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FM WASHINGTON 011937Z MAY 84  
TO IMMEDIATE FCO  
TELEGRAM NUMBER 1339 OF 1 MAY

FROM SIR ALAN WALTERS, FOR J REDWOOD, AND A TURNBULL ONLY, NO 10  
DOWNING ST.  
BRITISH TELECOM.  
TELECOM.

1. THE MAIN CONCERN IS MERCURY'S PROSPECTS AS A CREDIBLE COMPETITOR OF BT, AND THE NEED TO ENSURE AN INCREASINGLY COMPETITIVE ENVIRONMENT FOR BT.  
INTERCONNECT.
2. IN THE BT LICENCE THE PRINCIPLE OF NON-DISCRIMINATION SHOULD BE WRIT LARGE. I BELIEVE THAT THE BILL PROSCRIBES QUOTE UNDUE DISCRIMINATION UNQUOTE. THE LICENCE SHOULD SPECIFY THAT DISCRIMINATION WILL BE DEFINED AS QUOTE UNDUE UNQUOTE IF DIFFERENCES IN PRICES ARE NOT JUSTIFIED BY DIFFERENCES IN QUALITY OR COST. IN PARTICULAR DISCRIMINATION SOLELY ACCORDING TO CUSTOMERS IS QUOTE UNDUE UNQUOTE. THE PROOF THAT ANY PRICE/QUALITY DIFFERENCE IS NOT UNDUE SHOULD BE ON BT, NOT ON ITS COMPETITORS.  
THE REGIME.
3. THE SECOND MAJOR ISSUE FOR MERCURY WHERE ITS REQUIREMENTS HAVE BEEN NEGLECTED IS THE LICENSING POLICY TO WHICH ITS CUSTOMERS WILL BE SUBJECTED. MERCURY'S CUSTOMERS WILL BE OBLIGED TO FOLLOW THE RULES DEVISED BY BT FOR ITS OWN CUSTOMERS IN A MONOPOLY ENVIRONMENT (WITH FEW EXCEPTIONS).
4. IT SEEMS THAT PUBLIC OPERATORS' LICENCES ARE THOUGHT OF AS BEING SYMMETRICAL WITH RESPECT TO THE LEASING RULES. SO IN EFFECT, MERCURY HAS TO BASE ITS COMMERCIAL POLICY ON BT - ORIENTED RULES. THIS IS POTENTIALLY A GREAT HANDICAP. MERCURY'S TECHNIQUES AND PRICING NEEDS, PARTICULARLY AS IT IS GETTING GOING WITH SPECIALIZED BUSINESS SERVICES, ARE VERY DIFFERENT FROM BT'S. IT NEEDS A MUCH FREER HAND THAN IT SEEMS LIKELY TO GET.  
THE X FACTOR.
5. THE FINAL MAJOR THREAT FOR MERCURY ARISES FROM THE DEAL, JUST CONCLUDED WITH BT, ON PRI - X. THE KEY ISSUE HERE IS THE RELATIONSHIP BETWEEN THE BUNDLE OF SERVICES TO WHICH THE RPI - X CONSTRAINT APPLIES AND THE DEVELOPMENT OF COMPETITION. THE BUNDLE IS IMPORTANT - MORE IMPORTANT THAN THE SIZE OF QUOTE X UNQUOTE - NOT ONLY BECAUSE IT DEFINES THE SCOPE OF PRICE CONTROL, BUT BECAUSE IT ALSO DEFINES BT'S SCOPE FOR MANOEUVRE VIS A VIS THE COMPETITION UNDER REGULATION.
6. TO COVER THE DANGER THAT BT WILL RAISE RESIDENTIAL RENTALS TO FINANCE DISCRIMINATION AGAINST COMPETITION, BT HAS BEEN PREVAILED ON TO SAY IN ITS PROSPECTUS (NOT AS A LICENCE CONDITION) THAT IT WILL NOT INCREASE RESIDENTIAL RENTALS MORE THAN 1 PERCENT A YEAR. BUT MERCURY IS OPEN TO THE FOLLOWING KIND OF PLOY:- BUSINESS RENTALS RAISED, TRUNK CALL PRICES KEPT LOW. ALL BUSINESSES- MERCURY'S MAIN PROSPECTIVE MARKET- HAVE TO RENT FROM BT. TRUNK PRICES CONSTITUTE A MERCURY ADVANTAGE. FOR THIS KIND OF REASON, MERCURY WOULD PREFER THE AVERAGE RESIDENTIAL BILL APPROACH, TO REDUCE BT'S SCOPE FOR MANOEUVRE ON TRUNK CALLS.  
CONCLUSION.
7. UNLESS BT CAN BE BROUGHT TO AN ATTITUDE MORE MINDFUL OF THE GOVERNMENT'S NEED TO PROMOTE EFFECTIVE COMPETITION IN TELECOMS, THE GOVERNMENT WILL BE PREY TO THE QUOTE WORSE MONOPOLY UNDER PRIVATE OWNERSHIP UNQUOTE THEME. BT'S WHOLE ATTITUDE IS QUITE PREPOSTEROUS. WITH THE FAIREST WIND FOR COMPETITION, THEY ARE THE DOMINANT INCUMBENT IN A VERY FAST GROWING INDUSTRY. BT'S MARKET MUST INCREASE RAPIDLY WHATEVER HAPPENS. THE LINE SHOULD BE QUOTE MORE COMPETITION EQUALS A MORE ALERT BT OPERATION, WHICH IS GOOD FOR STOCK MARKET RATINGS UNQUOTE. THE CITY IS LOOKING FOR A NON-UTILITY GROWTH STOCK, NOT A DULL ONE.

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MR TURNBULL

2 May 1984

BT AND ALAN WALTERS

We share Alan's concern that Mercury should be seen as a credible competitor and should have rules of the game that enable it to be so.

Today's announcement does not pre-judge these licence questions in any way. BT and the DTI are still locked in debate about the form of the licence and we will be arguing in favour of a fair deal for Mercury in the normal course of business on this issue.

The nature of RPI-X is in broad outline being announced today. I have explained in a telephone call to Alan the arguments on both sides, the value of X that has been determined and he agrees that it was right to go for the wider basket. On the issue of BT using the freedom of the wider basket to juggle tariffs and rentals to the detriment of Mercury, this should become a matter for the Director General of OFTEL. Again this point does not seem to be prejudiced unduly by the statement made in the House today and it is another good point.



JOHN REDWOOD

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