

## Unbundling of energy undertakings in relation to Corporate Governance Principles

*Florence School of Regulation Workshop in cooperation with ERGEG Task  
Force on Unbundling, Reporting  
and Benchmarking (TF URB)*

### A Case Example: BT Openreach

Dr. Chris Doyle  
Consultant Economist and  
Associate, Warwick Business School and  
Department of Economics, Warwick University

25 September 2009, Federal Network Agency, Berlin

[chris.doyle@apexeconomics.com](mailto:chris.doyle@apexeconomics.com)

## Telecoms vs Energy in the EU

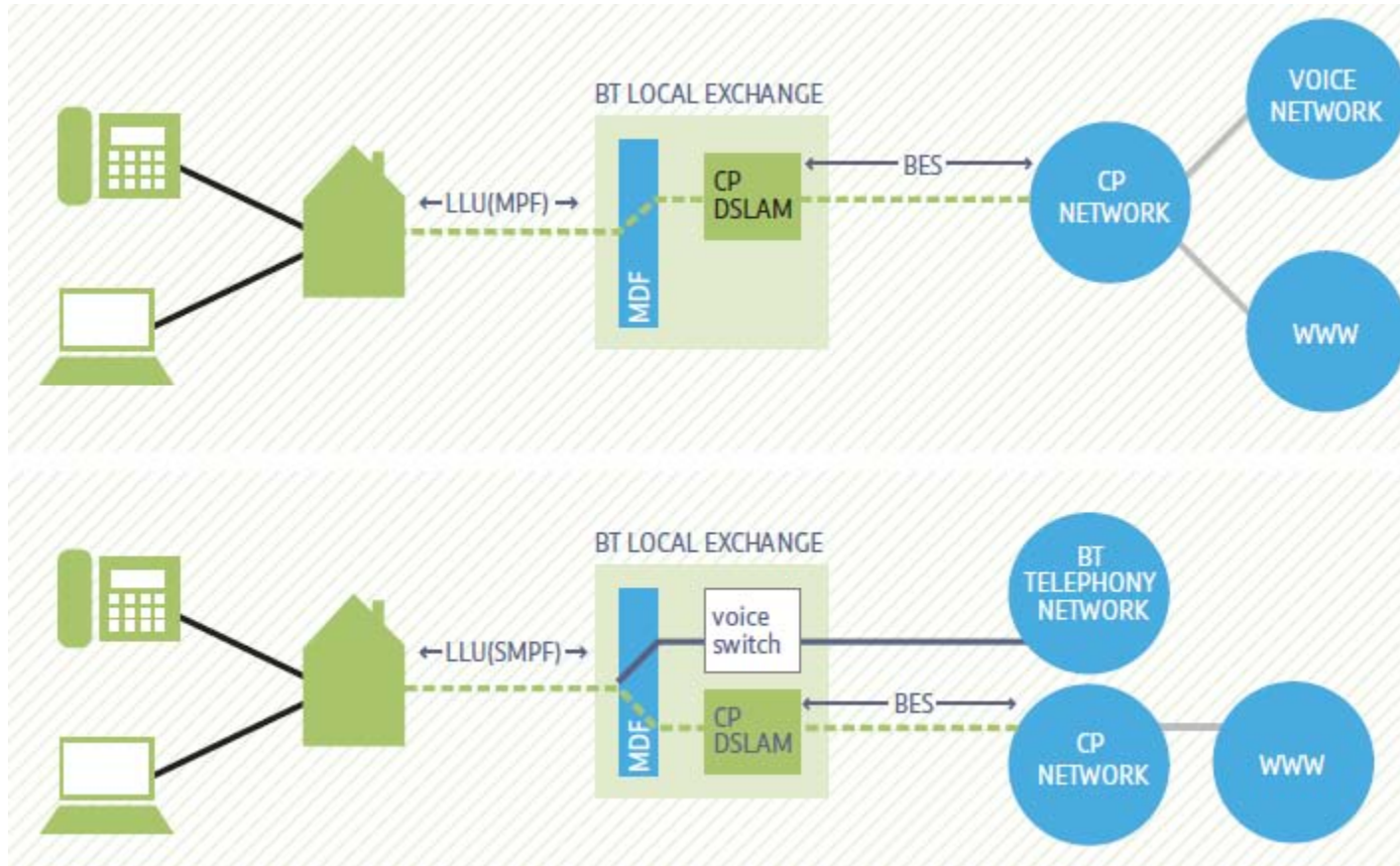
- Vertical network industry
- Regulated bottlenecks
- Unbundling of some services (local loop)
- No mandatory unbundling of businesses
  - Functional separation is proposed as an ultimate measure
- Why pressure for unbundling?
  - Non-price discrimination
- Vertical network Industry
- Regulated bottlenecks
- Unbundling of network services
- Mandatory legal separation of ITOs allowing common ownership

# Models of Unbundling

6	Ownership separation (in whole or part)	Full structural separation – may involve club ownership of bottleneck
5	Legal separation (separate legal entities under common ownership)	Legal separation (which may or may not embody elements of functional separation)
4	Functional separation with localised incentives and/or separate governance arrangements	Variants on functional separation
3	Functional separation	
2	Virtual separation	Variants on accounting separation
1	Creation of a wholesale division	
	Accounting separation	

## BT Openreach: Overview

- Openreach owns, maintains and develops the BT access network which links homes and businesses to the networks of Britain's communications providers
- Customers are given equivalent access to the BT local access and backhaul networks, this enables them to provide their customers with everything from analogue telephone lines and calls packages, to high speed broadband connections and complex networked IT solutions
- The regulator Ofcom launched a Telecommunications Strategic Review (TSR), December 2003
- After extensive public consultation, Ofcom accepted a set of Undertakings, or legally-binding commitments, offered by BT (**supported by UK competition law**)
- Undertakings signed between BT and Ofcom on 22 September 2005
- Openreach operations started January 2006



----- Openreach responsibility and line of service

## Principles of Unbundling

1. Unbundling of functions
  - YES
2. Unbundling of professional interest
  - YES
3. Unbundling of decisions
  - NO – BT Group plc is not a pure financial investor
4. Unbundling of information
  - YES

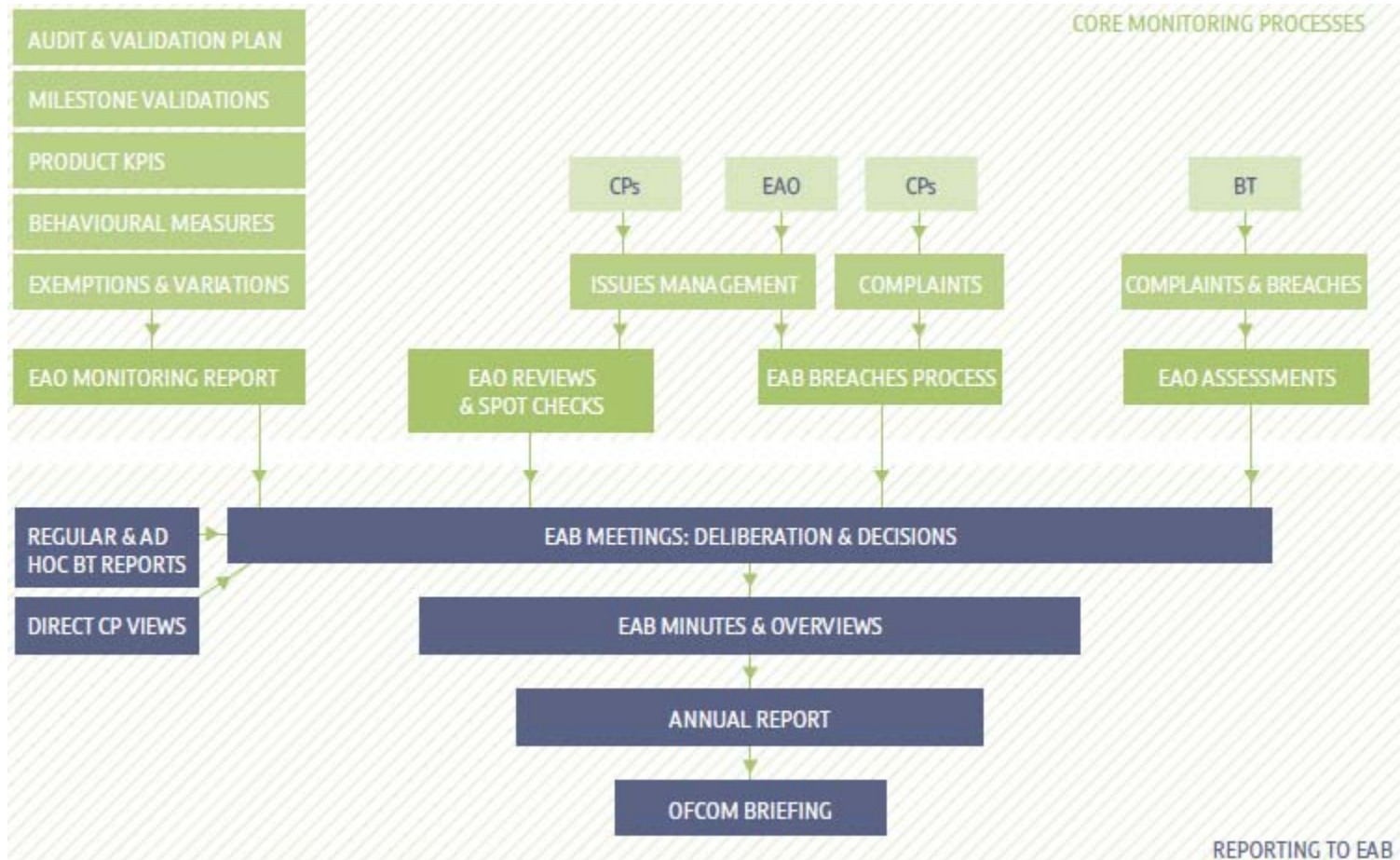


## The Undertakings

- The establishment of Openreach requires BT to adhere to the commitments in the Undertakings
- The Undertakings have required:
  - Changes to BT's internal systems, processes and ways of working.
  - Updating and developing employees' skills and
  - The implementation of a Code of Practice
- Openreach has changed fundamentally the way employees are incentivised
  - The Openreach senior management reward structure is, for example, linked solely to the performance of Openreach
- Openreach remains part of the BT Group, though it is a separate business with its own:
  - Headquarters,
  - Identity
  - Financial reporting and
  - Commercial principles
- The progress and performance of Openreach in meeting the Undertakings is monitored by an independent Equality of Access Board (EAB)

## Equality of Access Board

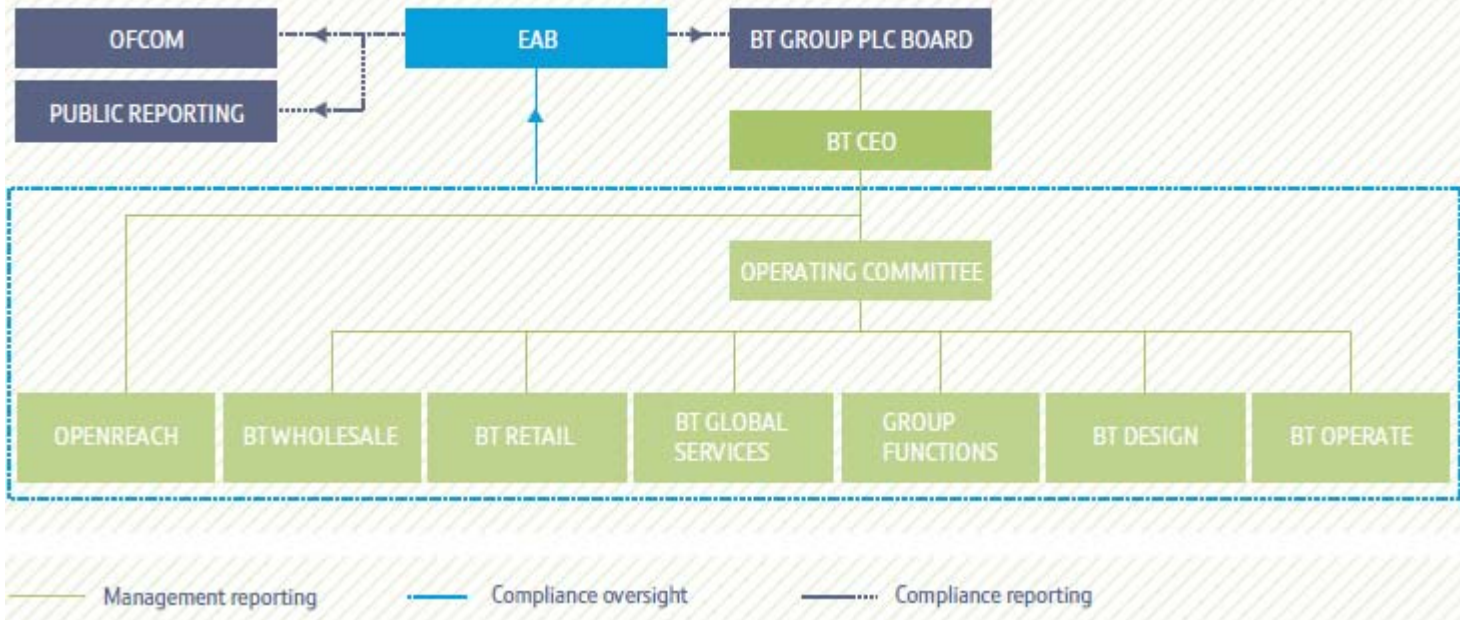
- Established November 2005
- The EAB monitors compliance with the Undertakings
- The EAB also assesses the delivery of Equivalence of Inputs by Openreach and regularly reports to the BT Group Board and to Ofcom
- The EAB is a committee of the BT Group plc Board. It is supported by the EAB Secretariat and the Equality of Access Office (EAO)
- The EAB consists of five members: three independents, one BT Group plc non-executive director and one BT senior manager
- The EAB shall publish in June each year an annual report on its activities as a distinct part of BT's annual regulatory compliance report. The EAB annual report shall be audited by independent external auditors



## Openreach governance Structure – monitoring compliance

Formal and informal channels are used  
CPs = Communication Providers

## THE EAB'S ROLE WITHIN BT'S REPORTING STRUCTURE



EAB role within BT

## BT Governance Structure

- The governance structure that was established in 2005/6 has remained largely unaltered in function
- The current framework consists of the:
  - Enterprise Programme Board: a group-wide body for setting policy and direction, managing priorities, resolving issues and ensuring consistency across BT's lines of business
  - BT Group Undertakings Programme Team: supports the Enterprise Programme Board by providing regular monitoring and reporting information on BT's delivery of the Undertakings
  - BT's line of business Undertakings programme delivery offices:
    - provide detailed Undertakings progress reports to the Undertakings Programme Team and to the EAB.

## Governance and Investment

- 5.28 With effect from the BT financial year 2006/2007, AS shall establish an annual operating plan which shall be submitted to the BT Group plc Board for approval. Once approved, execution of that plan shall be the responsibility of the AS CEO and the AS Management Board. The plan will establish the budget, including capital and operating expenditure, for AS. The plan shall include plans and targets for implementing and applying those sections of these Undertakings applicable to AS for the relevant year. Following each year of operation of AS such plan shall include a commentary on the previous year's implementation and application of these Undertakings as they apply to AS. The annual operating plan and commentary shall be shared with the EAB.
- 5.29 The AS CEO shall have delegated authority from the BT Group plc Board to authorise capital expenditure of up to £75 million within the annual operating plan referred to in section 5.28. This limit may be varied from time to time at the discretion of the BT Group plc Board. Ofcom and the EAB shall be notified of such variation within five working days.

## EAB Opinions

- “satisfied that these [governance structures] are functioning well and that it is effective in monitoring progress and advising BT on future steps”
  - Page 7 EAB Annual Report 2009
- “worked well in terms of monitoring and reporting but there are elements of BT’s governance of specific processes, for example, Openreach billing and product management processes that need to be improved”
  - Page 15 EAB Annual Report 2009

## Ofcom Opinions

- “Our annual evaluation continues to indicate that the net effect of the Undertakings to date, both for competition and consumers has been positive”
  - Executive Summary, Ofcom, Impact of the Strategic Review of Telecoms: Implementation Review, May 2009
- “We consider that Openreach has made good progress in becoming a functionally independent entity. It is now a recognised brand that is operating on a more stable, business as usual, basis.”
  - Para 5.14, Ofcom, Impact of the Strategic Review of Telecoms: Implementation Review, May 2009
- “The EAB has continued to build its organisational credibility by performing its compliance duties in an effective and objective manner.”
  - Para 5.20, Ofcom, Impact of the Strategic Review of Telecoms: Implementation Review, May 2009
- We continue to remain of the view that the Undertakings are an appropriate and comprehensive solution to the competition concerns that we set out in the TSR
  - Para 1.40, Ofcom, Impact of the Strategic Review of Telecoms: Implementation Review, May 2009

# Competitors' Opinion

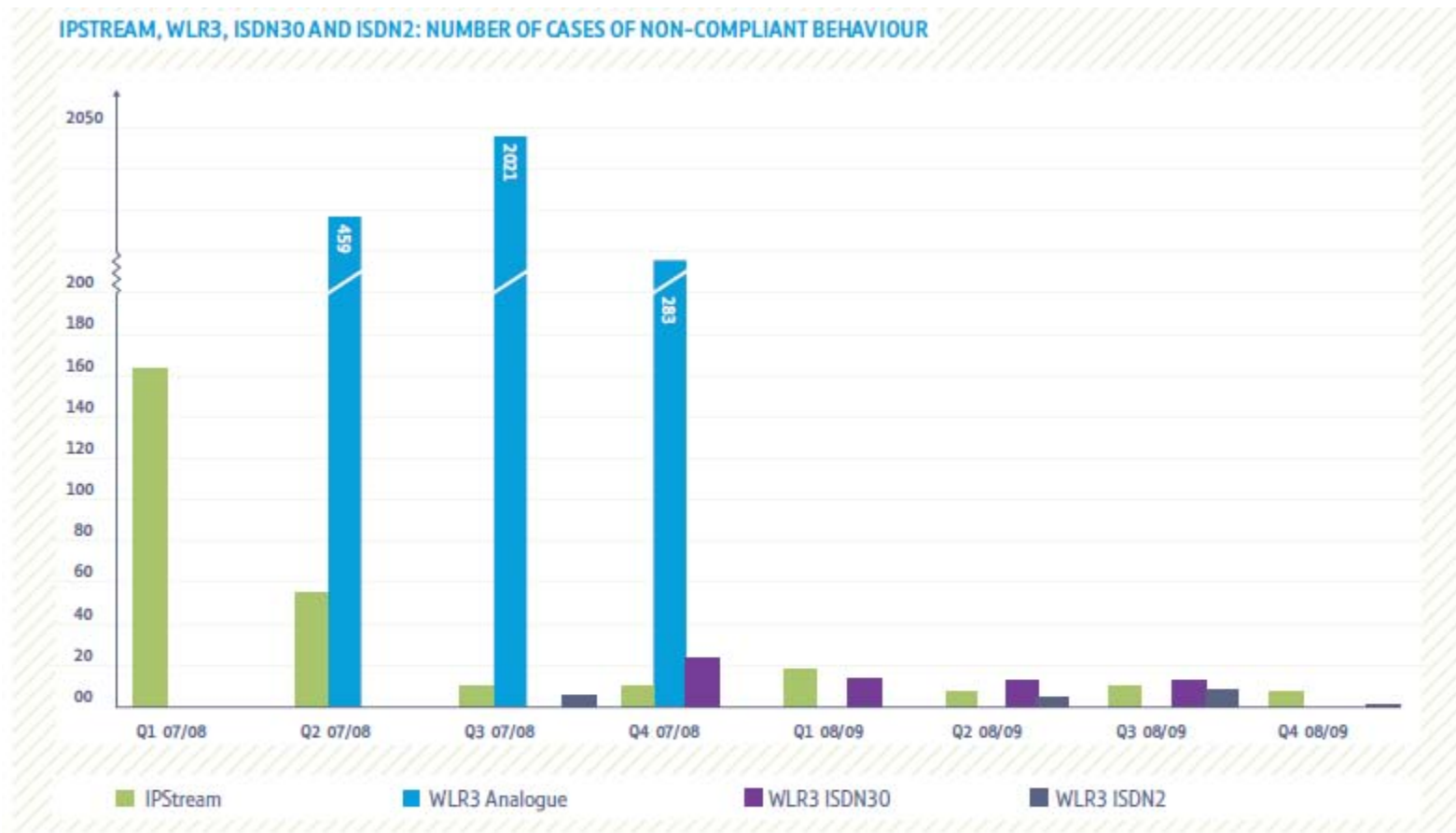
- “We enjoy the partnership relationship we have with Openreach, rather than us being just another customer and Openreach just another supplier.”
  - Justin Fielder
    - Director of Research & New Technologies, BSkyB

## Independent Opinion

“The implementation of functional separation in the UK to date has not been without its problems. The unravelling of the numerous relationships that bound Openreach with the rest of BT has been complicated, probably more so than anticipated when the undertakings were agreed in late 2005. As the relationships have been unwound, BT has asked for exemptions and variations from the undertakings as well as for more time. If nothing else, the difficulties that have been encountered should be sufficient for any government/regulator that is considering the replication of the UK approach to functional separation to think twice.”

“Is Functional Separation BT-Style the Answer?” Jason Whalley & Peter Curwen, *Communications & Strategies* no. 71, 3rd quarter 2008, pp. 160-161.

## Compliance Performance



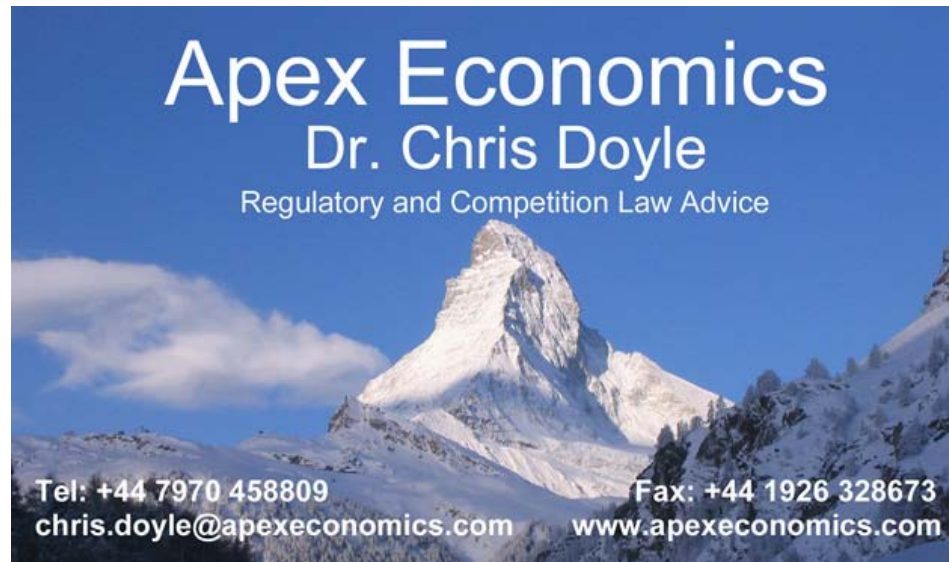
Source: BT

## Concluding Remarks 1

- The governance structures established to oversee Openreach in the UK appear to have functioned effectively, though a number of difficulties have emerged
- The oversight combines self-regulation (reinforced by legally binding commitments – ‘the undertakings’), independent audit and external regulation
- The structure in practice is complex, but probably no more so than similar structures found in the financial services sector
- The governance arrangements appear to have adapted well to changing circumstances
- Has it been a nightmare for the regulator?
- No – but it has been administratively detailed (hence relatively costly) and has cost BT more than £100m to establish and increased opex

## Concluding Remarks 2

- The European Commission has advocated the need for functional separation as an ultimate measure
- There is much opposition to functional separation – among operators and some regulators (e.g. Arcep in France)
- A number of NRAs have chosen not to apply functional separation (Opta in NL), others have threatened application (UKE in PL), some incumbents have volunteered application (Telecom Italia, Telia-Sonera)
- Jury still out on the net benefits/costs in the UK – study required
- Outside the EU separation has been considered in Australia where the Federal Government announced on 15 August 2009 structural separation (legal separation) of the incumbent Telstra – a model similar to the third energy package



Thank you