February 2016

A Nation Disconnected? Potential implications of Brexit on telecoms markets

Grant Forsyth and David Lewin

The date for the referendum on whether Britain should remain in the European Union has been set. Companies within the telecoms sector, their boards and customers are all likely to be impacted if Britain was to exit – Brexit. Here we provide a short overview of the possible legal and regulatory implications for the telecoms sector that might result in the aftermath of Brexit. However, the big unknown is the nature of the trade relationship to be negotiated between the UK and the EU following Brexit. If the UK exits it will be important for industry players to determine the impacts specific to them.

Brexit would probably weaken the economies of both the UK and the reduced EU over the next decade with commentators predicting lower GDP and possibly even a recession.[1] The strong arguments for Brexit are political (migration of people, sovereignty) rather than economic.

Weaker economic performance would likely mean reduced demand for telecommunications products. In the past telecommunications has been relatively immune to economic slowdown, but that was not the case following the 2008 economic crisis, possibly due to the ever increasing importance of telecommunications as an input to productivity.

Large UK operators with a substantial presence in the EU, such as BT and Vodafone, may experience a particularly negative impact. But this impact is highly uncertain.

Nature of the trade deal to follow

The impact of Brexit on the telecommunication sector would depend on the nature of the trade deals negotiated with the EU following exit, and this is far from clear. Would the UK:

- follow the Norwegian model of strong compliance with EU regulations and a free trade agreement with the EU;
- follow the Swiss model of bilateral deals with the EU on various trade matters; or
- rely on WTO rules which maximises UK sovereignty at the expense of favourable trade agreements?

It is easier to predict the effects of Brexit on the regulation of the telecommunication sector in the UK. There are two aspects here: competition law changes, and changes to sector-specific regulation.

[1] Economist 18 Feb 2016 http://www.economist.com/blogs/economist-explains/2016/02/economist-explains-11?fsrc=scn%2Ffb%2Fwl%2Fbl%2Fee%2Fst%2Fwhythemarketsfearbrexit

Competition law changes

The UK would no longer be bound by EU competition law. Mergers such as 3/O2 would become the responsibility of the Competition Markets Authority (CMA) rather than DG Competition. While in the long term this may lead to different results, the CMA's approach to competition law cases – whether on merger or abuse of dominance – is presently aligned with that of DG Competition.

A larger change may come in terms of the approval of investment by the UK government: the UK would no longer need to seek state aid approval from DG Competition for telecommunications investment in high cost areas. This could possibly lead to a more interventionist approach in the UK, but such an approach is not consistent with the current economic rationality of HM Treasury.

Changes to sector-specific regulation

Brexit would mean that the outcome of Ofcom's Digital Communications Review – its across-the-board sector strategic review – would take precedence over the parallel review of the EU's regulatory framework – part of the EU's Digital Single Market strategy. Both are ongoing and both expect to deliver proposed changes by the end of 2016.

There may be conflict within the UK between the Department for Communications Media and Sports (DCMS) and Ofcom. Reading DCMS's *UK Non-Paper: Review of the Electronic Communications Regulatory Framework*, September 2015, is instructive. DCMS appears to favour a more light handed approach to regulation than Ofcom: for example in the treatment of tight oligopolies or structural separation of BT.

For the past 20 years the UK Government has relied largely on a policy of leaving Ofcom to regulate a competitive telecommunications sector based around private investment. DCMS may wish in future to take more control of policy, going on recent public comments by the Minister and DCMS's contribution to the EU review.

Possible UK divergence from EU

The UK Government believes that the current EU regulatory framework is working well. So we would not expect immediate major changes in regulatory processes. However the DCMS '*Non-Paper*' identifies a number of key areas where the UK might diverge from the EU following a Brexit, with:

- a more pro-investment policy on regulation than most other EU member states. For example the UK would likely extend the market review period from 3 to 5 years, as proposed in the *Non-Paper*, to provide more investment certainty to market players. (In our view this proposal could be counter-productive);
- a dropping of the need to take account of the Digital Agenda for Europe (DAE) broadband targets.[2] It is more likely to stick with its "*10 Mbit/s for all"* target announced recently. It would also have more freedom in how to fund implementation of this target given the removal of EU state aid rules;
- greater deregulation of communication services rather than the imposition of sector-specific regulation on OTT services;
- continued adherence to the principle of technology neutrality[3]. In contrast there are strong arguments from powerful figures within EU institutions for abandoning this principle;
- a shift in the standard for appeals against regulatory decisions by Ofcom: from consideration of the merits of the decision, towards a judicial review standard;
- the imposition of stricter conditions on market players offering bundles so as to enable easier end-user switching between suppliers; and
- support for allowing operators to retire legacy networks more easily - something that does not seem to us to be the current position of Ofcom

The UK would probably adopt the European Commission's position on net neutrality with a light handed implementation, rather than the more extreme principles put forward by many in the European Parliament. That is, it would provide basic safeguards for end-users but allow some price-product differentiation to service providers.

In other areas, such as spectrum allocation, the UK government would preserve the EU status quo of national allocations with international (preferably global) coordination to prevent interference and to build economies of scale for equipment supply. The UK government has also stated that it will retain the EU's *Roam like at home*[4] regulation for roaming in the EU.

Commercial impacts

The commercial impacts of the regulatory changes which Brexit might produce will depend on the individual market player concerned. Overall the UK is likely to shift towards a more liberal and investment friendly environment which will benefit infrastructure players like BT, Virgin Media, and the mobile operators. At the same time a shift towards a judicial review like appeal process of Ofcom's decisions would benefit some UK players more than others.

The big unknown, as noted above, is the nature of the trade deal to be negotiated following exit. If the UK exits, and when the preferred approach to trade becomes clear, it will be important for UK market players to quantify the commercial impacts which Brexit will create for them.

Plum's commercial advice capabilities

Plum Consulting has extensive experience in assisting operators, service providers, equipment manufactures, and trade bodies with understanding change and its impact. Plum's advice has covered public policy, legal and regulatory, and technological change.

Plum has recently completed work for the Mexican regulator IFT on detailing the commercial implications of implementing new regulatory interventions.

Similarly, for an investor in an African operator, Plum undertook a review of the commercial impacts and opportunities to be achieved through regulation. Closer to home, Plum has undertaken a number of studies for major European operators focused on the impacts of change in policy and regulation.

For more information contact Grant Forsyth at
grant.forsyth@plumconsulting.co.uk, or
+44 7918 88 68 49

[2] Especially the 30 Mbit/s availability for all.
[3] Technology neutrality is a key principle of the EU regulatory framework for electronic communications. In this context it means the same regulatory principles should apply regardless of the technology, and regulation should not be used to favour one technology over another.
[4] Due for implementation in 2017.