passive remedies. How realistic this is remains to be seen.

The novel remedy is not, however, without its critics. Both Virgin Media and City Fibre have made investments in their own end to end networks, and have complained that the impact of the introduction of the dark fibre remedy and the pricing regulation thereof will seriously undermine their networks and reduce their incentive to continue investing in their existing infrastructure or extend their networks.

Ofcom acknowledges that the introduction of the dark fibre remedy could push some smaller alternative providers to exit the market or reduce their investment, but argues that this is outweighed by the efficiencies and greater competition that will be introduced through the use of the dark fibre remedy.

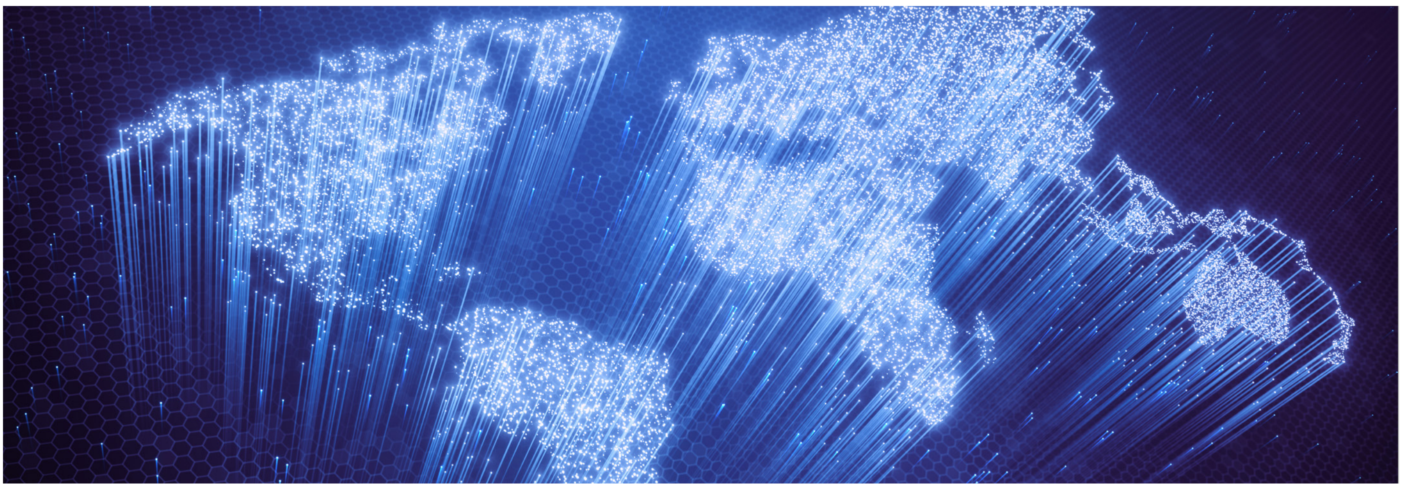
The other far reaching Ofcom intervention comes in the form of significant price control over BT. On the first day of the new regulatory period, BT was required to make immediate price reductions on wholesale Ethernet services up to and including 1 GBps of 12%, and a price cut of 9% on wholesale TI services up to and including 8 Mbps. These reductions will be followed by a series of annual price caps. Ofcom estimates that the combined effect of the charge control will result in a reduction for BT of approximately £800m in revenue over the three year period.

In addition to the argument of enhanced efficiencies, another, perhaps more interesting, justification raised by Ofcom for the introduction of a dark fibre remedy and the amended charge control rests on the fact that it has chosen to reconsider how it approaches the definition of the geographical markets compared to its 2013 review. In the 2013 review, Ofcom based its definition of a competitive geographic market on the existence of BT and at least 2 Originating Communications Providers ("OCPs") within 200 metres of a given business premises. In the 2016 review, the criteria now requires that BT and at least 5 OCPs are situated within 100 metres of a given business premises. As such, only the Central London Area meets the new criteria and the London Periphery is now no longer seen as being fully competitive. In addition, the review highlights that Central Business Districts ("CBDs") of Birmingham, Bristol, Glasgow, Leeds and Manchester are not seen as being adequately competitive.

Alternative operators have critiqued the change in criteria adopted by Ofcom. This change of approach was also picked up on by the European Commission in its comments on the draft statement. The Commission noted that a "more granular geographic differentiation of remedies for areas with less than five or six competing infrastructures could reduce the likelihood that alternative providers - having already deployed or committed to deploy infrastructure – would be incentivised to downscale their investments or even exit the market because of the imposition of remedies undermining their business cases."

The Commission therefore asked Ofcom to consider the imposition of less heavy remedies not only in the London Periphery areas, but also in other parts of the UK including the CBDs of the five other main cities. Whilst Ofcom states that it has taken account of the Commission's comments there is little in the final statement to suggest that Ofcom has considered the Commission's opinion, and there is little change in the granularity that would entail more bespoke and appropriate remedies depending on the specific area.

We expect therefore to see a number of appeals on the BCMR both by BT and alternative operators. This may therefore be the start of a long and fraught battle about what constitutes the encouragement of infrastructure investment. We hope to update you in the next quarterly report.



## 3 may be a crowd, but not a competitive one

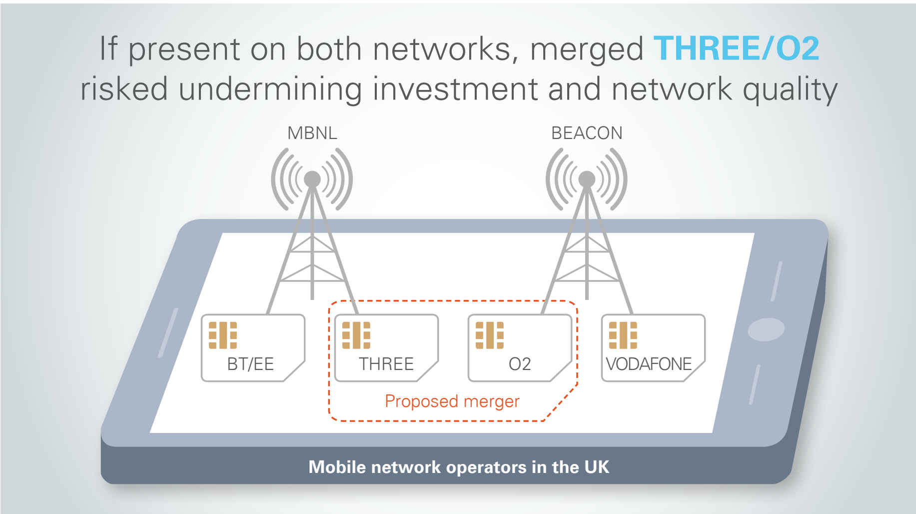
The European Commission's 11 May decision to block the merger of 02 and 3 illustrates that rather than 2 being company and 3 being a crowd, in the Commission's view three operators, plus numerous virtual mobile operators ("MVNOs"), is not a large enough group to ensure choice, quality of service and continued low prices for UK consumers.

When one considers the Commission's comments, it is clear that one significant factor in the decision making process was the existence of the two network sharing arrangements in the UK, one between EE and 3 ("MBNL" arrangements) and one between O2 and Vodafone ("Beacon" arrangements). The Commission noted that the merged entity would have been part of both arrangements, and would therefore have insight into the network plans of the other two mobile operators in the UK post-merger. The Commission suggested that being part of both network sharing arrangements would have allowed the merged entity to weaken both its competitors and could slow-down the ongoing development of mobile infrastructure in the UK, particularly as regards the rollout of 5G infrastructure.

The Commission also considered that the reduction of operators to three would have reduced the number of operators willing to host MVNOs, and would therefore have affected competition for both existing and prospective MVNOs. The proposed commitments offered by Hutchison were considered inadequate to address the Commission's concerns. These included an offer to freeze mobile prices for five years and invest £5bn in the network – neither of which were sufficient enough to allay the Commission's fears.

Given the Commission's focus on the shared infrastructure arrangements, there is a question as to whether the Commission's decision is the death knell for all four to three mergers, or whether there may still be hope for mergers in countries where, post-merger, there would still be three completely separate networks at both the infrastructure and the spectrum level.

Ofcom will no doubt be very happy with the Commission's decision to block the merger. Not only did its Chief Executive Sharon White come out strongly against the merger, but the decision also complements the approach taken by Ofcom in designing the last round of spectrum auctions, in that Ofcom agreed that there needed to be four credible wholesale players for a competitive mobile market in the UK.




Now that the merger has been officially blocked the question is what next for the mobile industry in the UK. Rumours have already begun to circulate that Liberty Global (owner of Virgin Media) may now seek to acquire O2. If true, this would mean a BT/EE alliance versus a Virgin Media/O2 alliance. BskyB could be left the last non-mobile player standing. We may therefore see over the coming months BskyB seeking out a mobile partner of its own, given that its MVNO play is now looking very much out of fashion.

## The Great British debate about the BBC

Like complaints about the weather, politicians and competing media operators bemoaning the bias and unfair nature of BBC programming is an inevitable part of British life. With the release of the Government's White Paper "A BBC for the Future", and the debate about the role of the world's oldest national broadcasting organisation has resurfaced in a dramatic fashion, with the Government attempting to conclude whether it is: a treasured national icon; an unfair competitor to Rupert Murdoch and other private enterprises; both; or neither.

The White Paper is the culmination of one of the largest and most open consultations ever conducted: the scale of responses, with 190,000 individual respondents, could be seen to reflect the impact the BBC has on British lives. In addition to a review of the public feedback, the White Paper also incorporates an independent review on governance, undertaken by Sir David Clementi, and a review on the BBC's market impact. An additional public opinion study, focussing on underrepresented groups, was also taken into consideration.

The key reforms contained in

the White Paper focus on the independence of the BBC and on its funding. Some of the principal changes are as follows:

- The next Charter, replacing the existing one that expires in December, will be valid for an 11 year period, the purpose of which is to separate the renewal process from the political cycle of five years;
- The licence fee is to be set every five years, but from 2017/18 to 2021/22 it shall be increased in line with inflation;
- An independent oversight body, the existing regulator Ofcom, is to be appointed to monitor the BBC and ensure compliance with its Mission Statement and the BBC Charter. In addition Ofcom will be imbued with the power to assess the BBC's impact on the market and how it affects its commercial rivals;
- The National Audit Office is to become the BBC's financial auditor and to scrutinise the BBC for value for money;
- The BBC Trust is to be abolished and replaced with a 'Unitary Board' of between 12-24 members that will be responsible for ensuring that the BBC acts in the public interest and meets its Charter obligations. The BBC will appoint half of these members, with the remaining members appointed through a Public Appointments process lead by the Government;
- The previous Reithian "Mission Statement" of the BBC, which required the organisation to "inform, educate and entertain" will be expanded to include the requirement to "act in the public interest serving all audiences with impartial, distinctive, high quality content and services that inform, educate and entertain"; and
- A contestable public service content fund will be established, removing the previous 'in-house' guarantee for BBC television content. This will allow competing content producers to apply for hundreds of millions of pounds of funding to help them produce content for the BBC. This will not apply to news and news related current affairs programmes, in order to maintain impartiality.

Other changes that have been hitting the headlines revolve around the transparency of BBC stars' salaries (with the names of those earning £450,000 annually to be disclosed) and a commitment to diversity in BBC programming.

The BBC has given its support for many of the proposals, although concerns remain over the oversight mechanisms envisioned. In particular, the installation of Ofcom as regulator and the replacement of the BBC Trust with the Unity board have been heralded as the "most significant reform" in the BBC's long history. In particular, concerns about the independence of the Unity Board, since a number of the members will be assisted into the position by Government, are shared across the BBC, with Tony Hall decreeing the current proposals inappropriate.

How the changes manifest themselves will, at least in part, depend upon the way in which Ofcom and the other independent oversight bodies choose to approach their role as regulators of the BBC.

For example, as the gatekeeper of the charter, how will Ofcom choose to interpret the new mission statement and ensure that the BBC produces content of a "distinctive" and "high quality" nature? The White Paper itself admits that such assessments "necessarily involve a degree of judgement" so it is understood additional guidelines and content requirements will subsequently be put in place.

Additionally, Ofcom's new requirement to assess the impact of BBC services on its commercial rivals may also prove controversial. When is this impact to be assessed? How is to be judged? Show by show or across the BBC's output as a whole? Again, this is to be laid out in more detail in the future, with the establishment of a fair trading framework setting out broad principles, and rules to ensure that the BBC's interactions between its public and commercial activities do not unduly distort competition in the market.

The devil of course will be in the detail, and the new Charter will not be finalised until January next year. Supporters and opponents of the BBC will therefore be spending the next few weeks combing through the White Paper and lobbying the Government ahead of the draft publication of the Charter. However, given the short time-frame until final publication, there is a limited time to persuade the Government to make further changes.

## Contact Shepherd and Wedderburn


Gordon Moir
Partner
T +44 (0)20 7429 4988
M +44 (0)741 426 7467
E gordon.moir@shepwedd.co.uk


@shepwedd · Shepherd and Wedderburn · Shepherd and Wedderburn · shepwedd.co.uk

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