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# **Progress on delivering a more independent Openreach**

## **Implementation Report**

Update on the legal separation of Openreach

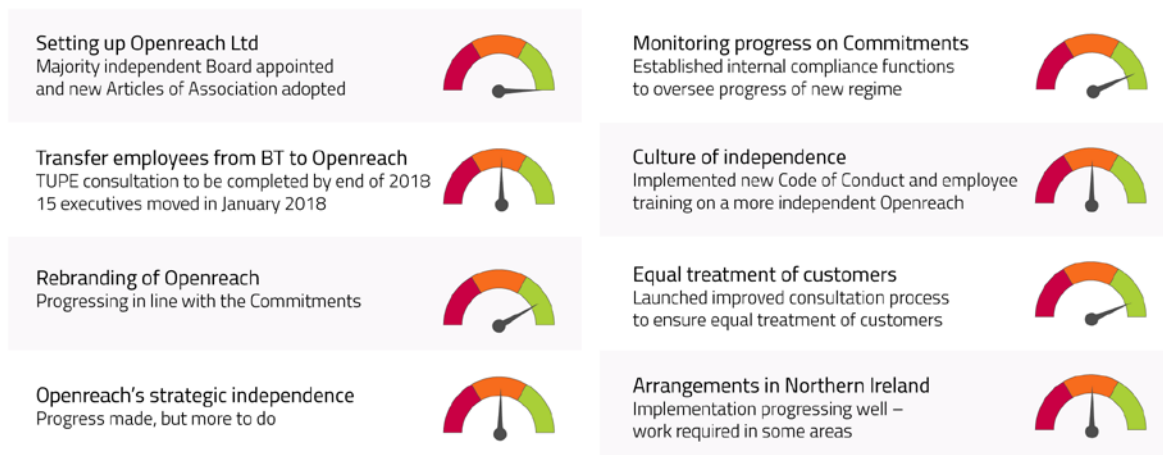
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# 1. Summary

- 1.1 BT and Openreach have been implementing changes to make Openreach a distinct and more independent company from BT, with its own Board of Directors and a duty to serve its customers equally. As part of this, Openreach will have its own brand, staff, management and strategy. This greater independence will help ensure Openreach is responsive to all its customers, supporting increased investment and delivering higher service quality. A more independent Openreach is part of Ofcom’s broader strategy to deliver better broadband for people and businesses.
- 1.2 Since March 2017, Ofcom’s Openreach Monitoring Unit has been assessing BT’s and Openreach’s work to put in place the new arrangements. We have been measuring their performance against a set of agreed commitments. Full Openreach reform also depends on several pre-conditions being met, such as BT consulting on transferring staff from BT to Openreach.
- 1.3 Many of the governance changes have already been implemented by BT and Openreach, but due to complexities with BT’s pension scheme (many of which were difficult to foresee) the new model is not fully in place. Our review has found there has been broadly satisfactory progress towards legal separation, but some steps have still not been completed. As this progress chart illustrates, material progress has been made, particularly on culture and leadership at the top. However there is more to do to fully realise the vision of independence - especially in decision making - and to achieve better service for consumers.

## Progress on delivering a more independent Openreach

This graphic indicates how far aspects of Openreach’s greater independence have been implemented so far. We will report on how effective these measures are in later reports.



- 1.4 **Full legal separation has not been finalised, due to complexities with BT’s pension scheme and transferring staff to Openreach.** Moving employees from one company to another is covered by the Transfer of Undertakings (Protection of Employment)

Regulations 2006 – or TUPE. The majority of staff have not yet been transferred from BT to Openreach, due to complexities with the pension scheme. However, BT has now resolved the pensions issue, and the need for Government to amend the Crown Guarantee has fallen away. BT has confirmed it will commence the TUPE process in the coming months and complete the consultation with staff by the end of 2018. BT and Openreach consider that the remaining actions and governance arrangements for the separation are in force as of 9 April 2018.

- 1.5 **We are broadly satisfied with the steps taken on the remaining Commitments so far, but there is more to do.** Openreach is now a separate legal entity from BT, with its own independent board and progress has been made in many areas. This includes removing “BT” from branding; putting in place compliance procedures; and carrying out staff training on the changes. Both BT and Openreach have worked openly and constructively with Ofcom throughout the implementation phase. Senior executives have demonstrated a strong commitment to making the new regime a success, but also recognised there is more to do.
- 1.6 **Openreach has committed to invest in faster, better broadband networks.** While it is still early in the reform of Openreach, we are seeing some positive signs. These include Openreach’s recent announcement to extend its planned roll-out of a full-fibre broadband network by an additional 1 million premises, to reach 3 million by the end of 2020; and the adoption of a “Fibre First” strategy. Openreach has been involved in investment discussions with its customers, including around co-investment opportunities and risk sharing. It is vital this momentum builds, and we would expect to see bolder commitments to full fibre over time.
- 1.7 **Further work needed to ensure more independent decision-making from Openreach.** Although progress has been made, we are concerned that BT and Openreach have not yet struck the appropriate balance between BT as a parent company, and Openreach as a legally separate and more independent part of the BT Group. We will be monitoring this area closely in the next financial year, to make sure BT does not have more influence than necessary and Openreach is making key decisions independently.
- 1.8 **Industry is cautiously optimistic about the new arrangements.** Many customers of Openreach stressed the importance of making sure the new arrangements result in tangible positive change, such as greater transparency in Openreach’s decision making. Some are uncertain as to whether the new arrangements allow Openreach to act with greater independence and treat all its customers equally in practice.
- 1.9 **Positive signs in Northern Ireland, but better progress needed in some areas.** We have closely monitored how BT has met its commitments in Northern Ireland, where Openreach does not operate. The main implementation steps have been taken promptly, including strengthening information sharing arrangements and training employees, though progress has not yet been made on some aspects.
- 1.10 **Overall, we are broadly satisfied with progress made towards legal separation, but some steps have still not been completed.** We are closely monitoring the outstanding

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implementation steps to ensure they are completed without further delay. The 2005 Undertakings, which established Openreach as the regulated network division of BT, remain in force until these are completed. We will assess and report on a range of measures that will consider whether Openreach's behaviour and performance is delivering positive changes in the industry. Our interim compliance update is due to be published in November 2018.

## 2. Background

### Our competition concern

- 2.1 Ofcom’s Strategic Review of Digital Communications (“DCR”) set out our strategy to bring about fast, reliable broadband services, a move towards a fibre future and decent broadband for everyone. Openreach will play a crucial role in delivering these improvements for the millions of people and businesses in the UK who rely on its network.
- 2.2 Our review identified a competition concern that the current structure of Openreach gave BT the ability to discriminate against those retail competitors who rely on the Openreach network to provide broadband. Specifically, as Openreach is vertically integrated within BT, we considered this led to a risk that BT had the incentive and ability to influence or determine strategic investment decisions that could favour BT’s retail divisions over other downstream competitors.
- 2.3 We considered that, without intervention, this competition concern could undermine the incentive for BT’s retail competitors to invest in developing their products and services. Ultimately it could influence the price, quality and availability of services. So we set out our view that Openreach needed to have more independence in making strategic and operational decisions, taking equal account of all its customers’ interests.

### BT’s voluntary commitments

- 2.4 BT notified Ofcom on 10 March 2017, under Section 89C of the Communications Act 2003, of its plans to meet Ofcom’s requirements by reforming Openreach and increasing its independence from BT. As part of this, BT committed that Openreach will become a legally separate company and have its own individual brand, staff, management and strategy. BT’s notification stated that BT intended to adopt:<sup>1</sup>
- a) a set of commitments to operate the Openreach business as a functionally separate division of BT (the “Commitments”);
  - b) a governance protocol that sets a framework for the relationship between Openreach and BT (the “Governance Protocol”); and
  - c) an Agency and Services Agreement (“ASA”) to set out the contractual terms on which Openreach controls relevant assets, and the trading relationship with its customers.
- 2.5 A separate governance protocol details the relationship between BT Northern Ireland Networks (“NIN”) and the rest of BT Group (the “NI Protocol”). These include reforms to how BT operates in Northern Ireland, where Openreach does not operate, to ensure that people and businesses benefit from the new arrangements in the same way as the rest of the UK.

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<sup>1</sup> See: <https://www.btplc.com/UKDigitalFuture/Agreed/index.htm>

- 2.6 On 13 July 2017,<sup>2</sup> we confirmed our decision to release BT from the 2005 Undertakings<sup>3</sup> 30 days after it had notified us that four pre-conditions had been satisfied. This included the Government amending the Crown Guarantee to cover Openreach Limited's pension liabilities; and BT undertaking a consultation under the Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE) to enable the transfer of staff from BT to the newly established Openreach Limited.

## Implementation of the new arrangements

- 2.7 BT originally estimated that full implementation of the new arrangements would take around 12 months (until April 2018). This was subject to resolution of all matters relating to the Crown Guarantee and BT's pension scheme. In October 2017, BT informed us that the TUPE consultation and transfer of employees could not take place within the timetable originally envisaged, due to complexities relating to the BT pension scheme.
- 2.8 The pre-conditions could therefore not be completed by April 2018 and the new arrangements could not be fully implemented. However, BT confirmed that the TUPE delay did not affect the timetable for most of the other outstanding changes, which remained on track for implementation by April 2018.
- 2.9 In March 2018, BT announced that it would be closing the BTPS to future accrual later in 2018 and replacing it with a new pension scheme in respect of future service.<sup>4</sup> This development means that the need for the Crown Guarantee to be extended falls away.
- 2.10 BT confirmed to Ofcom that it deemed the Commitments and Governance Protocol as being adopted, and in force in all respects, from 9 April 2018, except for any elements that could trigger a TUPE transfer of individuals working for Openreach.
- 2.11 BT will commence the TUPE consultation in the coming months and expects to complete the process by 31 December 2018 (subject to the outcome of the TUPE consultation). We will closely monitor progress on the outstanding implementation steps and will provide a further update in future reports.
- 2.12 The OMU has been closely monitoring the implementation of the new arrangements by BT, Openreach and NIN. This includes verifying the steps BT, Openreach and NIN have taken to establish the processes and changes required by the Commitments; and observing whether the parties are demonstrating behaviour consistent with the content and intention of the Commitments in advance of their formal adoption.

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<sup>2</sup> See: [https://www.ofcom.org.uk/\\_\\_data/assets/pdf\\_file/0020/104474/delivering-independent-openreach.pdf](https://www.ofcom.org.uk/__data/assets/pdf_file/0020/104474/delivering-independent-openreach.pdf)

<sup>3</sup> BT offered Undertakings to Ofcom in 2005, under which Openreach was originally created. See:

<https://www.ofcom.org.uk/phones-telecoms-and-internet/information-for-industry/policy/bt-undertakings>

<sup>4</sup> BT press release, 19 March 2018: <https://www.btplc.com/News/#/pressreleases/bt-announces-closure-of-its-defined-benefit-pension-scheme-2451910>

## 3. Implementation of the Commitments

3.1 We have closely monitored the implementation of the new arrangements since BT's notification to Ofcom on 10 March 2017. We agreed memoranda of understanding with both BT and Openreach, which set out the level of cooperation and transparency expected during our monitoring activities.<sup>5</sup>

3.2 Our monitoring programme has included a comprehensive information-gathering exercise with BT and Openreach and interviewing senior personnel from both entities, including the CEOs of BT and Openreach and various non-executive directors. We have also had regular engagement with BT and Openreach, attended various Board and Committee meetings and observed training sessions. In addition, we have proactively sought regular feedback and commentary from communications providers ("CPs") and other industry stakeholders.

3.3 We have considered BT and Openreach's progress under the following six broad themes:

- **Legal separation of Openreach**
- **Increased strategic independence from BT**
- **Compliance and oversight**
- **Embedding a culture of independence**
- **Equal treatment of customers**
- **Arrangements in Northern Ireland**

3.4 The sections below summarise the main steps that Openreach and BT have taken to put the Commitments and Governance Protocol into practice for each of the areas above,<sup>6</sup> together with our observations and stakeholder feedback on the observed changes.

### Legal separation of Openreach

3.5 Openreach Limited was formally incorporated as a separate legal entity in March 2017 and adopted its Articles of Association on 15 December 2017. Pending the formal transfer of employees from BT to Openreach, the Openreach Chief Executive and his 15 direct reports voluntarily transferred to Openreach Limited on 1 January 2018.

3.6 Openreach has its own headquarters at Judd Street in central London, and controls are in place to restrict BT access to Openreach's systems. It has developed a new brand and logo, removing the reference to 'BT' and 'BT Group'. As at 31 March 2018, 16.61% of Openreach's fleet of 23,703 vehicles had been rebranded and 12 of Openreach's 28 centres of excellence had been rebranded to remove references to 'BT'.

3.7 Furthermore, Openreach has taken many steps to build its organisational, technical and strategic capabilities. For example, it has developed its own Technology and Information, Strategy, Corporate Affairs, Legal and Regulatory Teams, as well as ensuring Openreach

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<sup>5</sup> Both memoranda of understanding are published alongside this report.

<sup>6</sup> For further detail, see BT's and Openreach's submissions published alongside this report.

representation on a number of industry bodies. Openreach has also announced its intention to recruit an additional 3,500 engineers<sup>7</sup> to support its commitment to accelerate its full-fibre (or fibre-to-the-premise, “FTTP”) build programme.

- 3.8 Some stakeholders have expressed concerns about the time taken to implement the Commitments and the lack of information available about the satisfaction of the pre-conditions. We consider that BT and Openreach could have been more transparent with industry early in the implementation phase. However, we note that Openreach subsequently engaged with industry and provided information on the adoption of the Commitments. In addition, Openreach intends to attend an industry forum on 5 July 2018 to discuss the Commitments. BT has confirmed that it will complete the TUPE consultation by 31 December 2018. We will closely monitor the remaining implementation steps.

### Increased strategic independence from BT

- 3.9 On 15 December 2017, BT delegated authority to the newly established Openreach Board to set Openreach’s strategy and oversee its performance. BT and Openreach have also introduced a new process under the Commitments to limit BT’s access to Openreach Commercial Information and Customer Confidential Information.
- 3.10 Early industry feedback suggests some stakeholders have doubts as to whether the new arrangements allow Openreach to act with greater independence and treat all its customers equally in practice.
- 3.11 Importantly, the Commitments and Governance Protocol are intended to provide Openreach with more independence in making strategic decisions, so it can be responsive to customers, support increased investment and improve service quality. This does not mean Openreach can, or should, operate with absolute independence. This is because, as Openreach’s parent company, BT has a duty to oversee Openreach’s financial performance within BT and retains a legitimate interest in its activities.
- 3.12 Nonetheless, we expect to see Openreach operating with the greatest degree of strategic and operational independence practically possible within the new model of legal separation. Crucially, we do not expect to see BT exerting undue influence over Openreach’s strategic direction and operation of its network.
- 3.13 Our early observations are that Openreach has made positive progress in establishing the new governance structures, capabilities and processes necessary to enable Openreach to operate with greater strategic independence. However, we are concerned that BT and Openreach have not yet struck the appropriate balance between BT’s interests as parent company, and the separate, more independent Openreach that exists as part of the wider group.
- 3.14 For example, we have concerns about BT’s involvement in the development of Openreach’s strategic plans. During interviews, several individuals suggested that BT was

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<sup>7</sup> See Openreach website: <https://www.homeandbusiness.openreach.co.uk/news/trainee-engineer>.



significantly involved in this year's planning process. This is supported by emails exchanged between senior executives which demonstrate that BT was involved throughout the financial planning process. We are also concerned that BT's newly established Investment Board reviewed Openreach's investment proposals to be included in its strategic plans before the final draft plans were presented to the Openreach Board for approval. This is an issue that we will explore fully in the next monitoring period.

- 3.15 During the first compliance monitoring period, we will carry out further work looking into Openreach's strategic planning processes, including the nature of BT's involvement.

## Compliance and oversight

- 3.16 Openreach established the Openreach Board Audit Risk and Compliance Committee ("OBARCC")<sup>8</sup> in March 2017 and BT established the BT Compliance Committee ("BTCC")<sup>9</sup> on 12 December 2017. OBARCC and BTCC committed to take on the relevant functions of the Equality of Access Board,<sup>10</sup> including the investigation of breaches of the Undertakings, while they remain in force.
- 3.17 OBARCC and BTCC (and their respective working offices) appear to be operating effectively and have developed a positive and constructive working relationship with Ofcom. Jan du Plessis (Chairman, BT Group) attended the inaugural BTCC meeting and emphasised his personal commitment to the new arrangements, also noting that he intended to attend all BTCC meetings in an observer capacity.

## Embedding a culture of independence

- 3.18 Openreach and BT have each put in place new Codes of Practice for employees, which set out the main organisational changes to Openreach and BT and specifically note that disciplinary action will be taken if the Commitments are not followed. Openreach has implemented new remuneration arrangements, which include appropriate incentives relating to customer experience.
- 3.19 Both BT and Openreach have deployed significant training programmes for 'high-risk'<sup>11</sup> employees alongside the deployment of the new arrangements, as well as introducing new mandatory training for all staff, called "Living up to Our Commitments". As at 31 March 2018, BT had trained more than 3,000 individuals in "high risk" teams, while more than 10,000 employees have completed the new training module. Similarly, Openreach had trained 853 individuals in "high risk" teams, and around 1,000 employees have completed the relevant training.

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<sup>8</sup> OBARCC's members are Edward Astle (Chair), Sir Brendan Barber, Liz Benison and Mike McTighe (Chairman, Openreach).

<sup>9</sup> BTCC's members are Isabel Hudson (Chair), Mike Inglis, Jasmine Whitbread and Dr Tim Whitley. See:

<https://www.btplc.com/Thegroup/Ourcompany/Theboard/Boardcommittees/BTComplianceCommittee/index.htm>

<sup>10</sup> The Equality of Access Board had the role of monitoring, reporting and advising BT on BT's compliance with the 2005 Undertakings.

<sup>11</sup> 'High-risk' individuals are employees who are directly involved in the information-sharing and disclosure process.

- 3.20 Our monitoring has shown both BT and Openreach have provided comprehensive information to their employees regarding the purpose of the Commitments and necessary operational changes, via internal communications. This includes making sure they are aware of the Codes of Practice and updating them on progress regularly.
- 3.21 BT's Chief Executive acknowledged the importance of embedding the new regime during the coming years and highlighting where behaviour falls short of expectations. We remind both BT and Openreach of the importance of sending clear messages about the advantages of a more independent Openreach for wider industry, people and businesses.

## Equal treatment of customers

- 3.22 The Commitments require Openreach to treat all customers equally. This means Openreach must act in a way that ensures all customers receive fair and equal treatment that has regard to their individual circumstances and does not unduly favour any one customer over another. However, equal treatment does not mean that all customers must always be treated *identically*. Openreach customers will have different requirements dependent on their characteristics, and these should always be taken into account.<sup>12</sup>
- 3.23 Openreach has acknowledged the need to put the treatment of their customers at the front and centre of their strategy. Openreach Chairman Mike McTighe has highlighted that Openreach's ultimate aim is to provide access services to all its customers in a fair, reasonable and transparent way.
- 3.24 The Commitments require Openreach to consult with its customers on significant investments relating to the future development of its networks and products. In May 2017 Openreach published proposals on the new consultation processes for all future industry changes, whether instigated by Openreach or CPs.<sup>13</sup> This included details about how Openreach consults with industry, details on a new confidential engagement phase, and changes to the Statement of Requirement ("SOR") process.<sup>14</sup> Openreach then followed this up with a number of industry workshops with CPs to discuss these proposals. We observed one of these workshops and found that Openreach had taken on board stakeholder suggestions. Openreach has also conducted several product consultations since March 2017. We are also aware that Openreach is already engaging with CPs using the confidential phase of the consultation process.
- 3.25 We consider Openreach has taken positive steps to improve communication with CPs, and most stakeholders broadly welcomed the increased level of engagement from Openreach and the product consultations conducted since March 2017. However, other stakeholders

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<sup>12</sup> The principle of equal treatment is a new commitment which goes further than the requirement under the 2005 Undertakings for Openreach to provide its products to all CPs on an Equivalence of Inputs ("EoI") basis. It does not just apply where Openreach has been found to have significant market power ("SMP"). While the Undertakings' EoI obligations will fall away once BT is released from the Undertakings, the EoI principle does not fall away completely. Openreach will still be required to supply products on an EoI basis in markets where BT has found to have SMP and where an EoI SMP obligation has been imposed.

<sup>13</sup> The full consultation can be found at:

<https://www.openreach.co.uk/orpg/home/updates/briefings/generalbriefings/generalbriefingsarticles/gen03117.do>

<sup>14</sup> An SOR is a requirement from a CP (or a number of CPs) requesting a change to an existing Openreach product.

felt the level of engagement was unchanged, particularly below senior levels. Many CPs also emphasised that any improvements in engagement must lead to improved outcomes. We will closely observe how the new consultation process operates in practice to ensure Openreach is treating all its customers equally.

## Arrangements in Northern Ireland

- 3.26 Openreach does not operate in Northern Ireland. Its products and services are provided by NIN, which is a virtually separate organisation and is hosted within BT's Business and Public Sector ("B&PS") division. The Commitments and NI Protocol do not fundamentally change the current arrangements but mirror key principles from the new model of Openreach separation.
- 3.27 Following BT's notification of the Commitments, NIN promptly took steps to implement new information sharing arrangements and formalise the relationship with Openreach. It also took steps to minimise the flow of information to B&PS. As of 31 March 2018, 98% of NIN staff had completed training on the new arrangements.
- 3.28 NIN has also appointed two senior staff to lead on the implementation of the new arrangements, who act as the first line of assurance and report to BT Group Regulatory Compliance.
- 3.29 Slow progress in the rebranding of NIN has been a concern amongst some Northern Ireland stakeholders, and we expect the rebranding process to be carried out without further delay. Stakeholders have also expressed concern that the position of NIN within the BT B&PS unit is not conducive to building an open and trusting relationship between NIN and CPs. We encourage NIN to continue engaging with its stakeholders to build positive working relationships.

## 4. Conclusions and next steps

### Conclusions on implementation

- 4.1 While full implementation of the Commitments has taken longer than anticipated, largely due to complications around the pension scheme, we are broadly satisfied by the progress in putting in place all other changes required for the new model of legal separation of Openreach. Both BT and Openreach have demonstrated an open and cooperative approach to engagement with Ofcom and a strong commitment to make the new model of legal separation work effectively.
- 4.2 Openreach has put significant effort and resource into bringing the new regime into effect and we have started to see the behaviour we would expect from a more independent organisation. In interviews with Ofcom, Openreach's and BT's senior teams have communicated a clear commitment to making the new model of legal separation work well. However, more work is needed to ensure that Openreach has the greater independence it needs to deliver positive results for consumers and industry.
- 4.3 We have also seen signs of benefits arising from the new model. Openreach has been responsive to early investment proposals from its customers, including around co-investment and risk sharing. Furthermore, Openreach's recent announcement of its Fibre First programme to extend full-fibre roll-out by 1 million premises, to reach 3 million premises by the end of 2020 (and longer-term intention to deploy a further 7 million by the mid-2020's), is a positive step forward. It is vital this momentum continues.
- 4.4 Industry stakeholders have noted improvements in Openreach's levels of customer engagement, although some are hesitant to attribute this positive change to implementation of the Commitments. We are receptive to stakeholders' views and will continue to seek feedback on how the new model is operating in practice.

### Next steps

- 4.5 During the implementation phase, **we identified several priority areas where we consider close monitoring will be required** to ensure that the new arrangements are operating in line with the overriding objectives of the Commitments, including:
- **the final steps of implementation**, to ensure the new regime is fully deployed; and
  - **Openreach's strategic planning process for the 2019/20 financial year**, to make sure BT does not have more influence than necessary and Openreach's decision-making reflects its increased independence.
- 4.6 **We will undertake a programme of engagement with CPs and other industry stakeholders** to ensure the new model of legal separation is delivering positive changes.
- 4.7 **We will publish an interim compliance monitoring update in November 2018**, reporting on the period 1 April 2018 to 30 September 2018. This will include an update on full

adoption of the Commitments and Governance Protocol. A full annual compliance monitoring report will be published in 2019.

- 4.8 **We will monitor Openreach's performance** against a number of consumer and industry measures over time, in a series of 'wider outcomes' reports to help us assess the overall success of the new model in addressing our competition concern. The first compliance monitoring report will detail these metrics. It will also an early view on the effectiveness of the new Openreach and the resulting benefits to industry and consumers.