



10 DOWNING STREET

THE PRIME MINISTER

24 May 1983

Dear Richard

Thank you for your letter of 18 April in which you explained your concern about the Telecommunications Bill. Much of what you say appeared in the Economist leading article of 23 April and in your own letter published in the issue of 14 May. Patrick Jenkin's reply to the Economist has answered most of your points.

You raise a number of interesting points about our telecommunications policy. I agree that our aim must be competition in telecommunications. I agree that BT's monopoly power is a real cause for concern. And I agree that it is essential that the Office of Telecommunications should have all the powers needed to prevent BT abusing its monopoly. Since telecommunications is perhaps the fastest growing sector of the economy and is so vital to our national prosperity, we must get the regulatory framework right. I am, however, satisfied that the broad framework set out in the Bill is right. I think your analysis is based on what may be a number of mistaken assumptions.

Your first assumption is that the Office of Telecommunications will not provide the checks on monopoly abuse that apply in the United States. We have in fact studied the American experience closely and I have to say that you are virtually the only commentator to have a good word to say about the Federal Communications Commission. Other commentators are agreed that the American regulatory arrangements are bureaucratic, that they have suffered comprehensively from "agency capture" and that they have been an obstruction to competition and technological change. The Americans have also made

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the mistake of attempting direct price regulation which caused the huge size of the FCC itself and the game of "hide and seek through AT&T's books" which you mention in your letter to the Economist. We set out deliberately to avoid the weaknesses of the American arrangements.

One of the main reasons why the FCC was "captured" lies in its status outside the mainstream of the US Government where it has not had adequate guidance or been subjected to proper Governmental or Congressional control. In this country, Ministers and Parliament could not constitutionally divest themselves of all responsibility. That is why the Government is retaining control of licensing and why we have chosen to make OFTEL a non-Ministerial Department. This in our view strikes a balance between removing regulation from day-to-day Ministerial interference whilst retaining overall control; if competition flags we can always step in to issue fresh licences.

You assume that there is no redress in the Courts if BT engages in predatory behaviour. The Bill, however, provides OFTEL with clear powers to order a licensee such as BT to take any action which the Director thinks requisite to comply with licence conditions about fair competition. The Bill provides that, once an order is made, any person affected by a breach of the order can seek compensation in the Courts. If anyone is damaged by a failure on OFTEL's part to make an order, they also can seek compensation to be paid. My concern has been that the Bill's powers about issuing orders to redress monopoly abuses are too sweeping and we had expected pressure to place increased checks on OFTEL. You would actually have us go further - and I could not accept that.

You also assume that America has introduced widespread and effective competition whereas we are content with a pale shadow. This simply does not bear scrutiny. There is no country in the world where there is competition between two or more public telephone operators to supply local telephone services to domestic subscribers; this does not occur in America where they have been liberalising telecommunications for some fifteen years. Moreover, in America

much of the apparent competition for the Bell system comes from firms who lease circuits from Bell and resell capacity on them to others. In this country our liberalisation efforts date from the British Telecommunications Act 1981, which came into force only eighteen months ago. Modern telecommunication systems are among the most complex and sophisticated systems we know. Planning and installation can take many years. Yet Mercury has completed the planning, ordering and installation of its system to the point where it is starting to do business, all in less than two years from its initial conception. This is a remarkable achievement. Mercury itself is the world's first independent and competitive network to be licensed to combine international, trunk call and local services. No other country has attempted this before, although the Americans are now falling into line behind us.

As you say, Mercury will concentrate initially on business customers but its licence permits it to deal with all subscribers. The two cellular radiotelephone networks, however, which will employ radically new technology, will provide services to individual subscribers; if as expected the cost of equipment falls as a result of competition, mobile telephones may well provide genuine competition for wired telephones, particularly in rural areas. We do not yet know what the final cost structure will be but we have high hopes that cellular radio will provide competition to BT at the domestic level.

Your third assumption is that by privatising BT we will in some way set it free to act inefficiently and to impose costs on the Community. The truth is that, as a nationalised industry, BT is supposed to have commercial freedom except that the Treasury controls its borrowing. Although we have pressed BT to keep its prices down, we have no formal powers to control BT's prices and successive Governments have found themselves unable to improve efficiency in monopoly nationalised industries. In contrast, the Bill will introduce arrangements which for the first time will subject BT to effective external controls over its prices and efficiency. Instead of being able to resist pressure to keep its prices down BT will be in a position where, provided we get the terms of the licence right, it can be

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ordered not to make a price increase.

You go on to suggest that sectional commercial interests will be able to exert de facto control over BT and to exploit consumers for private profit. I simply do not see how this can happen. Apart from the Government's 49% shareholding, there will be a maximum limit on individual shareholdings to prevent undesirable control. If, nevertheless, a Board of Directors was elected which sought to exploit the consumer, OFTEL would have a duty to step in either to issue orders to stop the offending practices or to amend the licences to deal with the abuse. And the Government could issue further licences.

You suggest that we did not consider breaking up BT into separate geographical and service units. I myself examined this option with great care but to my regret had to accept that it is not technically possible within any realistic timescale. BT has been developed over 70 years as a single integrated telecommunications network. There is a single management structure with integrated accounts. The equipment comprising the network has been installed so that the same buildings contain equipment used for local and trunk services and where one set of equipment provides both simple telephony and more sophisticated services. The management can be regionalised - indeed Sir George Jefferson is taking major steps in this direction - but this is taking a considerable time. The network itself, however, cannot be divided up in any meaningful way.

In contrast, the Bell system in America was always organised on the basis of separate local companies, partly to reflect the immense distances between major cities and partly to reflect the Federal structure of America where most of the States have their own regulatory authorities investigating local pricing etc. As a result Bell was organised and the equipment in the system was installed in a way which made divestment a practicable proposition. Even so nothing could be done about the long lines operation and divestment itself is taking many years. If we were to seek divestment here these practicalities would mean that flotation could probably not take place for five years or more.

I very much hope that you will, in the light of what I have written, feel able to support the Bill, when it is reintroduced after the Election.

Yours sincerely

Langford

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Richard Shepherd, Esq.