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PRIME MINISTER

COMPETITION POLICY IN TELECOMMUNICATIONS

As requested in your Private Secretary's letter of 31 October, I am circulating the draft of the statement on future competition in telecommunications which Kenneth Baker proposes to make next week in the Standing Committee considering the Telecommunications Bill.

2 The statement is needed to explain what we have so far decided so as to provide a framework to facilitate the flotation of both Cable and Wireless shares later this month and of BT shares next year. We should not underestimate what we have already achieved: complete liberalisation of the supply of terminal apparatus by 1987, the licensing of a second national and international carrier (Mercury), a general licence for Value Added Network Services, the licensing of two national cellular radio networks and the imminent licensing of 12 pilot cable projects. This is a complete transformation of the market for telecommunications and it has taken place in the short period of two years since the British Telecommunications Act became law. The full impact of what we have done will take some time to work through into the market place simply because telecommunications



are complex and the necessary investments take a long time to plan and implement.

3 You will remember that when we decided to license Mercury we decided that there should be no additional national telecommunications networks "for the foreseeable future". There are sound economic reasons for this. Mercury will need to invest around £600m before it establishes itself as an effective independent carrier covering the major population centres of the country. Until that is achieved, companies looking for a secure alternative to BT are likely to refrain from committing major tranches of their traffic to Mercury and the Mercury partners will have very low returns. The Mercury partners need a clear run and settled policy environment so that they can establish their system on a nationwide basis.

4 Our decision to establish Mercury as a second national carrier is an important move; it has not been tried anywhere else in quite the same way. Our objective from the start has been to give telecommunication users a genuine choice of telecommunications network and to ensure that no individual group has a stranglehold over the nation's vital telecommunications links. But ^{it is important that we} in the early days there is a risk that Mercury may fail to establish itself. That is why I am convinced that we must give Mercury an opportunity to develop ^{and establish itself} before we risk licensing additional competition. The BT/Mercury duopoly is, itself, undesirable and I propose that the statement should

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indicate that the duopoly will be reviewed after five years. This announcement would represent a positive advance over the present situation which envisages that there will be no additional network competition "for the foreseeable future". You should, however, be aware that the Chairman of Cable and Wireless has expressed some misgivings about an early ending of the assurances given to Mercury and I shall need to discuss the situation further with him.

5 Mercury's commercial success depends on its ability to attract business from Britain's top 300 companies who together provide around 60 per cent of BT's revenue. Unfortunately, these potential customers are being deterred by the current POEU dispute. Many of the companies would prefer to avoid Mercury provided they could gain some easement of the rules of the use of private leased circuits (tie lines) supplied by BT. Such arrangements, involving what is loosely called "resale", are currently the subject of considerable public debate and it must clearly be our long-term objective to secure the maximum possible relaxation of the restrictions on resale. However, in the short term some forms of resale - in particular "simple resale" where companies sell to third parties capacity on the circuits they lease from BT - could seriously damage Mercury's immediate prospects. Moreover, simple resale, while it would allow competition in the use of the network and would have all the superficial appearances of creating additional networks, would in fact leave users in the hands of BT and its unions, since it is they who provide the leased circuits used by resellers and also share in the revenue.



6 On resale, I am therefore convinced we need to proceed in a measured way. This is also necessary to avoid too abrupt a protective reaction by BT on tariff rebalancing which could lead to big price increases for leased circuit and domestic rentals. It could also lead to BT offering terms to resellers to undercut Mercury in certain important market segments. I propose that we should ease the restrictions on resale as they affect closed user groups, shared use of leased circuits and interconnection between leased circuits and the public switched telecommunications network. If we can secure progress on these three fronts we would provide benefits to business in different parts of the country, whilst not doing the harm which would result from early simple resale. I envisage that we would announce our policy on simple resale at the time of the review of the BT/Mercury duopoly.

7 Finally, I would like to draw attention to a timetable constraint. The prospectus for the Cable and Wireless flotation must be prepared before 22 November and the contents of Kenneth Baker's statement are material to Cable and Wireless's UK activities. Kenneth Baker needs to discuss the contents of the statement with Cable and Wireless, and other Mercury partners and BT urgently before any public release. Before doing so, I think it best to determine our own position and I would be grateful for clearance of the statement by close of play on Tuesday 8 November.

8 I am copying this to the Chancellor of the Exchequer, the



Home Secretary and the Foreign and Commonwealth Secretary, and to
Sir Robert Armstrong.

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4 November 1983

Department of Trade and Industry

DRAFT STATEMENT ON FUTURE COMPETITION POLICY FOR
TELECOMMUNICATIONS

The Government have been pursuing a consistent policy of seeking to introduce competition into the three main sectors of the telecommunications market - the supply of apparatus for connection to networks, the provision of services over networks, and the running of networks themselves. The process has been a gradual one, because we have been determined to avoid market disruption and to give all concerned - BT, its traditional suppliers and new market entrants - adequate opportunity to adjust as we progress to the competitive environment. Much progress has been made and the Government have been considering the strengthening of competition in the future.

So far as apparatus is concerned, we have introduced independent standards - making arrangements under the aegis of the British Standards Institution and an independent approvals system under the new British Approvals Board of Telecommunications. We are drafting the independent and objective standards which apparatus must meet before connection to the networks. This work is expected to be complete in mid-1984. We have recently announced that from the end of this year British Telecom will cease to self-approve the apparatus which it supplies to the market. Like the USA the UK will shortly enjoy a completely independent system of approvals for telecommunication apparatus.

I announced in February the Government's intention to introduce competition into the two remaining significant areas of apparatus supply from which it had hitherto been excluded. I can now confirm that on the appointed day when the Telecommunications Bill enters into force the BT monopoly of supply and maintenance of the prime telephone instrument will end for those customers who have a standard socket fitted by BT. From the end of 1984 customers who do not want sockets will be free to buy the prime instrument from anyone but BT will remain responsible for installing and maintaining such instruments. Maintenance of new call-routing apparatus is being progressively liberalized and will be fully open to competition by 1987.

In short, in the brief period since the British Telecommunications Act came into force in 1981 we have moved from a position of almost complete monopoly of apparatus supply to a position where a completely open and competitive market is in sight.

I turn now to services provided over public telecommunications networks. The convergence of computing and telecommunications technology has created an entirely new market for these Value Added Network Services, or VANS. We have completely liberalized this VANS market. The General Licence for Value Added Network Services granted last October authorized any company which registers with my Department to run telecommunication systems for the purpose of providing such services over public networks. This is the most liberal

VANS regime in the world. The only condition imposed on those who offer VANS is that they must provide a service in addition to the basic telecommunication service of conveying or switching messages. Some 60 VANS projects are now under way and I expect a continuing rapid development of this sector of the market.

Within the network provision we have taken the most far-reaching steps towards competition. The provision of the telecommunications network has traditionally been the preserve of single monopoly operators throughout the world. In the USA, where network competition developed first, many independent operators have, since 1976, started to lease capacity from the dominant suppliers and to resell this capacity to their customers. We therefore naturally considered at the outset of developing our policy whether to permit simple resale of BT circuits here.

We decided, however, on a different course. Instead of licensing simple resale, we encouraged the development of a separate and independent network. Mercury, a consortium of Cable and Wireless, BP and Barclays Merchant Bank, has been licensed to provide every form of telecommunication service, including private leased circuits, switched services to business and domestic premises and the full range of international services. We expect Mercury to develop into a national public telecommunication system and we intend the new licence to be granted to Mercury under the Telecommunications Bill to contain specific obligations about the installation of the Mercury

network on a national basis. Mercury will have a licence very similar to BT's.

The creation of a new network requires very large investment, and over a long period little revenue can be earned.

Mercury therefore needs time to install and consolidate its national network. Similarly, British Telecom also needs time to adjust. Its public telecommunications system was developed as a unitary and integrated network without thought of competition and it needs time to adapt to competition.

Telecommunications can only be provided by means of cables or radio. The installation of cables may have an undesirable effects on the environment and disrupt highway surfaces and traffic. The radio spectrum is a limited resource, with many competing demands on it. It would not be right to license a multiplicity of operators to install overhead wires or to dig up streets, nor would it be practicable, at least for some time to come, to license more than two national telecommunications operators using radio.

Government therefore gave the Mercury partners at the outset an assurance that for the foreseeable future they would not license any additional national networks.

To avoid uncertainty the Government have now decided to make it clear that it will not license operators other than BT plc and Mercury Communications Ltd, during the next five years.

The position will then be reviewed. In the Hull area, BT's role will be carried out by the City of Kingston upon Hull.

3 In addition the Government has already licensed two national cellular radio telephone networks. They will provide increasing alternatives to BT and Mercury at the local level but their role will be limited to providing radio telecommunication services. The Government will shortly be licensing the first broadband cable networks; their operators will be licensed to offer the full range of telecommunication services within their areas but voice telephony services on cable systems will be allowed only if provided in association with BT or Mercury, who will also retain an exclusive role in the provision of data communication services in the City of London, Westminster and Camden and in the business centres of Manchester and Birmingham. The cellular radio companies, the cable operators and other operators, including private mobile radio, will be permitted to connect their systems by means of BT and Mercury only.

4 Arrangements for interconnecting different telecommunication systems are particularly important. The Government intends that subscribers to one telecommunication system should be able to call subscribers to other telecommunications systems. To this end, the draft British Telecom licence published on 25 October contains a precise obligation requiring BT to connect or to permit the connections of its systems to any other system where

the operator of the other system is licensed to connect and requires the connection. A similar obligation will be contained in the Mercury licence. It will be for BT and Mercury to negotiate the technical and commercial terms for the connections both between their two systems and between their systems and other systems. Connection may be on standard published terms but, where there is no agreement between the operators, BT, Mercury and others concerned will be obliged to carry out connections on terms and conditions laid down by the Director General of Telecommunications.

The BT licence leaves open the possibility of the future introduction of various forms of resale or leased circuits, including simple resale. So will the Mercury licence. The Government considers, however, that it would not be right to license simple resale during the next five years.

The Government are, however, anxious to explore the scope for reducing some of the restrictions currently imposed on the use of private circuits leased from BT and Mercury. We are therefore discussing the possibility of allowing closed user groups to share the use of leased circuits, of giving lessees discretion to permit others to use spare capacity on leased circuits and to provide less restricted interconnection facilities between leased circuits and the public switched networks. We also consider that BT and Mercury should have the option of bringing into public use spare capacity which may be available on privately owned networks.

Our liberalization policy aims to increase consumer choice, and

to stimulate both greater efficiency in the use of national resources and encourage growth and innovation. The competitive framework I have outlined will enable those aims to be achieved and will allow BT, Mercury and all the other companies in this rapidly expanding industry every opportunity to prosper through fair competition to the benefit of consumers and their workforces and the economy generally.

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