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Consultation on Non-domestic rates and the price for regulated Dark Fibre

As OFCOM is aware, Vtesse Harlow Limited represents the former shareholders of Vtesse Group Limited and Interoute Vtesse Limited, formally Vtesse Networks Limited, in relation to the 2010 rating list.

OFCOM is to be congratulated on performing the regulatory equivalent of putting lipstick on a pig[1]. The pig in this case is the unlawful non-domestic rating regime applied to telecommunications infrastructure.

The CMA Determination which caused OFCOM to issue this Consultation accepted the principal points of the TalkTalk appeal to the Competition Appeal Tribunal[2]. That appeal was that the use of the BT tax charge – NDR- to adjust the price of dark fibre would most likely, and in most circumstances, lead to a position where, due to the substantially higher level of NDR tax charged to Other Communications Providers ("OCPs"), the use by OCPs of the BT dark fibre would lead to an overall price including OCPs NDR charge at or above the benchmark lit service that the dark fibre remedy was intended to constrain. Therefore the remedy would be rendered ineffective.

The CMA Determination proposed that the matter be remitted to OFCOM to re-examine the pricing methodology. The Competition Appeal Tribunal agreed.

OFCOM's proposed response (the "Proposal") is to use a "middle of the road" level of OCP NDR as the basis for price adjustment of the benchmark BT lit service.

This would lead to a price which was still less than the charges levied on a small operator or end user, and would also lead to a position where larger operators rated on the rental basis, whose NDRs at the margin tend to zero[3], would have a disproportionately lower charge based on the DFA determination and then minimal NDR at the margin.

So, it would disproportionately benefit larger operators such as Vodafone, and disproportionately burden new entrants.

[1] To put "lipstick on a pig" is a rhetorical expression, used to convey the message that making superficial or cosmetic changes is a futile attempt to disguise the true nature of a product.
https://en.wikipedia.org/wiki/Lipstick_on_a_pig
[2] http://www.catribunal.org.uk/files/1259_Talktalk_Summary_070716.pdf
[3] https://www.gov.uk/guidance/rating-manual-section-6-part-3-valuation-of-all-property-classes/section-871-telecommunications-fibre-optic-networks footnote on Appendix 1

It could also lead to the bizarre scenario where a middle tier “rental” OCP could rent BT dark fibre at the discounted rate, and sell it back to BT or Virgin Media for onward sale at a profit.

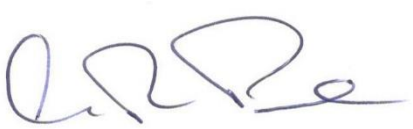
Finally, it is likely to have a chilling effect on investment in those areas where infrastructure competition might otherwise be economic, as the effect of using the “middle of the road” NDR adjustment on BT’s DFA would artificially reduce the competitive position of third party supplied fibre which would therefore have to compete against a BT LRIC cost less the benchmark NDR adjustment. This is clearly discriminatory and unfair.

In the last 35 years of UK telecoms regulation, there has never been a regulatory intervention which behaves in this highly discriminatory way.

Furthermore, OFCOM is aware that the rates regime constitutes unapproved state aid to BT, as outlined in the notes below. OFCOM has a statutory obligation flowing from EU law, and is clearly in breach of its statutory obligations in this respect. Those obligations are detailed below.

For these reasons, the Proposal should be revisited, and if necessary, remitted to the Competition Appeal Tribunal to deal with the state aid matters.

Yours sincerely



Aidan Paul

For and on behalf of Vtesse Harlow Limited

Notes on OFCOM's statutory obligations

These obligations flow from the Communications Act 2003 (as amended)[4] (the "Act")

In the Explanatory notes it says in respect of S 4[5]:-

32.The duty is a duty to act in accordance with six Community requirements. In the event that there is any conflict between this duty and the section 3 duties, the former, which is required by the EC Communications Directives[6], is to take precedence.

This makes it clear that the EC Communications Directives over-ride any of the terms of S 3 which describes OFCOM's general duties.

The principal obligations stem from the Framework Directive 2002 (as amended) Article 8.

Para 5 of Article 8 says:-

5. The national regulatory authorities shall, in pursuit of the policy objectives referred to in paragraphs 2, 3 and 4, apply objective, transparent, non-discriminatory and proportionate regulatory principles by, inter alia:
(a) promoting regulatory predictability by ensuring a consistent regulatory approach over appropriate review periods;
(b) ensuring that, in similar circumstances, there is no discrimination in the treatment of undertakings providing electronic communications networks and services;

It is clear that to the extent that the proposal result in a chilling effect on new investment in competing infrastructure, it fails the first of the 6 Community obligations (S 4 para 3 (a) of the Act).

By treating different actors in the market differently, it cannot be said that the proposal promotes the development of the single market. Furthermore, the proposal will have the tendency to increase BT's SMP in the provision of upstream services. (S4 para 4 of the Act).

By discriminating against new entrants to the market for downstream services and smaller operators, the Proposal does not comply with the third requirement.

By discriminating against third party fibre providers, the Proposal breaches the fourth Community law requirement (para 6 (a) and (b)).

By favouring the larger operators the Proposal it inhibits "efficiency and sustainable competition in the markets" (para 8 (a)) and therefore breaches the fifth requirement.

The Proposal does not breach the sixth requirement, but only because it is not entirely relevant.

[4] http://www.legislation.gov.uk/ukpga/2003/21/contents
[5] http://www.legislation.gov.uk/ukpga/2003/21/notes/division/5/1/4
[6] Directive 2002/21/EC (Framework Directive), Directive 2002/20/EC (Authorisation Directive) Directive 2002/19/EC (Access Directive), Directive 2002/22/EC (Universal Service Directive)

It is clear that the remedies proposed in dealing with the use by operators of BT dark fibre, and third party dark fibre do not comply with the requirements of the Framework Directive, Article 8 Para 5 and (b), as:-

- it discriminates between different operators, (BT, Virgin Media and other operators);
- it discriminates on the basis of their respective sizes;
- it discriminates on the basis of the calculation of their Non-Domestic Rates (R&E, rental)
- it discriminates on whether or not the fibre is “contiguous” (as that affects the NDR applied) and
- it discriminates on whether than fibre is provided by BT or third parties, which would be treated differently under these proposals.

The proposal therefore does not comply with OFCOM’s statutory obligations and breaches the fundamental principles of EU communications law.

Notes on State Aid

On Monday 10th April, the Competition and Markets Authority ("CMA") Final Determination involving the disaggregation of BT's rates payments was published by the Competition Appeal Tribunal ("CAT") in the case reference [2016] CAT 17. OFCOM had this Determination some weeks before its publication.

OFCOM is well aware of the Determination, that it involves the analysis of Non-Domestic Rates ("NDR") and has already put out to consultation the issues covered by it.

This Determination has been subject to a full judicial process including evidence from OFCOM, TalkTalk and its advisers Alex Stevens FRICS of GVA (formerly GVA Bilfinger), BT and its adviser Laurence Hatchwell MRICS of Colliers (formerly of the VOA) and a bench of economics and competition experts from the CMA including a Professor of Economics, a senior Investment Banker, a senior Competition lawyer, and a senior Chartered Accountant.

At 4.46 of the report it was reported that:-

In its [Notice of Appeal], TalkTalk said that OFCOM was wrong to use an attribution of BT's NDRs, as opposed to a measure of OCPs' NDRs, because, where dark fibre is provided to OCPs, it is OCPs, rather than BT, that become liable for paying the NDRs on the circuit. TalkTalk estimated that it may pay NDRs between 11 and 35 times the attribution of BT's NDRs for 2014/15, depending on the characteristics of the circuit concerned.

At Table 4.2, TalkTalk showed that certain operators may pay over £3,000 in business rates versus the payment of £70 - £100 made by BT for using the same fibre.

In its reply, BT's expert Laurence Hatchwell (formerly the VOA's valuer responsible for BT's rateable value) contended that there may be circumstances where large operators with multiple fibres on the same route may pay less than BT.

However, this assertion was rejected by the CMA which concluded at:-

4.77 We therefore conclude that TalkTalk has demonstrated that there is a material differential between OCPs' NDRs and the attribution of BT's NDRs in respect of the significant majority of circuits.

and then at:-

4.212 Both OFCOM and TalkTalk have provided evidence that the NDR Differential exists [ie that OCPs pay more than BT] and is material. In other words, there is a material difference in the NDRs payable by OCPs and those calculated based on the attribution methodology used by BT. It seems to be broadly accepted that the NDR Differential can be expected to be significant for the foreseeable future, unless the Government changes the rating rules.

The CMA coined the term NDR Differential to label the differences in the tax burden under the same or similar circumstance ie the lighting of a section of BT fibre. However, the same differential would apply in the use of other non-BT fibre.

The CMA Determination has been reached after a full judicial process, has been accepted by the Competition Appeal Tribunal and is judge-made English law. OFCOM has accepted it, and acted upon it.

The NDR Differential is nothing other than state aid. This can be demonstrated by reference to the Commission Decision in Case C 55/07 (ex NN 63/07, CP 106/06) published on 11 February 2009[7]. As OFCOM will know, this involved the discriminatory relief granted to BT flowing from its privatisation

[7] http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32009D0703&from=EN

from making certain pension related payments. This Commission decision was appealed by *inter alia* BT, but was ultimately upheld by the EU Court of First Instance, and the General Court (cases T 226/09 and T 230/09).

There are four ingredients for a state aid.

1. There must be an advantage
2. It must be granted through state resources
3. It must be selective and
4. It must distort, or threaten to distort, competition within and between member states.

In this case, it is difficult to dispute that paying between 1/35 and 1/11 of the tax of other operators confers an advantage to BT. OFCOM is fully aware of the rate of tax used internally by Openreach, and the CMA Determination confirmed that this was similar, if not identical, to the calculations undertaken to support Talktalk's appeal.

Differential taxation has been found to be a form of state aid[8]. This has also been decided directly in the English Courts. Thus in Lunn Poly[9] the Court of Appeal held that the unlawful state aid was the benefit provided to the group of taxpayers who paid the lower rate of 4%. Lord Woolf stated, at para 37:

"You can have a state aid in relation to a group of taxpayers, where you have the position, as here, of one body of taxpayers receiving a benefit which another body of taxpayers does not receive. This discrimination is capable of constituting a state aid. Those providing travel insurance, who are not subject to the higher rate of tax, are a clearly defined part of the group providing travel insurance and they received a benefit in the form of a lower tax rate which another defined part of those providing travel insurance, namely the travel operators and travel agents, did not receive. The aid was both specific and selective."

At para 49, Clarke LJ said:

"One of the express purposes of [Art 107 TFEU] is to prohibit aid which threatens to distort competition. Assuming that the differential rate of IPT threatens to distort competition, the reason that it does so is that it gives a benefit to those who pay at 4% at the expense of those who pay at 17.5%. That is so whether the standard rate is expressed to be 4% with a higher rate of 17.5% to be paid by some taxpayers or 17.5% with a lower rate of 4% to be paid by some taxpayers. In either such case the taxpayer who pays at the lower rate has received a benefit from the state as compared with the taxpayer who pays at the higher rate."

There can be no doubt that this advantage is selective – it specifically discriminates between BT and OCPs as noted above. If this were not the case, then the TalkTalk complaint would have been groundless.

The European Commission dealt with Point 4 above in Case C 55/07, where it noted at 5.1.4 that due to BT's dominance, and the persistent determination by OFCOM of BT's Significant Market Power any difference in treatment of levies (or taxes) that gave BT an advantage would be "liable to affect competition and trade between Member States within the meaning of Article 87(1) of the EC Treaty. (now Art 107 TFEU)".

As far as we are aware, this aid is unapproved and no application has been made to the European Commission to gain approval for it.

[8] Para 11 Commission notice on the enforcement of State aid law by national courts, (2009/C 85/01)
[9] R. v Customs and Excise Commissioners Ex p. Lunn Poly Ltd [1999] S.T.C. 350