



Draft re-determination to resolve a  
dispute between C&W, CPW and  
Gamma against BT about Carrier Pre  
Selection set-up charges

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**Draft**  
**Determination**  
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## Section 1

# Summary

### The nature of this document

- 1.1 This dispute is about the charge that BT makes to CPS operators when it applies Carrier Pre-Selection (CPS) to a line (except where CPS is provided in combination with Wholesale Line Rental (WLR), when a different charge applies). This charge is listed in BT's Carrier Price List as "Set-Up – Switch change effected" and referred to in this document as the "CPS set-up charge".<sup>1</sup>
- 1.2 CPS is a mechanism that allows consumers who have a BT line to select, in advance, alternative communications providers to carry some or all of their telephone calls without having to dial a prefix.
- 1.3 On 13 February 2009, Ofcom determined that BT was not entitled to recover the costs associated with sending the notification of transfer letter and handling the resulting inbound customer calls through the CPS set-up charge and was required to reduce the CPS set-up charge by 78p. BT subsequently amended its charged accordingly.
- 1.4 At the same time, Ofcom consulted further on whether it should exercise its discretion under section 190(2)(d) Communications Act 2003 ("the Act") to require BT to make any payments to the CPSOs by means of a repayment of an overpayment. Following further submission from stakeholders, Ofcom published a decision on 1 July 2009 in which concluded that it would not exercise its discretion to direct BT to make any payments to the CPSOs.
- 1.5 On 4 September 2009, the CPSOs lodged an appeal with the Competition Appeal Tribunal challenging the July decision on repayments.
- 1.6 On 13 October 2009, Ofcom filed its defence to the Notice of Appeal. Around the same time, Ofcom acknowledged to the CPSOs that its July decision on repayments contained an error in that Ofcom had not considered the question of competitive distortion in reaching its conclusion. Ofcom proposed that the appeal should be stayed, pending its redetermination of the matter, taking into account the question of whether BT's inclusion of the disputed costs had or might have given rise to a competitive distortion.
- 1.7 On 16 November, the Competition Appeal Tribunal made an order staying the proceedings, pending Ofcom's re-determination of the matters in dispute.
- 1.8 Ofcom invited submissions from the parties on the question of competitive distortion on 27 November 2009. Submissions were received from the CPSOs on 24 December 2009 and from BT on 4 January 2010.
- 1.9 This document sets out the exercise by Ofcom of its discretion in relation to its powers under section 190(2)(d) of the Act, taking into account all the factors that Ofcom considers to be relevant, and consistent with Ofcom's statutory duties.

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<sup>1</sup> The section of the BT Carrier Price list that includes the CPS set-up charge is published at: [http://www.btwholesale.com/pages/downloads/service\\_and\\_support/pricing\\_information/carrier\\_price\\_list\\_browsable/b7\\_01.rtf](http://www.btwholesale.com/pages/downloads/service_and_support/pricing_information/carrier_price_list_browsable/b7_01.rtf)

## Provisional Conclusions

- 1.10 Ofcom has considered carefully all the representations made to it, both prior to the July Determination and now specifically in respect of this draft re-determination.
- 1.11 In contrast to the July Determination, Ofcom has now also considered the question of competitive distortion. It has provisionally concluded that BT's charges may have given rise to a competitive distortion, but that any such distortion is likely not to have been material.
- 1.12 Ofcom remains of the view that BT's reasonable appreciation as to its charges, based on the directions given it by the Director General of Telecommunications in 2001 and 2002, and Ofcom in August 2005, and the lack of any other guidance from Ofcom as to its proper charges in this regard, is a relevant consideration which Ofcom must take into account.
- 1.13 Ofcom notes its conclusions in the PPC determination, and considers that the various principles which it set out in that determination, and which have been considered above, remain valid. However, for the reasons set out immediately above including in particular Ofcom's direction in August 2005, Ofcom considers that the facts of this case are significantly different to those in the PPC determination as regards BT's reasonable appreciation, and that as result, the PPC case can and should be distinguished from this case.
- 1.14 The exercise of Ofcom's discretion under section 190(2)(d) requires it to consider all relevant considerations, including those in favour of and those against a direction to make payments, and strike an appropriate balance based on those considerations.
- 1.15 The main considerations in favour of requiring BT to make payments to the CPSOs are the fact that we have already found that BT is not entitled to recover the disputed costs, that it is not relevant that the CPSOs may have passed those costs on to their own customers, and that the inclusion of the disputed costs may have given rise to a competitive distortion in the market, although our analysis suggests that if any such competitive distortion did arise, it is likely to have been immaterial. There is also a question of whether it would be unfair to the CPSOs not to require BT to repay
- 1.16 The main considerations against requiring BT to make payments to the CPSOs are the fact that both the Director General of Telecommunications and Ofcom gave binding directions to BT which required BT to reduce its charges to set levels, and those levels were calculated on the basis of the inclusion of the disputed costs, and that there is a question here of whether in light of this it would be unfair to BT to require it to make repayments to the CPSOs.
- 1.17 Ofcom is also mindful of the competing arguments made by the parties as to the incentives which Ofcom's decision on repayments might give. The CPSOs argue that a decision not to require BT to repay would incentivise BT to charge in breach of its regulatory obligations unless and until it was told to do otherwise by the regulator. On the other hand, requiring BT to repay costs which it can reasonably argue were sanctioned or even required by regulatory directions, provides little guarantee of regulatory certainty that regulatory decisions can be relied upon.
- 1.18 On balance, we are not convinced by the CPSOs' arguments that a decision not to require repayments would generally incentivise BT to breach its regulatory obligations. The onus remains on BT to charge in compliance with its regulatory obligations, and to be able to demonstrate the same. It is an exceptional feature of

the present case that Ofcom had imposed a legal obligation on BT in August 2005 to charge a CPS set-up charge which included the disputed costs, and that BT had been subject to similar obligation between January 2001 and November 2003. Further, Ofcom had not given BT any reason to suppose that the legal obligation which it imposed under SMP condition AA8.4(d) failed to comply with the general principle expressed in SMP condition AA8.4(a). In the circumstances, Ofcom did not undermine the pro-competitive objectives pursued by the SMP condition, nor did it incentivise non-compliance with those conditions, by refraining from requiring BT to make a repayment in respect of the historical period. Any decision here not to require BT to make repayments would be made on the basis of the specific facts of this case, and would not in our view have general application.

- 1.19 Taking all relevant considerations into account, we are minded to conclude that we should exercise our discretion under section 190(2)(d) of the Act not to require BT to make any payments to the CPSOs. In particular, we do not consider that the evidence we have seen on competitive distortion suggests that the potential for a non-material distortion in the relevant market is such that we should reach a different provisional conclusion.

## Section 2

# Introduction and Background

- 2.1 This dispute is about the charge BT makes to CPSOs when it applies CPS to a line (except where CPS is provided in combination with WLR, when a different charge applies). This charge is listed in BT's Carrier Price List as "Set-Up – Switch change effected" and referred to in this decision as the "CPS set-up charge".<sup>2</sup>
- 2.2 Section 185(1)(a) of the Act provides (in conjunction with section 185(3)) that in the case of a dispute relating to the provision of network access between different communications providers, any one or more of the parties to such a dispute may refer it to Ofcom.
- 2.3 Section 186 of the Act provides that where a dispute is referred to Ofcom in accordance with section 185, Ofcom must decide whether or not it is appropriate to handle it. Section 186(3) further provides that Ofcom must decide that it is appropriate for it to handle a dispute unless there are alternative means available for resolving the dispute, a resolution of the dispute by those means would be consistent with the Community requirements set out in section 4 of the Act, and those alternative means would be likely to result in a prompt and satisfactory resolution of the dispute.
- 2.4 In summary therefore, where a dispute which falls within section 185(1)(a) of the Act is referred to Ofcom, and Ofcom can not identify alternative means which meet the criteria set out above, it has a duty to decide that it is appropriate to handle that dispute.
- 2.5 Section 188 of the Act provides that where Ofcom has decided that it is appropriate for it to handle a dispute, Ofcom must make a determination resolving the dispute within four months, except in exceptional circumstances.

### Ofcom's powers when determining a dispute

- 2.6 Ofcom's powers in relation to making a dispute determination are limited to those set out in section 190 of the Act. Except in relation to a dispute relating to the management of the radio spectrum, Ofcom's main power is to do one or more of the following:
- 2.6.1 Make a declaration setting out the rights and obligations of the parties to the dispute,
  - 2.6.2 Give a direction fixing the terms or conditions of transactions between the parties to the dispute,
  - 2.6.3 Give a direction imposing an obligation to enter into a transaction between themselves on the terms and conditions fixed by Ofcom, and

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<sup>2</sup> The section of the BT Carrier Price list that includes the CPS set-up charge is published at: [http://www.btwholesale.com/pages/downloads/service\\_and\\_support/pricing\\_information/carrier\\_price\\_list\\_browser/b7\\_01.rtf](http://www.btwholesale.com/pages/downloads/service_and_support/pricing_information/carrier_price_list_browser/b7_01.rtf)

- 2.6.4 Give a direction requiring the payment of sums by way of adjustment of an underpayment or overpayment, in respect of charges for which amounts have been paid by one party to the dispute, to the other.
- 2.7 A determination made by Ofcom to resolve a dispute binds all the parties to that dispute (section 190(8)).

### **Ofcom's duties when determining a dispute**

- 2.8 The dispute resolution provisions set out in sections 185-191 of the Communications Act 2003 (the '2003 Act') are functions of Ofcom. As a result, when Ofcom resolves disputes it must do so in a manner which is consistent with both Ofcom's general duties in section 3 of the Act, and (pursuant to section 4(1)(c) of the Act) the six Community requirements set out in section 4 of the Act, which give effect, amongst other things, to the requirements of Article 8 of the Framework Directive<sup>3</sup>.

### **Summary of the dispute brought in this case**

- 2.9 In 2000, the Director General of Telecommunications ("the Director General") inserted a new condition 50A into BT's licence imposing a legal obligation on BT to provide CPS services. On 8 January 2001, the Director General imposed on BT a legal obligation to charge certain stipulated amounts for the CPS services. Those mandatory charges, which were amended by the Director General in August 2002, included the disputed costs.
- 2.10 In November 2003, condition 50A of BT's licence was replaced and replicated by SMP condition AA8. Although condition AA8.4(a) required charges for "CPS Facilities" to be reasonable and "*based on ... forward looking long-run incremental costs*", no guidance was given by Ofcom as to what was to be included within the definition of "CPS Facilities". BT continued to charge the sums which it had been obliged under condition 50A to charge, which included the disputed costs.
- 2.11 Under SMP condition AA8.4(f), BT was obliged to "...modify any of its charges for the provision of Carrier Pre-Selection Facilities in the manner in which the Director may direct". In August 2005, Ofcom issued a direction under SMP condition AA8, requiring BT to "...modify its charges for the provision of Carrier Pre-selection Interconnection Facilities as set out in the accompanying Addendum to this direction"<sup>4</sup> ("the August 2005 direction"). The Addendum to the August 2005 direction set the CPS set-up charge at £2.72, the effect of which was to include the disputed costs. The August 2005 direction was not appealed by any party.
- 2.12 Since the introduction of CPS in 2000, BT has included the disputed costs within the CPS set-up charge as it believed it was entitled to do so in compliance with its SMP obligations.
- 2.13 C&W argued in its original submission that BT was not entitled to recover the disputed costs from CPSOs and has not been compliant with its SMP obligations for the following reasons:
- a) The disputed costs are not part of the cost of providing CPS facilities;

<sup>3</sup> Directive 2002/21/EC of 7 March 2002

<sup>4</sup> Per-provider and per-customer line costs and charges for Carrier Pre-Selection, 18 August 2005 (Appendix 8 to the Notice of Appeal).

- b) the disputed costs are anomalous compared with those for other BT transferable products;
- c) the disputed costs put CPS providers at an unfair competitive disadvantage relative to BT;
- d) the disputed costs are levied on transactions where they are not incurred;
- e) BT is the main beneficiary from the inbound calls;
- f) the charges do not provide an effective or fair disincentive to mis-selling; and
- g) the recovery of the disputed costs by BT is contrary to Ofcom's cost recovery principles.

- 2.14 On 13 February 2009, Ofcom made a determination ("the February Determination") which concluded that BT is not entitled to recover the disputed costs and is required to reduce the CPS set-up charge by 78p.
- 2.15 On 20 February 2009, following the February Determination, BT notified the industry of a new CPS set-up charge of £1.69, implementing the Determination, with effect from 16 February 2009.<sup>5</sup>
- 2.16 Ofcom did not come to a final decision in the February Determination on the question of whether Ofcom should exercise its power under section 190(2)(d) of the Act to direct the payment of any sums by BT by way of an adjustment for an overpayment. However, it proposed to conclude that its determination of the dispute would be forward looking only, such that it would not require any such payment. Ofcom invited further submissions from stakeholders in this regard.
- 2.17 On 6 July 2009, having considered the further submissions received, Ofcom published a decision not to require any payments to be made by way of an adjustment of an overpayment (the "July Determination"). Ofcom's main reasoning to support this conclusions was that because:

- 2.17.1 BT decided to include the disputed costs in its CPS cost stack on the basis that to do so was in compliance with its obligation to comply with SMP Condition; and
- 2.17.2 Ofcom impliedly affirmed that position when it included the disputed costs in the charges it set in a binding Direction in 2005; and
- 2.17.3 Ofcom had not, prior to the first draft Determination, indicated that it was no longer reasonable for BT to include the disputed costs in the CPS cost stack;

it was reasonable for BT to include the disputed costs in its cost stack for CPS charges under SMP Condition AA8 from November 2003 to February 2009, when Ofcom determined that those costs should no longer be included for the purposes of that condition.

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<sup>5</sup> [http://www.btwholesale.com/pages/downloads/service\\_and\\_support/interconnect\\_pricing/nccn/nccn\\_601\\_650/accn\\_928.rtf](http://www.btwholesale.com/pages/downloads/service_and_support/interconnect_pricing/nccn/nccn_601_650/accn_928.rtf)

- 2.18 On 4 September 2009 the CPSOs filed a Notice of Appeal challenging the July Determination.
- 2.19 On 13 October 2009 Ofcom filed its Defence in the Appeal.
- 2.20 Around the same time, Ofcom indicated by letter to the CPSOs that it accepted that there was an error in the July Determination in that Ofcom failed to consider the question of competitive distortion in exercising its discretion under section 190(2)(d) of the Act as to whether to require the payment of any sums by way of an adjustment for an overpayment. On 3 November 2009, Ofcom wrote to the CPSOs proposing to re-determine the matters in dispute within four months of the date of an order staying the appeal, after considering the question of competitive distortion. The CPSOs agreed with Ofcom's proposal and on 16 November 2009 an order was made by the Competition Appeal Tribunal staying the proceedings pending such re-determination.
- 2.21 Ofcom invited submissions from the parties on the question of competitive distortion on 27 November 2009. Submissions were received from the CPSOs on 24 December 2009 and from BT on 4 January 2010.

### **The scope of this draft re-determination**

- 2.22 Ofcom must now re-take its decision on the exercise of its discretion under s.190(2)(d) of the Act as to whether to direct BT to make any payment to the CPSOs by way of an adjustment of an overpayment. In exercising its discretion in this regard, Ofcom must take into account the submissions made to it in relation to the question of competitive distortion. Ofcom is not reconsidering the conclusions which it reached in its Determination of 13 February 2009 that BT is not entitled to recover the disputed costs and is required to reduce the CPS set-up charge by 78p.
- 2.23 We have received submissions from the CPSOs and BT in respect of the question of competitive distortion, and Ofcom has considered those submissions in addition to the submissions previously made by the parties in respect of repayments (i.e. submissions made prior to July 2009). The CPSOs have now also made a number of submissions to Ofcom regarding issues raised in the Notice of Appeal which they suggest that Ofcom should address as part of this re-determination. Ofcom has therefore clarified in this draft re-determination a number of issues raised by the CPSOs in the Notice of Appeal.
- 2.24 The submissions of the parties made in relation to repayments prior to the July Determination are set out in Section 3 below. Section 3 also contains comments made by Ofcom on these submissions prior to the July Determination. Ofcom's assessment of the parties' submissions to the consultation on repayment, as set out in the July Determination, is set out in section 4.
- 2.25 Section 5 sets out the submissions of the parties in response to Ofcom's invitation of 27 November 2009 to make further submissions on the question of competitive distortion. Ofcom's assessment follows in section 6.

## Section 3

# Submissions of the parties submitted prior to the July Determination

3.1 This section sets out the submissions made prior to the July Determination in relation to whether any repayment should be required in respect of the period since 2003. It also contains comments made by Ofcom on these submissions prior to the July Determination. This section is directly copied from the July Determination and uses the paragraph numbering from that document.

### Arguments on the repayment date: C&W's submission

- 2.11 C&W's submission of 23 September 2008 set out a number of arguments for C&W's request to Ofcom to determine the appropriate CPS set-up charge from 28 November 2003 to date.<sup>6</sup>
- 2.12 C&W noted that Section 190(d) of the 2003 Act gives Ofcom specific powers to direct the repayment of overpayments in resolving disputes.
- 2.13 C&W argued that it would be fair as between the parties to the dispute, and reasonable from the point of view of the regulatory Framework objectives, for Ofcom to require BT to reimburse the CPSOs in dispute for any adjustment in the CPS set-up charge from 28 November 2003.<sup>7</sup>
- 2.14 C&W argued that requiring BT to make payments to CPSOs for overpayments since 28 November 2003 would:
- a) promote competition in the provision of retail fixed line telephone calls (in line with Ofcom's duty set out in section 4(3)(a) of the 2003 Act;
  - b) promote competition in the provision of electronic communications services; and
  - c) encourage the provision of network access and service interoperability (in line with sections 4(7) and 4(8)(a) of the 2003 Act).
- 2.15 C&W noted, referring to two recent disputes, that:
- “There is also precedent for Ofcom ordering reimbursement where BT's charges have not been cost-oriented.”<sup>8</sup>
- 2.16 C&W noted that Ofcom argued in its resolution of the 2006 WLR ISDN2 charges dispute that requiring BT to repay overpayments, in that case, encouraged BT to comply with SMP obligations imposed under the Market Review to promote competition.

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<sup>6</sup> Paragraph 2.56 of C&W's submission.

<sup>7</sup> This reference is taken from paragraph 178 of the CAT's TRD core issues judgment which states that “Ofcom must have regard to what is fair as between the parties and what is reasonable from the point of view of the regulatory objectives set out in the Common Regulatory Framework Directives and in the 2003 Act.” See section 5 below.

<sup>8</sup> Paragraph 2.62 of C&W's submission.

- 2.17 C&W submitted that given the representations made by stakeholders at the time of Ofcom's August 2005 Direction and Ofcom's commitment to consider this issue in the review of charges originally planned for 2006:

"it would be unreasonable for BT to claim to have any expectation that a retrospective adjustment would not at some point be made to rectify its overcharging and to reimburse CPS customers."<sup>9</sup>

- 2.18 C&W noted that "CPSOs met with Ofcom during the review [that led to the August 2005 Direction] and both during those meetings and in written submissions challenged the inclusion of BT Retail costs in the cost stack."<sup>10</sup>

- 2.19 C&W stated that it did not challenge Ofcom's decision not to address the issue of retail cost recovery in the August 2005 Direction "given Ofcom's commitment to address the issue via its proposed 2006 review of CPS charges".

- 2.20 C&W asked Ofcom to order BT to pay interest on any repayments to CPSOs.<sup>11</sup>

### **Arguments on the repayment date: BT's comments on C&W's submission**

- 2.21 In its initial comments on C&W's submission, BT argued that Ofcom should consider the CPS set-up charge from 1 November 2007 only:

"BT [...] does not agree that the scope of the dispute should cover the recovery of the costs related to sending out a [notification] of transfer letter and to inbound customer calls from 28 November 2003. The CPS per-customer line transaction charges, together with the other CPS charges, were set by Ofcom in August 2005 by means of [the 2005 statement] following an extensive review. Having set those charges as of the date of publication of the Determination, Ofcom deferred future consideration of the charges for a further review in 2006. This review never happened, so the CPS per customer line transaction charges remained effective as set by Ofcom in its [August 2005 Direction]. No CPS Operator questioned this decision, or exercised their right to raise an appeal against the charges set by Ofcom. As such the prices set by Ofcom were legally binding until BT carried out a review in 2007. The revised charges for CPS transactions became effective on 1 November 2007. It was after this date that discussions between the named parties and BT began. As a result it is only from this date that CPS charges can be subject to an investigation of the type requested by the CPSOs in dispute. Therefore the scope of the dispute should only examine whether BT's CPS transaction charges effective from

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<sup>9</sup> Paragraph 2.61 of C&W's submission.

<sup>10</sup> Paragraph 2.17 of C&W's submission.

<sup>11</sup> Paragraph 2.56 of C&W's submission and letter from Claire Robinson (C&W) to Louise Marriage (Ofcom), 23 October 2008.

1 November 2007 onwards should cover these two cost components.”<sup>12</sup>

2.22 BT went on to note that:

“the fact that by means of further regulatory intervention the August 2005 charges became applicable as of an earlier date does not have any bearing on whether the complainants or Ofcom can lawfully open an investigation into the August 2005 charges today.”<sup>13</sup>

2.23 Ofcom asked BT to set out in more detail its position as set out in paragraphs 0-0 above, notably its statement (see paragraph 0 above) that the charges set by Ofcom were legally binding until BT’s review. BT set out its position as requested in its letter to Ofcom of 20 November 2008. Referring to the Competition Appeal Tribunal Rules, BT concluded that:

“a decision that has not been appealed, cannot subsequently be reversed by either the parties or Ofcom in relation to the period, the parties and the matter it has decided upon...

“No-one appealed the [August 2005 Direction] and as a result the [August 2005 Direction] binds the parties and Ofcom for the period and on the matter it has decided upon.”<sup>14</sup>

2.24 BT went on to note Ofcom’s statement in the statement accompanying the August 2005 Direction that it intended to review charges again in 2006, and argued that setting charges in the context of such a review could be forward looking only:

“Ofcom said that the reason for [its decision not to address the retail cost recovery issue in 2005] was that it found more appropriate to consider the inclusion of these costs only in the future as part of a Market Review, which is by virtue of the Act forward looking only, and not as part of the dispute resolution at hand that looked into the past.”<sup>15</sup>

### **The Draft Determination: Ofcom’s proposals on the repayment date**

2.25 Having assessed the submissions of the parties and the evidence it gathered in considering the dispute, Ofcom’s provisional conclusion on the date from which its determination on the first two issues in dispute should apply and the issue of repayments was that its determination of the first two issues in dispute should apply from 1 November 2007 and that it would be proportionate and reasonable as between the parties to require BT to pay to the CPSOs a sum by way of an adjustment for the overpayment of the CPS set-up charge from 1 November 2007 to the date of Ofcom’s final determination, to include interest at standard contract rates.

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<sup>12</sup> Letter from BT to Ofcom 2 November 2008.

<sup>13</sup> *Ibid.*

<sup>14</sup> Letter from BT to Ofcom, 20 November 2008.

<sup>15</sup> Letter from BT to Ofcom, 20 November 2008.

- 2.26 On 30 December 2008 Ofcom issued to each of the parties in dispute and to a party that asked to be considered as an interested party a non-confidential version of the Draft Determination.
- 2.27 On 6 January 2009 Ofcom published the Draft Determination on its website.<sup>16</sup> Ofcom asked for comments from all stakeholders by close of business on 16 January 2009. Ofcom received six responses.

### **Responses to the Draft Determination: BT's comments on the repayment date**

- 2.28 BT stated that it "has been recovering these costs in good faith" and that:
- "BT had no reason to foresee Ofcom's present decision and we therefore disagree that Ofcom's reasoning on regulatory certainty is persuasive for the period from 28 November 2003 to 31 October 2007 but it is less persuasive for the period from 1 November 2007 to the publication date of this determination".

### **The August 2005 Direction**

- 2.29 BT suggested that:
- "we do not agree that Ofcom's statement in the August 2005 Direction that it would review the issue of retail cost-recovery should have signalled to BT that the outcome of this review would not favour the inclusion of the disputed costs".
- 2.30 BT stated that:
- "If a further review of the CPS costs had indeed taken place in 2006 as Ofcom planned, then there was no indication in the 2005 Direction as to which way the decision would have been made"
- 2.31 In response to Ofcom's comment (see paragraph 5.98 of the Draft Determination) that in light of stakeholders' responses to the consultation that led to the August 2005 Direction, BT should have reconsidered the assumptions used when it came to review its charges in 2008, BT stated that:
- "Whilst we always consider customers' feedback, [...] we firmly believe the charges were to be valid, so there was no reason to change this opinion when reviewing the costs in 2007".
- 2.32 BT noted that "Ofcom acknowledges [...] that the issue of retail cost recovery was not discussed by CPSOs and BT between August 2005 and early 2008, so it was hardly a burning issue with industry. This reinforces in our mind that the stakeholders' responses in August 2005 should not be relied upon to justify a direction to BT to make refund payments since November 2007."

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<sup>16</sup> [http://www.ofcom.org.uk/bulletins/comp\\_bull\\_index/comp\\_bull\\_ocases/open\\_all/cw\\_999/](http://www.ofcom.org.uk/bulletins/comp_bull_index/comp_bull_ocases/open_all/cw_999/).

## The WLR Statement

2.33 BT stated that:

“In fact Ofcom said in the WLR January 2006 decision that it had removed sales and marketing costs from the WLR costs stack. The disputed CPS costs are not related to sales and marketing activities”.

2.34 BT concluded that it “had no reason to interpret the WLR January 2006 decision as a signal that Ofcom took a particular view on the recovery of the retail costs”.

## Responses to the Draft Determination: the CPSOs' comments

2.35 C&W questioned Ofcom's statement at paragraph 5.88 of the Draft Determination that:

“Ofcom has not identified any specific ‘step change’ in the market on or since 28 November 2003 [...] which would have necessitated or justified a change in cost recovery arrangements.”

2.36 C&W argued that:

“there are at least three points between (and including) 28 November 2003 which could be considered ‘step changes’ to the same or greater extent that 1 November 2007 can be considered such a change:

- 28 November 2003: date from which revised CPS charges, as determined by Ofcom's August 2005 review, were applied
- 26 May 2005: Application of GC14.5
- 18 August 2005: Ofcom Direction on CPS charges”

## 28 November 2003

2.37 C&W considered that 28 November 2003 is the “most relevant” of the dates it proposes as “step changes” in the market. C&W noted that Ofcom's August 2005 Direction was “at least as significant a change as the price changes that came into effect on 1 November 2003” and that Ofcom subsequently required BT to apply the changes set in the August 2005 Direction to 28 November 2003. C&W concluded that “as such, this must be the logical date from which Ofcom's current determination is applied”.

2.38 Another respondent argued that 23 November 2003 has always been “the rather logical focal point in the negotiations between CPSOs and BT” as it is the date on which Ofcom introduced the SMP conditions on BT as a result of the Market Review.

2.39 UKCTA considered that:

“as Ofcom (through the dispute [...] brought by Opal) required BT to backdate the CPS charges set out in the August 2005 Direction to 28 November 2003, it must be a fair and reasonable outcome to backdate the revised CPS set-up charge in this dispute to the same date”.

2.40 Another respondent suggested that “Using the same logic as in [the Opal determination], if one strips out the retail costs from the CPS cost stack, the break-even date would also be 28 November 2003”.

2.41 C&W questioned Ofcom’s suggestion<sup>17</sup> that “had it considered the issue of retail costs at the time of the August 2005 review, it may have reached a different conclusion”, on the basis that “all the reasons that justify why BT is not entitled to recover these costs were as true in 2005 as they are today.” C&W also suggests that:

“it is reasonable to assume therefore that had Ofcom considered the issue of retail costs at that time [2005] and concluded that BT was not entitled to recover these costs, CPSOs would have benefited from repayment back to 28 November 2003 without recourse to a (further) formal dispute”.

## 25 May 2005

2.42 C&W noted that the introduction of GC14.5 (on 25 May 2005) might also be considered a step change, as it placed all providers of retail telecommunications services to consumers on the same footing. C&W states however that it considers the arguments for 28 November 2003 to be “more persuasive” than those for the date that GC14.5 was introduced.

## Developments following the August 2005 Direction

2.43 C&W stated that CPSOs “believed their concerns would be addressed without the need to challenge the [August 2005] Direction”, as a result of Ofcom’s statement that it would undertake a further review of CPS charges in 2006.

2.44 C&W stated that “It is inappropriate for Ofcom to infer that the lack of any challenge by CPSOs [in 2005] suggest an acceptance of the status quo”. Verizon Business made a similar comment that “This does not mean that the CPSOs accepted the practice of retail recovery by BT, just that the anticipated mechanism to address the issue never materialised”.

2.45 UKCTA considered that the fact no-one challenged the 2005 Direction is “irrelevant” since BT is still required to comply with its regulatory obligations. Global Crossing states that the absence of any challenge to the August 2005 Direction (particularly since Ofcom did not go ahead with its planned 2006 review) was “not in our view sufficient reason to determine that a date of November 2007 would be reasonable”.

2.46 Another respondent argued that it should be obvious to Ofcom that the reason the 2005 Direction was not challenged was because Ofcom had

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<sup>17</sup> See for example paragraph 5.91 of the Draft Determination.

committed to carry out a review of CPS charges (and specifically to address the issue of retail cost recovery) in 2006.

2.47 C&W stated that:

“it is not clear that Ofcom ever formally advised industry that it was not going to conduct a further review of CPS charges, making it difficult for CPSOs to challenge this change in ‘administrative priorities’.”

2.48 C&W stated that “further discussion with BT would have been inappropriate” in light of Ofcom’s assurance that the issue would be dealt with as part of the review originally planned for 2006.

2.49 C&W stated that BT’s indication to CPSOs in the summer of 2007 that it was going to conduct its own review “again left CPSOs in limbo on the issue of challenging the charges”. Another respondent states that, after the 2005 Direction, the next opportunity for CPSOs to raise the issue was BT’s introduction of new charges from 1 November 2007.

### **1 November 2007**

2.50 C&W questioned Ofcom’s statement at paragraph 5.92 of the Draft Determination that:

“Given that Ofcom set the CPS charges in its 2005 Direction, Ofcom considers that it was reasonable for BT to continue to recover retail costs, subject always to its ongoing obligation to comply with its SMP Conditions.

2.51 C&W considered that Ofcom’s statements elsewhere in the Draft Determination contradict this statement:

- paragraph 5.92, where Ofcom states that BT was not entitled to assume that the charges set in 2005 would apply until Ofcom made a further Direction
- paragraph 5.96, where Ofcom states that BT could not assume that the 2006 review, had it taken place, would have determined that BT was entitled to recover the retail costs;
- paragraph 5.98, where Ofcom states that in light of clear signals that the issue of cost recovery would be addressed at some point, BT should have taken this into account in setting new charges; and
- paragraph 5.101, where Ofcom notes that, contrary to statements made by BT, the 2005 Direction did not expressly state that it was reasonable for BT to recover the retail costs.

### **Effect of Ofcom’s proposal to require repayments to 1 November 2007**

2.52 C&W questioned Ofcom’s proposal:

“that BT can retain this significant over-recovery for four of the five years in dispute, on the basis of ‘what is fair and reasonable as between the parties’.”

2.53 Verizon Business echoed these comments, stating that:

“As Ofcom have determined that BT is not entitled to recover the referenced costs, then surely the over recovery should be repaid in full”.

2.54 C&W considered that Ofcom’s proposed determination would “[send] clear signals to BT that it is acceptable – and indeed, commercially prudent – as the likelihood is that they will get to ‘keep the cash’”. This view is echoed by another respondent, who considers that Ofcom’s proposed determination “in effect allows BT to “keep the proceeds of the crime” – hardly any incentive to discourage them in future”, and that:

“by failing to require BT to remedy the consequences of its breach Ofcom would leave CPS operators to bear the financial loss of BT’s illegal actions and effectively set a future policy which says it is acceptable to breach regulatory obligations unless or until challenged.”

2.55 C&W did not accept that requiring BT to make repayments from 1 November 2007 is in line with Ofcom’s statutory objectives, which “can only be met if any non-compliance issue is rectified in full”.

2.56 UKCTA and Verizon Business make similar comments, Verizon Business suggesting that:

“..surely Ofcom’s prime duty is to uphold the regulatory framework and ensure compliance is maintained by all operators; this to promote competition and benefit consumers. If the draft decision stands, then Ofcom will have undermined the regulatory certainty they strive to create, which can only have a detrimental effect on competition and ultimately consumers.”

2.57 UKCTA stated that, by contrast, requiring BT to make repayments from 28 November 2003 “would provide a strong incentive on BT to actively seek to comply with its regulatory obligations at all times. Unlike Ofcom’s proposal, such an outcome would thereby promote effective competition in this market”. Global Crossing states that it fully supports UKCTA’s submission on this point and states that it considers the “most equitable” outcome would be “one which restored in full the financial equilibrium since the date of the breach”.

2.58 C&W considered that contrary to Ofcom’s statement that its draft determination promotes regulatory certainty (paragraph 5.92 of the Draft Determination), “allowing BT to ignore its SMP obligations creates massive uncertainty for the rest of industry”.

## Ofcom's analysis and proposed determination on the repayment date

- 2.59 In the Timing Consultation, Ofcom responded to the comments made by stakeholders in their responses to the Draft Determination on the issue of the date from which its determination should apply, and the question of repayments (if any) as follows<sup>18</sup>.
- 2.60 Ofcom highlighted that in the Draft Determination, it had considered a number of possible dates and proposed that BT should be required to make repayments from 1 November 2007.
- 2.61 Ofcom noted that:
- a) BT had argued that Ofcom's position on recovery of the retail costs had not been made clear to it or to industry previously;
  - b) C&W had argued that it should always have been clear to BT that it was not entitled to recover retail costs through the CPS set-up charge. C&W had not identified any clear statement by Ofcom (to BT or industry) on this matter. Rather, it recognised, as does Ofcom, that Ofcom had proposed to carry out a review of CPS charges that would address the issue of the retail costs. Ofcom did not carry out its planned review, as a result of an internal review of its administrative priorities.
- 2.62 In light of stakeholders' responses to the Draft Determination and previous Ofcom statements relevant to recovery of the retail costs, Ofcom proposed that its determination of the dispute would apply on a forward-looking basis only.
- 2.63 Ofcom set out its reasoning for this proposal at paragraphs 7.33--7.42 of the Timing Consultation which are repeated at paragraphs 0-0 below:
- 2.64 BT is subject to SMP Condition AA8 (which implements the requirements of the Universal Service Directive, specifically, the requirement that pricing for the provision of CPS is cost oriented).
- 2.65 SMP Condition AA8.4 defines what BT, as the dominant provider, has to do to ensure that its charges for CPS are cost oriented. The specific requirement in SMP Condition AA8.4 is that the charges for CPS shall be based on the long-run incremental costs of providing CPS facilities.
- 2.66 The first element of this dispute was to determine whether it was appropriate for BT to recover the retail costs. While Ofcom's analysis of this point drew on the provisions in SMP Condition AA8, it was not necessary, in reaching a view, to establish whether or not the retail costs were reflective of BT's long run incremental cost – Ofcom's focus in resolving the first element of this dispute was on whether the disputed costs constituted a cost of providing CPS facilities (such that they should be included in the CPS cost stack).
- 2.67 In considering the date from which the CPS charge should be reduced (having found that the disputed costs were not costs of providing CPS

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<sup>18</sup> The text that follows is taken directly from the Timing Consultation and references are to paragraphs and tables in the Timing Consultation not this document.

facilities), Ofcom examined at what point BT could reasonably be expected to know that the retail costs in its cost stack were not costs of providing CPS facilities.

- 2.68 When SMP Condition AA8 was introduced in 2003, Ofcom did not give any guidance (in the Market Review) as to how it would interpret SMP Condition AA8 in relation to the recovery of the retail costs. It is therefore Ofcom's view that, at this time, BT could not reasonably be expected to know that the retail costs were not costs of providing CPS facilities under SMP Condition AA8.
- 2.69 In the August 2005 Direction, Ofcom set BT's charges for CPS. The disputed retail costs were included in the cost stack used to set those charges. Although Ofcom stated that it was appropriate for it to consider stakeholders' concerns in relation to the retail costs in its planned 2006 review of CPS charges, it did not indicate what the result of this review might be. In Ofcom's view, the August 2005 Direction did not indicate to BT that the retail costs were not costs of providing CPS under SMP Condition AA8.
- 2.70 On 24 January 2006, Ofcom published the statement *Reviewing and setting the charge ceilings for WLR services* ("the WLR Statement")<sup>19</sup>. The cost stack that Ofcom used to calculate the charges set out in the WLR Statement did not include any end user costs. In particular, it did not include the equivalent of the disputed retail costs that are the subject of this dispute, which are incurred by BT and other providers for WLR transfers in the same way that they are for CPS transfers (the consumer protection mechanism for WLR and CPS is the same). However, Ofcom did not expressly state in the WLR Statement that BT should similarly remove end user costs, including the disputed retail costs in this case, from the CPS cost stack. While the WLR Statement may have suggested to BT that Ofcom would at some point adopt a similar decision in relation to CPS, Ofcom does not consider that the WLR Statement alone was sufficient to move the burden of reassessing the CPS cost stack (and removing the retail costs) from Ofcom onto BT.
- 2.71 Further, Ofcom's determination of the Opal dispute on 16 May 2006 was based on the charges set by Ofcom in the August 2005 Direction, and Ofcom did not make any statement at this time to suggest that the retail costs should be removed from the CPS charges, in line with the position taken by Ofcom in the WLR Statement. At the end of 2006, Ofcom had not carried out its planned review of CPS charges due to an internal review of its administrative priorities. Therefore, by the end of 2006, Ofcom had not made any statement that would have indicated to BT that the retail costs were not costs of providing CPS facilities under SMP Condition AA8 and that BT should therefore remove them from the CPS cost stack.
- 2.72 Based on a review of statements made by Ofcom between 28 November 2003 and the date of the Timing Consultation, Ofcom found that by 1 November 2007, when BT changed its CPS charges, Ofcom had not indicated with sufficient clarity to BT that it was not reasonable for it to include the disputed retail costs in the CPS cost stack. While the WLR Statement, and Ofcom's commitment to review the inclusion of the retail costs in its planned 2006 review, could be interpreted as suggesting that Ofcom would at some point conclude that BT was not entitled to recover the

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<sup>19</sup> *Wholesale Line Rental: Reviewing and setting charge ceilings for WLR services*, <http://www.ofcom.org.uk/consult/condocs/wlrcharge/statement/statement.pdf>

retail costs from CPSOs, Ofcom's view set out in the Timing Consultation was that these statements together were insufficient for us to conclude that it would have been reasonable to expect BT proactively to remove the retail costs from the CPS cost stack when it came to review its CPS charges in November 2007. Further, Ofcom has not made any statements between 1 November 2007 and the date of the Draft Determination that would have given BT any further clarification regarding this issue.

- 2.73 Based on the analysis above, Ofcom proposed in the Timing Consultation to conclude that its determination of this dispute would apply on a forward-looking basis only. Ofcom invited any further comments on its proposal by 5pm, Friday 27 February 2009.

### **Date of application of Ofcom's Determination – stakeholders' comments**

- 2.74 Ofcom went on (at paragraphs 7.44 -7.64 of the Timing Consultation) to consider the dates suggested by the respondents, their comments on Ofcom's proposal as set out in the Draft Determination, and Ofcom's views on those comments. This is set out below:

### **Alternative dates proposed by C&W**

- 2.75 Ofcom acknowledged (see paragraph 5.89 of the Draft Determination) that it stated that in resolving this dispute one option would be to order repayments from 28 November 2003. One respondent noted that 28 November 2003 is the "logical starting point", being the date that SMP Condition AA8 came into effect (as also noted by C&W in its original submission).
- 2.76 Ofcom considered that the fact that the relevant SMP Condition came into effect on this date was in itself insufficient to establish that it is appropriate to require BT to make repayments from this date. The Market Review did not include any guidance as to how Ofcom would interpret SMP Condition AA8 in relation to the recovery of the retail costs. In the absence of any indication from Ofcom that it was not reasonable for BT to recover the retail costs as at 28 November 2003, it would not therefore be fair to BT to require it to make repayments to the CPSOs from this date. This is supported by the fact that Ofcom's binding August 2005 Direction set charges at a level that enabled BT to recover the retail costs.
- 2.77 C&W, UKCTA and another respondent argued for 28 November 2003 on the basis that the charges set in the August 2005 Direction were subsequently backdated to 28 November 2003 as a result of Ofcom's determination of the Opal dispute, and that Ofcom should therefore apply the same logic in this case as it did in resolving the Opal dispute.
- 2.78 As set out at paragraphs 5.74-5.77 of the Draft Determination, the methodology used in determining the appropriate repayment date in the Opal dispute is not appropriate in this case. In the Opal dispute, Ofcom was concerned with identifying a point at which BT "broke even" and recovered its costs (calculated on the basis of underlying transaction volumes). Here, there is no "break even" point, and the same logic cannot therefore be applied in this dispute. Ofcom did not provide any guidance in the Market Review as to how it would interpret SMP Condition AA8 in relation to the recovery of the retail costs, and so it is not appropriate to require BT to make

repayments to 28 November 2003. Ofcom did not, in the Opal dispute, require BT to remove the retail costs from the CPS cost stack.

- 2.79 Ofcom further set out its view that it did not agree with C&W's suggestion that it is "reasonable to assume" that, had Ofcom considered the issue of retail cost recovery in 2005 and reached the conclusion that BT was not entitled to recover the retail costs, it would have required BT to make repayments to 28 November 2003. Ofcom did not consider the issue in 2005, and had it done so it may well have reached the same view that it has in this dispute, i.e. that it is not reasonable to require BT to make repayments to 28 November 2003 because at that time Ofcom had not provided guidance as to how it would interpret SMP Condition AA8 in relation to the recovery of the retail costs.
- 2.80 C&W further mentioned 25 May 2005, which was when GC14.5 came into effect, as a possible date for repayments. Ofcom set out its view that it does not consider that it is appropriate to require BT to make repayments from 25 May 2005, as Ofcom did not provide any guidance at this time as to how it expected BT to apply SMP Condition AA8 in relation to the recovery of the retail costs.

### **The August 2005 Direction**

- 2.81 While C&W mentioned 18 August 2005, the date of the August 2005 Direction, as one "step change" in the period under consideration, it does not appear to be arguing that Ofcom should consider requiring BT to make repayments from this date. However, the August 2005 Direction did not indicate to BT that the retail costs were not costs of providing CPS facilities under SMP Condition AA8. Ofcom therefore set out its view that it is not appropriate to require BT to make repayments from 18 August 2005.
- 2.82 BT argued that Ofcom's comments in the August 2005 Direction on recovery of the retail costs, and Ofcom's commitment to review CPS charges in 2006, did not suggest to BT that, had such a review taken place, Ofcom would have determined in 2006 that BT was not entitled to recover the retail costs from CPSOs.
- 2.83 Ofcom acknowledged that it did not, in the August 2005 Direction, take a view on whether or not BT was entitled to recover the retail costs from CPSOs. In light of the fact that the August 2005 Direction set BT's CPS charges at a level that enabled BT to recover the retail costs through the CPS set-up charge, Ofcom considered (as argued at paragraph 5.92 of the Draft Determination) it was reasonable for BT to continue to recover the retail costs through the CPS set-up charge following the 2005 Direction.
- 2.84 While C&W questioned this interpretation, Ofcom set out its view that it does not consider that the other statements in the Draft Determination that C&W has highlighted (see C&W's comments at paragraph 0 above) suggest that BT should have been expected to foresee the conclusions that Ofcom has reached in considering this dispute.
- 2.85 Ofcom's statements in the 2005 Direction put BT on notice that Ofcom intended to consider this issue at some point in the future, and that Ofcom might at some point change the approach it had adopted in the August 2005 Direction. As set out at paragraph 5.92 of the Draft Determination, BT could

not assume that the charges set in 2005 would apply until Ofcom made a further Direction. Ofcom therefore considered that it was consistent with BT's SMP obligations for it to review its CPS charges. However, the comments made by Ofcom in the August 2005 Direction, on their own, were insufficient to have indicated that BT should have changed its approach to cost recovery and excluded the retail costs from the CPS cost stack when it came to review its charges in 2007.

### **The January 2006 WLR statement**

- 2.86 BT noted that in the WLR Statement Ofcom removed BT's sales and marketing costs from the WLR cost stack. BT submitted that since the retail costs are not sales and marketing costs, it could not have inferred from the WLR Statement that it was not entitled to recover the retail costs through the CPS set-up charge.
- 2.87 At paragraphs 3.64-3.66 of the WLR Statement, Ofcom stated that it had used the costs of BT's PSTN takeover activity as a starting point for estimating the reasonable cost of analogue WLR migrations, as the two activities were similar. As part of this exercise, Ofcom considered that it was not appropriate to include all of BT's costs in the cost stack for WLR charges, and excluded all costs associated with serving end users – not only sales and marketing costs, but also the costs of the notification of transfer letter and inbound calls. The fact that the retail costs are not sales and marketing costs is therefore irrelevant.
- 2.88 Ofcom set out its view that while it considers that the WLR Statement acted as a signal to BT that Ofcom would take the same approach to the retail costs when it came to review CPS charges, it did not expressly state that Ofcom would take a similar approach to the retail costs in the CPS cost stack. Ofcom did not therefore consider that the WLR Statement alone was sufficient to move the burden of reassessing the CPS cost stack (and removing the retail costs) from Ofcom onto BT.

### **Developments following the August 2005 Direction**

- 2.89 C&W questioned Ofcom's statement that, had it considered the issue of retail cost recovery in 2005, it might have reached a different view, as "all the reasons that justify why BT is not entitled to recover these costs were as true in 2005 as they are today." Ofcom set out its view that while this may be true, the fact remained that Ofcom had not until this dispute, reviewed the inclusion of the retail costs in the CPS cost stack or made any clear statement as to whether BT is entitled under SMP Condition AA8 to recover the retail costs from CPSOs.
- 2.90 Ofcom did not dispute C&W's explanation that it did not challenge the August 2005 Direction because Ofcom had committed to carrying out a review of CPS charges in 2006. In response to a comment by Global Crossing, Ofcom clarified that it was not arguing in the Draft Determination that the absence of a challenge to the August 2005 Direction was, in itself "sufficient reason to determine that a date of November 2007 would be reasonable".
- 2.91 Nevertheless, Ofcom set out its view that none of the parties to this dispute could infer from the August 2005 Direction that Ofcom's planned 2006

review of CPS charges would conclude that BT was not entitled to recover the retail costs. It was still open to C&W and the other parties to the dispute to exercise their right to challenge the August 2005 Direction.

- 2.92 Ofcom acknowledged that it did not formally notify the parties of the review of its administrative priorities that led to the cancellation of the planned 2006 review of CPS charges. However, Ofcom set out its view that it does not agree with C&W and others that CPSOs had no further opportunity to raise the issue until BT introduced new charges and were therefore “in limbo” until BT announced those new charges on 10 December 2007. C&W or any other party could have brought the issue to Ofcom formally at any time.

### **1 November 2007**

- 2.93 Ofcom went on to set out that in the absence of any challenge to the August 2005 Direction or further discussion between the parties of recovery of the retail costs, the next step change after the WLR Statement that is relevant for resolving this dispute was on 1 November 2007, when the revised CPS set-up charge (announced by BT on 10 December 2007 but applied with retrospective effect) came into effect. Ofcom explained that the Opal dispute (which concluded in May 2006) is not a relevant precedent for Ofcom’s consideration of this dispute, and the date at which Ofcom resolved the Opal dispute is not therefore a relevant benchmark.
- 2.94 By this time, BT was aware that stakeholders had concerns with BT’s recovery of the retail costs and that Ofcom had acknowledged those concerns and undertaken to review CPS charges. In the meantime, Ofcom had also set new charges for WLR that did not enable BT to recover the retail costs through WLR charges. Ofcom explained that it therefore remained of the view, as set out at paragraph 5.98 of the Draft Determination, that BT should have reconsidered the assumptions it used in setting new CPS charges in 2007.
- 2.95 However, Ofcom went on to explain that it accepted that the statements made in the August 2005 Direction and the WLR Statement were insufficient to have suggested to BT, in the absence of any further discussion with the industry and Ofcom, that it should have removed the retail costs from the CPS cost stack.

### **Responses to the timing consultation**

- 3.1 Ofcom received five responses to the Timing Consultation, from:
- BT;
  - C&W;
  - UKCTA;
  - Verizon Business; and
  - another respondent who asked not to be named.

- 3.2 In addition, Ofcom's case team met C&W and other parties to the dispute on 24 February 2009 to discuss their views in advance of written submissions.
- 3.3 Comments from respondents other than BT are set out at paragraphs 0-0 below. BT's comments are set out at paragraphs 0-0 below.

### **Comments from respondents other than BT**

- 3.4 With the exception of BT, none of the respondents to the Timing Consultation supported Ofcom's proposal that BT is not required to make repayments to CPSOs. C&W, Verizon Business and the respondent who asked not to be named all submit that BT should be required to make repayments to CPSOs from 28 November 2003.
- 3.5 Respondents' comments can be separated into three broad areas. First, they argue, Ofcom has used an inappropriate test to determine that BT is not required to make repayments. In any case, BT should have been aware that it was not entitled to recover the disputed costs. BT is also subject to a no undue discrimination obligation that is relevant to Ofcom's consideration of this dispute.
- 3.6 Second, they argue that Ofcom's approach is inconsistent with the approach taken in other disputes. Two respondents provide details of specific disputes that, they submit, suggest Ofcom's proposed approach here is inappropriate.
- 3.7 Third, they suggest that Ofcom's proposal not to require repayments has wider implications, and that Ofcom's Determination is inconsistent with Ofcom's statutory obligations and regulatory principles.
- 3.8 These three broad issues are discussed in turn in the following paragraphs.

### **Ofcom has used an inappropriate test to determine that BT is not required to make repayments**

- 3.9 C&W states that it does not consider Ofcom's approach to be "legitimate":
- "BT has a positive obligation to comply with its SMP Conditions...This obligation cannot be set-aside on the excuse that Ofcom hadn't provided any clear guidance on the treatment of the retail costs in question. It exists as a positive obligation on BT regardless".
- 3.10 UKCTA comments that:
- "BT has a positive obligation to comply with all its SMP Conditions, which is not reliant on it having regulatory clarity on how those Conditions should be discharged [...] Where there is ambiguity, it must be incumbent on BT to either seek clarification from the regulator, or accept the risk that its approach may be successfully challenged at a later date."
- 3.11 Another respondent, who asked not to be named, submits that "Ofcom has misconstrued or misinterpreted BT's regulatory obligation to offer CPS at cost-oriented prices" and that:

“it is inaccurate to interpret the SMP Conditions, as Ofcom appears to do, to only require BT to adjust its CPS charges as and when Ofcom explicitly requires it to do so”.

3.12 The respondent notes that SMP Condition AA3.1 provides that BT shall:

“secure, and shall be able to demonstrate to the satisfaction of the Director, that each and every charge offered, payable or proposed for Network Access [...] is reasonably derived from the costs of provision based on a forward looking long-run incremental cost approach and allowing an appropriate mark up for the recovery of common costs including an appropriate return on capital employed.”

3.13 The respondent concludes that:

“[the SMP Conditions] impose on BT a specific responsibility to ensure that its charges are reasonably derived from cost. In other words, the burden of proof lies firmly with BT to show that its CPS charges are duly cost-oriented”.

3.14 The respondent suggests that:

“where BT becomes sufficiently aware that there is a concern that one of its charges is not so cost-oriented, it must take reasonable steps to achieve clarity for instance by seeking views from Ofcom”.

In any case, BT should have been aware that it was not entitled to recover the disputed costs

3.15 C&W submits that, even if Ofcom’s approach did have merit:

“we don’t accept Ofcom’s assertion that BT couldn’t have known it was breaching its SMP Conditions before this current dispute”.

3.16 C&W notes that Ofcom made a number of decisions on charges for other products “that should have flagged the CPS anomaly” as early as 2002, when Ofcom first set charges for WLR that, C&W submits, “clearly did not include any element for the retail costs that arise from the provision of WLR”, although the same transfer process applies to both products. C&W submits that:

“even if the linkage to the CPS situation wasn’t explicit, a prudent operator would have recognised the link and sought to clarify the implications for other products”.

3.17 C&W adds that BT’s SMP obligations to provide CPS and WLR arise from the same Market Review and there is a “clear association” between CPS and WLR.

3.18 C&W argues that in any case Ofcom did not give BT “positive signalling in the [August 2005 Direction] that they could continue to recover these costs”, as Ofcom “clearly signalled [in the August 2005 Direction] that it **hadn’t**

reached a definitive view on the inclusion of retail costs in the wholesale charges” (C&W’s emphasis).<sup>20</sup>

- 3.19 The respondent who asked not to be named submits that “there can be little doubt that BT was aware of the concerns expressed by CPS operators over the inappropriateness of including BT retail costs in the charge” and like C&W, argues that Ofcom’s August 2005 Direction “did not say that retail costs could be included in the CPS set-up charge”. The respondent also notes that in 2006 (in the WLR statement) Ofcom “explicitly ruled that retail costs could not be included in the directly related WLR set-up charge”.<sup>21</sup> The respondent argues that BT should therefore have “remove[d] the retail costs and then [sought] urgent clarification from Ofcom as to whether retail costs could be lawfully included”.

### BT is also subject to a no undue discrimination obligation

- 3.20 C&W notes that BT is subject to a requirement not to unduly discriminate (SMP Condition AA2) as well as an SMP Condition setting the basis of its CPS charges (SMP Condition AA8). C&W argues that BT:

“has always been aware that it was the only operator recovering the costs of its retail activities from other operators. By definition this must be considered discrimination and given the magnitude of this element of its recovery [...] BT should have recognised that this would constitute undue discrimination”.

- 3.21 C&W argues that:

“This situation has existed since before the 2003 Market Review that set the current SMP Conditions, so BT should have been cognisant of this breach from Day 1 of the new Conditions, i.e. 28 November 2003. Should Ofcom continue to rely on its proposed ‘test’ in concluding this dispute, then that must lead it to conclude that BT should repay the overcharges back to 28 November 2003 on this basis.”

- 3.22 C&W states that:

“we believe that the undue discrimination point highlighted above is of itself sufficient evidence to change Ofcom’s position.”

- 3.23 UKCTA also notes that BT is subject to a requirement not to unduly discriminate in relation to CPS, as well as a cost orientation obligation.

- 3.24 [§<]

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<sup>20</sup> *Per-provider and per customer line costs and charges for Carrier Pre-selection* (“the August 2005 Direction”), 18 August 2005, published at <http://www.ofcom.org.uk/consult/condocs/carrier/statement>.

<sup>21</sup> See *Reviewing and setting the charge ceilings for WLR services* (“the WLR Statement”) 24 January 2006, published at <http://www.ofcom.org.uk/consult/condocs/wlrcharge/statement/statement.pdf>.

## Ofcom's approach is inconsistent with the approach taken in other disputes

3.25 UKCTA submits that Ofcom's approach in this dispute:

“changes a fundamental principle on which regulation is based, that where an SMP operator has breached its SMP obligations, it will be required to remedy that breach in full”.

3.26 UKCTA notes other respondents' submissions on previous disputes that “demonstrate how Ofcom's current approach differs from that adopted in previous cases”.

3.27 One respondent, who asked not to be named, argues that “Ofcom's proposal contradicts current regulatory practice around retrospection” in relation to repayments. The same respondent submits that:

“There is in our view an established practice [...] according to which any revised regulated charges can be backdated to a previous period regardless of whether the regulated operator, at the time the charge was originally set, would have known that a particular cost item could not be included.

“This practice has been established through several disputes over the years in which the regulated operator has been required to revise its charges downwards to comply with new requirements around cost-orientation, new methodologies to assess appropriate cost recovery and new approaches to cost calculation whereby specific cost items have been excluded from calculations.”

3.28 The respondent refers to a number of cases it suggests are “examples of where Ofcom/Oftel/Competition Appeal Tribunal have backdated determined interconnection charges without any previous indication to the regulated operator that the original charges were too high or otherwise included inappropriate cost items”:

- the Director's determination of a dispute about the NTS retail uplift (referred to below as “the NTS retail uplift dispute”),<sup>22</sup>
- the Director's determination of a dispute between BT and C&W concerning the level of the Premium Rate Services (PRS) bad debt surcharge within the NTS formula (referred to below as “the PRS bad debt surcharge dispute”);<sup>23</sup>
- Ofcom's determination of a dispute between BT and others about payments to terminating communications providers (TCPs) for the

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<sup>22</sup> Direction under the provisions of regulation 6(6) of the Telecommunications (Interconnection) Regulations 1997 resolving a dispute between Energis and BT concerning BT's method of calculating its NTS retail uplift charge since April 1997, 19 September 2002, published at:

<http://www.ofcom.org.uk/static/archive/oftel/publications/pricing/2002/ener0902.htm>

<sup>23</sup> Direction under the provisions of regulation 6(6) of the Telecommunications (Interconnection) Regulations 1997 resolving a dispute between Cable & Wireless UK ('C&W') and British Telecommunications plc ('BT') over a bad debt surcharge relating to calls to Premium Rate Services, 28 March 2003, published at:

[http://www.ofcom.org.uk/static/archive/oftel/publications/licensing/2003/nts0303\\_1.htm](http://www.ofcom.org.uk/static/archive/oftel/publications/licensing/2003/nts0303_1.htm)

termination of NTS calls NTS outpayments (referred to below as “the first NTS dispute”);<sup>24</sup>

- Ofcom’s determination of a dispute between BT and Energis about BT’s charges for WLR ISDN2 (referred to below as “the WLR ISDN2 charges dispute”);<sup>25</sup>
- Ofcom’s determination of a dispute between Opal and BT about the retrospective application of CPS charges (referred to below as “the Opal dispute”);<sup>26</sup>
- Ofcom’s determination of a dispute between BT and others about payments to TCPs for the termination of NTS calls (referred to below as “the second NTS dispute”);<sup>27</sup> and
- Ofcom’s determination of various disputes between BT and mobile providers about termination rates (referred to below as “the mobile termination rates disputes”) and subsequent redetermination of those disputes following appeal to the Competition Appeals Tribunal (CAT).<sup>28</sup>

3.29 The same respondent goes on to submit that:

“What Ofcom is now proposing with regard to the CPS set-up charge is completely at odds with past practice. In previous disputes, it has never been suggested by Ofcom that the regulated operator would have had to be explicitly told beforehand that a particular cost item should not be included in a regulated charge in order for backdating to be a possible remedy”

3.30 The respondent suggests that:

“if anything it should be even clearer in the current dispute that retrospection should apply given that BT [...] was aware over many years that the inclusion of retail costs was an issue of significant concern to CPS operators and something Ofcom was planning to review”.

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<sup>24</sup> *Resolution of a dispute between BT and various providers about NTS outpayments*, 27 May 2004, published at: [http://www.ofcom.org.uk/consult/condocs/nts\\_dispute/bt\\_dispute/nts\\_outpayments.pdf](http://www.ofcom.org.uk/consult/condocs/nts_dispute/bt_dispute/nts_outpayments.pdf).

<sup>25</sup> *Resolution of a dispute between Energis and BT relating to BT’s charges for WLR ISDN2 from 28 November 2003 until 1 October 2004*, 9 March 2005, published at: <http://www.ofcom.org.uk/consult/condocs/energis-bt/resolution/resolution.pdf>

<sup>26</sup> *Determination to resolve a dispute regarding the retrospective application of CPS charges*, 16 May 2006, published at: [http://www.ofcom.org.uk/consult/condocs/cps\\_charges/determination.pdf](http://www.ofcom.org.uk/consult/condocs/cps_charges/determination.pdf)

<sup>27</sup> *Determination to resolve a dispute between BT and various communications providers about NTS outpayments*, 4 June 2007, published at: [http://www.ofcom.org.uk/consult/condocs/deter\\_nts/bt\\_nts.pdf](http://www.ofcom.org.uk/consult/condocs/deter_nts/bt_nts.pdf)

<sup>28</sup> *Determinations to resolve mobile call termination rate disputes between T-Mobile and BT, O2 and BT, Hutchison 3G and BT and BT and each of Hutchison 3G, Orange and Vodafone*, 19 July 2007, published at: [http://www.ofcom.org.uk/bulletins/comp\\_bull\\_index/comp\\_bull\\_ccases/closed\\_all/cw\\_942/deter.pdf](http://www.ofcom.org.uk/bulletins/comp_bull_index/comp_bull_ccases/closed_all/cw_942/deter.pdf). See also the CAT’s judgment of 20 May 2008 in relation to Ofcom’s determination of disputes between T-Mobile and BT, O2 and BT, Hutchison 3G and BT and BT and each of Hutchison 3G, Orange Personal Communications Services and Vodafone relating to fixed to mobile and mobile to mobile termination (the “TRD core issues judgement”), [2008] CAT 12 and Ofcom’s subsequent redeterminations of the same disputes, 16 January 2009, published at: [http://www.ofcom.org.uk/bulletins/comp\\_bull\\_index/comp\\_bull\\_ccases/closed\\_all/cw\\_1008/](http://www.ofcom.org.uk/bulletins/comp_bull_index/comp_bull_ccases/closed_all/cw_1008/)

- 3.31 C&W submits that there are “many examples” of disputes where Ofcom has adopted a different approach to repayments, and gives three examples:
- in the mobile termination rates disputes, “Ofcom originally concluded that the MNOs could recover their 3G costs, but, following appeal to the CAT, have now amended that position and determined that these costs cannot be recovered and have ordered repayment of these charges, with interest”;
  - in its determination of the NTS retail uplift dispute on 19 September 2002, Ofcom “recalculated BT’s NTS retail uplift factor with retrospective effect from 1 April 1999 until 31 March 2000”; and
  - in the second NTS dispute, Ofcom:  
“backdated adjustments to NTS outpayments (by changing the way in which they were calculated) to 1 October 2006 (the date of BT’s original pricing letter). [This] case is directly analogous with the current dispute; BT couldn’t have known that Ofcom would require them to calculate the charges differently at the time, yet Ofcom still considered retrospection to be appropriate, irrespective of any earlier ‘signalling’ to the contrary”.

#### Wider implications of Ofcom’s proposal not to require repayments

- 3.32 C&W argues that the Determination:

“sends a signal to BT (and other SMP operators) that it is commercially prudent to include spurious costs in charges for SMP products as, even if subsequently challenged, Ofcom will not require it to repay these charges”.

- 3.33 C&W argues that the Determination:

“incentivises BT (and other SMP operators) to review every public Ofcom decision or statement and every private meeting note to find evidence that they can use to exploit their SMP obligations and increase their charges. Wherever Ofcom hasn’t made a decision on a particular cost element, there will be opportunity for this exploitation”.

- 3.34 Another respondent submits that:

“in essence, Ofcom is suggesting that there is no obligation on BT to review its regulated charges until such time that Ofcom specifically and explicitly instructs BT as to what costs can and cannot be included in the charges”

- 3.35 The respondent considers that this:

“would significantly reduce BT’s incentive in the future to engage in constructive and meaningful negotiations with other operators [...and] to prevaricate and delay any interconnection negotiations for as long as possible.”

3.36 The same respondent suggests that Ofcom's proposal means that:

“an SMP operator would be required to adjust its regulated charges only if and when specifically required by Ofcom and then only on a forward-looking basis. This would provide the strongest incentive possible on an SMP operator to include new cost items in its charges and then, as much as possible, limit transparency and delay any negotiations with other operators wanting to challenge the charges on reasonable grounds”.

3.37 C&W argues that “the whole process of a dispute can take many months”, including the negotiation with BT as well as Ofcom's dispute resolution process, and that this could mean C&W would find itself “overpaying on any number of products for periods of a year or more before Ofcom issues a determination”.

3.38 UKCTA echoes C&W's comments, stating that:

“Given that disputes take many months to crystallise and up to six months to resolve once they are accepted by Ofcom, any over-recovery could continue for a year or more before it is rectified. By resolving this current dispute in the way proposed, Ofcom will set an incentive on SMP operators to exploit this opportunity, safe in the knowledge that they will be able to retain the windfall gains made by their overcharging for 12 months or more”.

3.39 Another respondent notes that it usually takes around four and a half months from the date of submission for Ofcom to make a final determination and suggests that:

“Ofcom's position would leave competitors with no option but to start challenging every single BT charge as soon as possible to avoid losing too much money in case a charge is subsequently held by Ofcom to include unlawful cost items”.

### Ofcom's Determination is inconsistent with Ofcom's statutory obligations and regulatory principles

3.40 C&W notes that Ofcom has a duty under Section 3(3)(a) of the 2003 Act to have regard, in all cases, to “the principles under which regulatory activities should be transparent, accountable, proportionate, **consistent**...” (emphasis added), and notes that Ofcom's proposal not to require repayments in this dispute contradicts this duty to have regard to consistency.

3.41 C&W argues that Ofcom's proposal not to require BT to make repayments in this dispute “create[s] uncertainty in the market as to how Ofcom will view similar situations, which is not only in conflict with this duty, but ultimately will harm competition”.

3.42 C&W argues that Ofcom's proposals impact on the ability of C&W and others “to manage our cost base and accurately forecast changes to that base in line with known variables (eg RPI)”. C&W submits that:

“at any time BT could increase its charges on any number of products and we’d have no ability to predict that increase, nor comfort that Ofcom would order BT to repay the increase should they be found to be unallowable following a dispute”.

3.43 Verizon Business submits that:

“to allow BT to levy unjustified charges for SMP products in the knowledge that if ultimately those charges are deemed inappropriate they will not be required to repay those charges risks skewing the regulatory arena, lessening competition and ultimately damaging consumers”.

3.44 One respondent states that it has suffered a loss as a result of BT’s recovery of the disputed costs from CPSOs, as it has not been able to recover the charges from its own consumers “because it had to follow and preferably undercut [BT] who did not face the same cost”. The respondent suggests that this led to “a competitive distortion between [the respondent] and [BT]”.

3.45 The same respondent suggests that Ofcom’s proposals contradict its duty “to act in a proportionate and transparent manner”.

### **BT’s comments**

3.46 BT supports Ofcom’s proposal not to require repayments, and submits that:

“This not only falls in line with [BT’s] legitimate expectations of the outcome, but also allows for regulatory certainty to be maintained, a benefit for operators and Ofcom itself.”

3.47 BT submits that it

“had absolutely no reason to foresee Ofcom’s present decision to exclude these costs from the retail cost stack going forward [...] We are pleased that Ofcom has now agreed that there was no reason that [the various statements considered in the Draft Determination] should have indicated to BT that it should have removed the disputed costs at the time of the cost review in November 2007”.

3.48 BT states that while it still believes it is entitled to recover the disputed costs, it will comply with Ofcom’s determination of 13 February 2009, and states that it has issued an ACCN (Access Charge Change Notice) to the industry notifying “the rate as directed by Ofcom” for the CPS set-up charge from 16 February 2009.

3.49 BT reiterates comments made in its letter of 20 November 2008 to Ofcom on Ofcom’s power to require repayments:

“A decision that has not been appealed, cannot subsequently be reversed either by the parties or Ofcom in relation to the period, the parties and the matter it has decided upon. [...] No-one appealed the [2005 Direction], and as a result [it] binds the parties and Ofcom for the period and on the matter it has decided upon. It cannot therefore be subsequently reversed; either directly via the route of an appeal, or

Draft re-determination to resolve a dispute between C&W, CPW and Gamma against BT about Carrier Pre Selection set-up charges

indirectly by taking a subsequent decision that makes a different ruling on the same matter, period and parties that were the subject of that decision”.

## Section 4

# Ofcom's assessment of the parties' submissions to the Timing Consultation on repayments as set out in the July Determination

4.1 This section addresses stakeholders' responses to the consultation on repayments in the same order that they are set out in section 3 above. This section is directly copied from the July Determination and uses the paragraph references from that document.

### **Ofcom has used an inappropriate test to determine that BT is not required to make repayments**

- 4.2 As set out at paragraphs 3.9-3.1400 above, several respondents argue that BT has a "positive obligation" to comply with its SMP obligations proactively, and should not need to rely on explicit guidance from Ofcom as to what costs it is entitled to recover through its charges. They suggest (see for example paragraph 3.140 above) that, where there is any uncertainty as to the way in which BT is expected to meet its various obligations, it should seek guidance from Ofcom.
- 4.3 Ofcom agrees that BT is required to comply with its SMP obligations proactively, as discussed at paragraphs 1.11-1.23 above. As discussed at paragraph 5.97 of the Draft Determination, it is entirely appropriate for BT to review its charges on a regular basis (as it did in this case) to ensure that they are, and continue to be, in compliance with its SMP obligations.
- 4.4 When SMP Condition AA8 was introduced in 2003, BT took the view that in complying with SMP Condition AA8 it was reasonable to include the disputed costs in the cost stack for CPS.
- 4.5 As set out at paragraphs 7.30-7.42 of the Timing Consultation, by 1 November 2007, when BT changed its CPS charges, Ofcom had not indicated with sufficient clarity to BT, that it was not reasonable for it to include the retail costs in the CPS cost stack or that these costs were not costs of providing CPS facilities under SMP Condition AA8. Ofcom's August 2005 Direction set charges at a level that enabled BT to recover the disputed costs. The August 2005 Direction was binding on BT and had ongoing effect. While in January 2006, Ofcom determined in the WLR Statement that the equivalent costs should be removed from BT's WLR cost stack, it made no reference to the treatment of the equivalent costs in the context of CPS. Ofcom's subsequent determination of the Opal dispute in May 2006 was based on the CPS charges set by Ofcom in the August 2005 Direction, and Ofcom did not make any statement at this time to suggest that the disputed costs should be removed from the CPS charges, in line with the position taken by Ofcom in the WLR Statement. The August 2005 Direction, therefore remained unchanged and continued to be binding on BT.

- 4.6 Ofcom agrees that, as suggested by one respondent, “the burden of proof lies firmly with BT to show that its CPS charges are duly cost-oriented”. In this case, however, Ofcom accepts that BT reasonably considered its CPS charges **were** compliant with its obligations under SMP Condition AA8. Ofcom had not, prior to the Draft Determination, indicated that it was no longer reasonable for BT to include the disputed costs in the CPS cost stack or that these costs were not costs of providing CPS facilities under SMP Condition AA8.
- 4.7 Respondents argue that, where there is any “ambiguity” or “uncertainty” as to the interpretation of BT’s SMP obligations, BT should seek clarification from Ofcom. Respondents suggest that Ofcom’s statement in the August 2005 Direction that it intended to consider further stakeholders’ concerns about BT’s recovery of certain retail costs created “uncertainty” as to how BT’s SMP obligations would be interpreted in the future.
- 4.8 Ofcom does not agree that the August 2005 Direction created “uncertainty” about BT’s SMP obligations. Ofcom noted stakeholders’ concerns about BT’s recovery of retail costs, and undertook to consider them further. Ofcom gave no indication what the outcome of Ofcom’s planned 2006 review would be. The August 2005 Direction set charges at a level that enabled BT to recover the disputed costs, while Ofcom’s determination of the Opal dispute was based on the charges set by Ofcom in the August 2005 Direction, and Ofcom did not make any statement at this time to suggest that the disputed costs should be removed from the CPS charges, in line with the position taken by Ofcom in the WLR Statement.
- 4.9 C&W argues (see paragraph 3.160 above) that “a prudent operator would have [...] sought to clarify the implications [of Ofcom’s policy on WLR] for other products”. BT could have sought guidance from Ofcom. However, as discussed in the preceding paragraphs, Ofcom does not agree that the August 2005 Direction created “uncertainty” around BT’s SMP obligations, and we do not consider that BT acted unreasonably in not seeking further guidance from Ofcom on this occasion on the interpretation of SMP Condition AA8 in relation to recovery of the disputed costs.

In any case, BT should have been aware that it was not entitled to recover the disputed costs

- 4.10 Ofcom does not agree with C&W’s suggestion (see paragraph 3.160 above) that BT should have known that its approach was not consistent with its SMP obligations before the current dispute as a result of Ofcom’s approach to WLR (the “CPS anomaly” that C&W refers to). As another respondent (who asked not to be named) notes, Ofcom excluded all retail costs from the WLR cost stack (see paragraphs 5.43-44 of the Draft Determination), and we acknowledge that there is a “clear association” between CPS and WLR. However, Ofcom has never made any explicit statement, in its consideration of WLR, that suggested BT should make changes to the way it dealt with the equivalent costs in its treatment of CPS.
- 4.11 Nor does Ofcom accept C&W’s statement (see paragraph 3.180 above) that Ofcom did not give BT “positive signalling in the [August 2005 Direction] that they could continue to recover these costs”. As noted above, in its August 2005 Direction Ofcom acknowledged stakeholders’ concerns

about BT's recovery of the disputed costs but decided at the same time to set charges at a level that enabled BT to recover the disputed costs. The August 2005 Direction was binding on BT. Ofcom's determination of the Opal dispute was based on the charges set by Ofcom in the August 2005 Direction, and Ofcom did not make any statement at this time to suggest that the disputed costs should be removed from the CPS charges, in line with the position taken by Ofcom in the WLR Statement.

#### BT is also subject to a no undue discrimination obligation

- 4.12 Ofcom does not agree with C&W that the fact BT was able to recover the cost of its retail activities from CPSOs (but not vice versa) must "by definition" (see paragraph 3.200 above) be considered discrimination.
- 4.13 We acknowledge (as noted at paragraph 5.60 of the Draft Determination) that it could be argued that allowing BT to recover its retail costs from CPSOs, when CPSOs cannot recover their retail costs from BT or anyone else, would be discriminatory. However, it is not within the scope of this dispute to assess whether BT's recovery of the disputed costs did in fact constitute discrimination and if so over what period. As stated in the Draft Determination in response to C&W's arguments on this point (see footnote 102 of the Draft Determination), Ofcom has not assessed whether this alleged discrimination has any impact on competition such that it would be contrary to SMP Condition AA2.
- 4.14 [X]

#### **Ofcom's approach is inconsistent with the approach taken in other disputes**

- 4.15 Respondents have argued that the approach Ofcom has taken in this dispute is inconsistent with its approach to repayments in a number of previous disputes and contrary to "established practice" (see paragraph 3.270 above).
- 4.16 Some of these disputes were determined before 2003 and were therefore resolved by the Director under section 6(6) of the Telecommunications (Interconnection) Regulations 1997. The Director had powers to impose "retrospective" determination of terms and conditions (including charges).<sup>29</sup> In the following discussion, we therefore refer to retrospective decisions (rather than repayments) in disputes that were resolved by the Director.

#### **The NTS retail uplift dispute**

- 4.17 The NTS retail uplift is the amount that BT retains from the price of a retail NTS (Number Translation Services) call (eg a call to an 0845 number) to cover its retail costs. An increase in the NTS retail uplift results in a corresponding reduction in the payment that BT makes to TCPs for termination of NTS calls. The NTS retail uplift is subject to a cost orientation requirement.<sup>30</sup> BT had reviewed the NTS retail uplift on an

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<sup>29</sup> Article 7(3), fourth paragraph, of the Interconnection Directive, in force at that time, stated: "When an organisation makes changes to the published reference interconnection offer, adjustments required by the national regulatory authority may be retrospective in effect, from the date of introduction of the change."

<sup>30</sup> SMP Services Condition AA11 and Network Charge Control.

annual basis, but in 1999, following a change in its accounting methodology which meant the approach it had been using was no longer appropriate, froze the retail uplift at its 1999 level. Energis asked the Director to resolve a dispute about the appropriate level of the NTS retail uplift. In his determination of 19 September 2002, the Director required BT to calculate the NTS retail uplift for the period between 1 April 1999 and 31 March 2000.

- 4.18 The Director's reasons for requiring BT to calculate the NTS retail uplift with retrospective effect is set out at paragraphs 5.13 and 6.5 of his determination:

"5.13 As BT states itself, the 61.5 per cent figure was an output of a calculation. The Director therefore does not see the rationale behind using this as an input to calculate the following year's charge. Moreover, the freezing of the percentage figure at 61.5 percent does not reflect the change that should have occurred over time to the ratio of retail to network costs. Accordingly, the Director believes that it is reasonable to apply a retrospective charge back to 1 April 1999.

"6.5 The Director believes that, in not reviewing the charge from 1 April 1999 BT acted unreasonably. BT could have sought the advice of Oftel but instead chose to freeze the uplift at 61.5 per cent pending Oftel's impending review of the methodology for which, at the time (late 1998), no date had been agreed."

- 4.19 BT had argued (see paragraph 5.23 of the NTS retail uplift dispute):

"that it was wholly inappropriate to use the methodology proposed by the Director to resolve a dispute for a period earlier than the one for which that specific methodology was intended. BT could not have formed the basis of a calculation that was required in applying the NTS formula before that methodology was developed. BT added that it had also been agreed by Oftel and operators that the new method would only be applied from 1 April 2000."

- 4.20 In response to that argument the Director stated at paragraph 5.24 that:

"The Director accepts that notice had been given that the new method would apply from April 2000. However, this was in the context of an impending review of the NTS retail uplift which has now been completed. At that time, the Director and other operators had not been aware that BT had ceased to review the retail uplift after August 1998. The Director was then referred this dispute which he is required to resolve under Regulation 6(6) of the Interconnection Regulations. In these exceptional circumstances he remains convinced that it is reasonable to use the new methodology to set the disputed charge."

- 4.21 At paragraph 6.9 the Director:

“stresses that this decision to apply retrospection in this instance should not be viewed as setting any general precedent in the event of future reviews of disputes concerning BT’s charges. This decision is based upon the merits and circumstances of this particular case.”

### **Ofcom’s response**

- 4.22 In his consideration of the NTS retail uplift dispute, the Director found that the parties to the dispute other than BT had a “reasonable expectation” that BT would regularly review the NTS retail uplift, and that BT had “acted unreasonably” in not reviewing the charge from 1 April 1999.<sup>31</sup>
- 4.23 In the current dispute, however, Ofcom does not believe that BT acted unreasonably in not removing the disputed costs from the CPS cost stack when it came to review its CPS charges in November 2007, in light of the August 2005 Direction, which set charges at a level that enabled BT to recover the disputed costs, and Ofcom’s determination of the Opal dispute, which was based on the charges set by Ofcom in the August 2005 Direction. Neither statement suggested that the disputed costs should be removed from the CPS charges, in line with the position taken by Ofcom in the WLR Statement. Prior to the Consultation, Ofcom had not provided any specific guidance as to how it would interpret SMP Condition AA8 in relation to the recovery of the disputed costs.
- 4.24 The Director required BT to calculate the NTS retail uplift for a period in the past, using a new methodology, but, as noted above, made it clear that this decision was based on the “exceptional circumstances” of that case and should not be viewed as a precedent in future disputes. We consider that there are no exceptional circumstances in the current dispute that would lead us to adopt the same approach.
- 4.25 We also note that the current dispute is factually different to the NTS retail uplift dispute. In this dispute we have focused on determining whether BT is entitled to recover the disputed costs through the CPS set-up charge (and if so, how much the charge needs to fall and whether BT is required to make repayments to CPSOs as a result). The level of the CPS set-up charge is not (as discussed at paragraph 3.24 of the Draft Determination) within the scope of this dispute.
- 4.26 On the basis of the reasoning at paragraphs 4.22-4.25 above, Ofcom concludes that its proposal that BT is not required to make repayments to the CPSOs is not inconsistent with the Director’s determination of the NTS retail uplift dispute.

### **The PRS bad debt surcharge dispute**

- 4.27 The PRS bad debt surcharge is the amount that BT retains from the net retail price of an NTS call to cover the extra bad debt costs and financing of working capital associated with PRS calls compared to other NTS calls. On 5 April 2002, C&W issued an Operator Charge Change Notice (OCCN) seeking a reduction in the PRS bad debt surcharge from 4.4 per cent to

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<sup>31</sup> See paragraph 6.5 of the NTS retail uplift dispute determination.

zero, to take effect from 28 June 2002, according to the industry convention of providing 56 working days' notice of such a price change.

- 4.28 In his determination of the resulting dispute, the Director required BT to reduce the PRS bad debt surcharge from 4.4 per cent to 2 per cent.
- 4.29 C&W asked the Director to recalculate the PRS bad debt surcharge for the period since the start of the Network Charge Control (NCC), 1 October 1997, "or at least be consistent with NTS retail uplift directions in requiring BT to retrospectively apply a charge for the period in which the PRS bad debt surcharge was not cost-oriented."<sup>32</sup>
- 4.30 The Director's determination of 28 March 2003 took effect from 28 June 2002, the date initially proposed by C&W when it issued BT with a price change notice.
- 4.31 The Director set out his reasoning for his proposals on "retrospective adjustment" at paragraphs 4.30-4.32 of his draft direction of 2 January 2003:

"4.30 The Director is of the view that retrospection should not be applied in the absence of strong evidence or argument to support its application. The Director's initial view is that there are no compelling reasons to support the request for retrospective adjustment in this dispute, prior to the date that C&W proposed the change come into effect when it submitted its OCCN to BT, which was 28 June 2002.

4.31 Whilst the Director accepts that BT has an obligation to ensure that its charges are cost-oriented, a prime consideration for the Director in this particular dispute is the fact that the level of the PRS bad debt surcharge was determined by previous directions and not set by BT itself. BT has been complying with these directions and the Director notes that until now no operator has referred a dispute to the Director.

4.32 The Director has also considered whether the parties have a legitimate expectation that retrospection would apply in this case. In its referral C&W requested that the Director be consistent with his decisions to set BT's NTS retail uplift retrospectively from 1 April 1999 and from 1 April 2000 in requiring BT to retrospectively adjust the PRS bad debt surcharge, were the Director to determine any change in the figure from the current level of 4.4 per cent. However, the Director's decision in relation to the retail uplift was based on the exceptional circumstances particular to that case as outlined in the explanatory memoranda. The Director's initial

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<sup>32</sup> Paragraph 3.4 of the PRS bad debt surcharge dispute.

opinion is that no such exceptional circumstances exist in relation to this dispute.”<sup>33</sup>

### Ofcom’s response

- 4.32 As set out above, in the PRS bad debt surcharge dispute, the Director’s view was that there were no compelling reasons to support C&W’s request for retrospective adjustment, prior to the date that C&W proposed the change come into effect when it submitted its OCCN to BT, which was 28 June 2002. The respondents have not submitted arguments as to why they think this case supports their argument that we should require BT to make repayments to 28 November 2003. In the absence of such arguments, it is Ofcom’s view that the PRS bad debt surcharge dispute clearly does not support a determination that BT should be required to make repayments for the disputed charges to 28 November 2003.
- 4.33 Ofcom accepts that it could be argued that in the present dispute, 1 November 2007, the date at which BT’s new charges came into effect, could be considered the equivalent of the pricing letter date in the PRS bad debt surcharge dispute. However, Ofcom does not believe that we should take a similar approach to that taken in that dispute on the facts here.
- 4.34 As discussed above and at paragraph 7.41 of the Timing Consultation, at the time BT’s new charges came into effect Ofcom had not indicated with sufficient clarity to BT, that it was not reasonable for it to include the retail costs in the CPS cost stack or that these costs were not costs of providing CPS facilities under SMP Condition AA8, while Ofcom’s determination of the Opal dispute was based on the charges set by Ofcom in the August 2005 Direction, and Ofcom did not make any statement at this time to suggest that the disputed costs should be removed from the CPS charges, in line with the position taken by Ofcom in the WLR Statement.
- 4.35 While the WLR Statement, and Ofcom’s commitment to review the inclusion of the disputed costs in its planned 2006 review, may have suggested that Ofcom would at some point conclude that BT was not entitled to recover the disputed costs from CPSOs, prior to the Consultation, Ofcom did not provide any specific guidance as to how it would interpret SMP Condition AA8 in relation to the recovery of the disputed costs. The WLR Statement and Ofcom’s commitment to the planned 2006 review are together insufficient for us to conclude that it is reasonable to expect BT to have proactively removed the retail costs from the CPS cost stack when it came to review its CPS charges in November 2007.
- 4.36 The issues in dispute are also somewhat different. The present dispute is about whether BT is entitled to recover certain costs through the CPS set-up charge. As noted above, the level of the CPS set-up charge is not within the scope of this dispute. By contrast, in the PRS bad debt surcharge dispute, C&W accepted that BT was entitled to recover its costs associated

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<sup>33</sup> *Draft direction under the provisions of Regulation 6(6) of the Telecommunications (Interconnection) Regulations 1997 resolving a dispute between Cable & Wireless Communications (Mercury) Limited (“C&W”) and British Telecommunications plc (“BT”) over a bad debt surcharge relating to calls to Premium Rate Services*, 3 January 2003, published at: [http://www.ofcom.org.uk/static/archive/oftel/publications/licensing/2002/nts1202\\_4.pdf](http://www.ofcom.org.uk/static/archive/oftel/publications/licensing/2002/nts1202_4.pdf)

with PRS bad debt, but wanted to ensure “that any bad debt retention which BT makes through the PRS bad debt surcharge recovers only those retail bad debt costs associated with PRS calls that are not recovered elsewhere”. The Director’s determination of the PRS bad debt surcharge dispute therefore focused on the methodology BT had used to calculate charges, whereas our determination of the current dispute focuses on the principle of whether the disputed costs should be included in the CPS cost stack.

- 4.37 On the basis of the reasoning at paragraphs 4.32-4.364.324.36 above, Ofcom concludes that its proposal that BT is not required to make repayments to the CPSOs is not inconsistent with the Director’s determination of the PRS bad debt surcharge dispute.

### **The first NTS dispute**

- 4.38 On 3 April 2003 BT announced a number of changes to its retail prices for calls to 0845, 0820 and 0870 numbers. On 4 July 2003, BT issued a pricing letter notifying changes to the level of payments made by BT to TCPs for the termination of calls to those numbers. BT proposed that those changes should take effect from 1 June 2003. On 24 October 2003 BT issued a second pricing letter notifying the same changes, with effect from 29 August 2003.
- 4.39 Ofcom directed the parties to accept the terms of BT’s pricing letter (subject to some adjustments to the amount of payments, made as a result of errors in BT’s data that Ofcom had uncovered during its consideration of the dispute). Ofcom’s determination of 27 May 2004 required the parties to make repayments to each other as appropriate from 29 August 2003, the effective date of the pricing letter (being 56 days after 4 July 2003 when BT told the industry what the new rates were going to be).
- 4.40 In its draft determination, Ofcom explained that BT accepted that the date of the pricing letter was the first formal notification to the industry of this change (although BT considered that this represented a compromise from its original position that the new rates should apply from an earlier date based on when BT had informed providers informally). Other providers had argued that a later date should apply, because the change in the level of payments they received from BT meant they needed to renegotiate agreements with third parties.<sup>34</sup>
- 4.41 Ofcom concluded that the proposed application date gave the parties “sufficient notification” of the price change and concluded that the new charges should take effect from that date. At paragraph 5.32 of its direction of the first NTS dispute, Ofcom stated that:

“Ofcom considers that, were it to direct BT and the Providers to accept the terms [...] from any date other than 29 August 2003, it would reduce the incentive on other termination providers to enter into future negotiations in good faith. It would, in fact, provide them with an incentive to delay the acceptance of new proposals”.

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<sup>34</sup> See paragraphs 4.14-4.18 of the draft determination in the first NTS dispute, published at: [http://www.ofcom.org.uk/consult/condocs/nts\\_dispute/nts\\_polo/exp\\_statmnt/section4/](http://www.ofcom.org.uk/consult/condocs/nts_dispute/nts_polo/exp_statmnt/section4/)

## Ofcom's response

- 4.42 In the first NTS dispute, BT was required by its SMP obligations (SMP Condition AA11, or the "NTS call origination condition") to reflect the change in its retail prices by recalculating its outpayments to TCPs. At paragraph 5.11 of the first NTS dispute, Ofcom stated that BT had "acted in line with its regulatory obligations in proposing new outpayments". The key question in determining from what date the new rates should apply was therefore when the industry had been properly notified of the changes.<sup>35</sup> Ofcom concluded that 29 August 2003 (56 days after BT's formal notification of the changes) gave providers "sufficient notification" of the changes.
- 4.43 However, in the current case, the relevant issue is not whether BT had given CPSOs adequate notice of the price change. Rather, the key issue is at what point BT should have removed the disputed costs from its cost stack given that Ofcom had not, by 1 November 2007 (when BT changed its CPS charges), indicated with sufficient clarity to BT, that it was not reasonable for it to include the disputed costs in the CPS cost stack or that these costs were not costs of providing CPS facilities under SMP Condition AA8. This contrasts with the first NTS dispute where, as discussed in the previous paragraph, the pricing change that prompted the dispute was found to be consistent with BT's SMP obligations.
- 4.44 The respondents have not submitted arguments as to why they think the first NTS dispute supports their argument that we should require BT to make repayments. In the absence of such arguments, it is Ofcom's view that the first NTS dispute does not support a determination that BT should be required to make repayments for the disputed charges it recovered prior to Ofcom's consideration of this dispute.
- 4.45 On the basis of the reasoning at paragraphs 4.42-4.44 above, Ofcom concludes that its proposal that BT is not required to make repayments to the CPSOs is not inconsistent with Ofcom's determination of the first NTS dispute.

## The WLR ISDN2 charges dispute

- 4.46 We discussed the WLR ISDN2 charges dispute at paragraphs 5.78-5.80 of the Draft Determination (and paragraphs 5.73-5.75 of the Timing Consultation), which are repeated below for convenience:

"5.78 In its determination of a dispute relating to BT's charges for WLR ISDN2 ("the WLR ISDN2 charges dispute") Ofcom concluded that BT had over-recovered from its wholesale customers the costs it incurred in providing WLR ISDN2 between 28 November 2003 and 30 September 2004. Ofcom's determination of 9 March 2005 required BT to make repayments by way of adjustment to the charges that applied over that period.

5.79 In the WLR ISDN2 charges dispute, Ofcom concluded that for a period of time BT's charges for WLR ISDN2

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<sup>35</sup> See paragraphs 5.27-5.34 of the first NTS dispute.

services were not based on the forward-looking LRIC of providing those services and that BT was therefore over-recovering its costs. Ofcom therefore required BT to make repayments in respect of the period for which it was over-recovering its costs, 28 November 2003-30 September 2004.

5.80 In the WLR ISDN2 charges case, Ofcom had never set BT's charges. BT was therefore responsible for ensuring that it was complying with its cost orientation obligations without a signal from Ofcom as to what level of charge would be appropriate. The current dispute, by contrast, relates to a charge that was originally set by the Director in 2002 and revised by Ofcom in 2005."

- 4.47 In addition (as noted at paragraph 5.83 of the Draft Determination and 5.78 of the Timing Consultation), the WLR ISDN2 charges dispute considered whether the costs that BT was recovering through its WLR ISDN2 charges were reflective of LRIC. By contrast, the level of the CPS set-up charge, and the question of whether the disputed costs (or indeed any other cost in the CPS cost stack) are based on the forward-looking LRIC of providing the service, is not within the scope of this dispute.
- 4.48 The respondent that submitted that the approach taken in the WLR ISDN2 charges dispute is not consistent with the position taken in the Timing Consultation (who has asked not to be named), has not explained in its response why it believes the interpretation set out above is incorrect. Ofcom stands by its interpretation, as set out in the Draft Determination and Timing Consultation. We do not therefore consider it necessary to expand on the reasoning set out in the Draft Determination and the Timing Consultation on the WLR ISDN2 charges dispute any further here.

### **The Opal dispute**

- 4.49 We discussed the Opal dispute at paragraphs 5.74-5.77 of the Draft Determination and 5.69-5.72 of the Timing Consultation, which are repeated below for convenience:

"5.74 As set out at paragraph 2.30 above, Ofcom's determination of the Opal dispute was published on 16 May 2006 but took effect from 28 November 2003.

5.75 The Opal dispute related to BT's recovery of the costs of CPS Facilities (including CPS Per Provider Set-up Costs, CPS Per Provider On-going Costs and CPS Per Customer line Set-up Costs, including transaction charges). Ofcom found that BT had been under-recovering its Per-provider costs and over-recovering its Per-customer costs and, on that basis, was able to calculate the point at which BT broke even. Ofcom concluded that BT had recovered its costs of providing CPS Facilities at the end of November 2003, and that an offer by BT to backdate its charges to 28 November 2003 was therefore reasonable. Ofcom required BT to make repayments by way of adjustment to the other charges in dispute to the same date.

5.76 The current dispute relates to costs that BT incurs (and recovers from other providers) on a transaction-by-transaction basis. As BT has consistently recovered these costs over the period in dispute, there is no “break even” point. We cannot therefore adopt the methodology that we used in resolving the Opal dispute in deciding whether BT should be required to make payments to CPSOs in this case.

5.77 Opal did not ask Ofcom to modify or withdraw the CPS charges Ofcom had set in the earlier August 2005 Direction. Rather, Opal asked for the “retrospective application” of certain of BT’s charges for the provision of CPS as set by Ofcom in the 2005 Direction. The facts in the current dispute are different, as C&W’s request to Ofcom to require BT to make payments to the CPSOs by way of adjustment for overpayments since 28 November 2003 can arguably be seen as a request to modify or withdraw the August 2005 Direction.”

- 4.50 The Opal dispute considered whether the individual cost items that BT was recovering through its CPS charges were cost oriented. By contrast, the level of the CPS set-up charge, and the question of whether the disputed costs (or indeed any other cost in the CPS cost stack) is based on the forward-looking LRIC of providing the service, is not within the scope of this dispute. Ofcom did not, in the Opal dispute, determine that BT was not entitled to recover certain cost items. The Opal dispute required BT to make repayments by way of adjustment for the overpayment of CPS charges set at a level that enabled BT to recover the disputed costs (in line with the August 2005 Direction).
- 4.51 The respondent that submitted that the approach taken in the Opal dispute is not consistent with the position taken in the Timing Consultation (who has asked not to be named) has not explained in its response why it believes the interpretation set out above is incorrect. Ofcom stands by its interpretation, as set out in the Consultation and Timing Consultation. We do not therefore consider it necessary to expand on the reasoning set out in the Draft Determination and the Timing Consultation on the Opal dispute any further here.

### **The second NTS dispute**

- 4.52 On 1 October 2006, BT announced changes to the way it charged for retail calls to 0845 numbers. BT notified consequent changes to its outpayments to TCPs by way of an OCCN of 3 August 2006, effective from 1 October 2006.
- 4.53 BT submitted a dispute to Ofcom after a number of communications providers failed to sign the OCCN. Ofcom accepted the dispute and considered whether BT’s proposed changes were consistent with its regulatory obligations.
- 4.54 Ofcom directed BT to amend the methodology it used to calculate the outpayments in dispute. Ofcom’s determination of 4 June 2007 required

the parties to make repayments to each other as appropriate from 1 October 2006, the effective date of BT's OCCN.

### **Ofcom's response**

- 4.55 In its determination of the second NTS dispute Ofcom does not consider the repayment date in any detail. BT's response (included as an annex to Ofcom's determination) supports Ofcom's proposal for its determination of the second NTS dispute to apply from 1 October 2006. The "main concern" and "additional concerns" addressed in the second NTS dispute do not include any consideration of the appropriate date for repayments<sup>36</sup>. Ofcom directed BT to adopt a new methodology, and required the parties to make repayments to reflect that methodology from 1 October 2006. Ofcom made it clear that it was imposing the "most reasonable" of three reasonable options.
- 4.56 In the present dispute, the key question is at what point BT should have removed the disputed costs from its cost stack, given that Ofcom had not, by 1 November 2007 (when BT changed its CPS charges), indicated with sufficient clarity to BT, that it was not reasonable for it to include the disputed costs in the CPS cost stack or that these costs were not costs of providing CPS facilities under SMP Condition AA8.
- 4.57 The respondents have not submitted arguments as to why they think the second NTS dispute supports their argument that we should require BT to make repayments. In the absence of such arguments, it is Ofcom's view that the second NTS dispute does not support a determination that BT should be required to make repayments for the disputed charges it recovered prior to Ofcom's consideration of this dispute.
- 4.58 On the basis of the reasoning at paragraph 4.574.57 above, Ofcom concludes that its proposal that BT is not required to make repayments to the CPSOs is not inconsistent with Ofcom's determination of the second NTS dispute.

### **The mobile termination rates disputes**

- 4.59 C&W and another respondent (who asked not to be named) note that Ofcom's redetermination of the mobile termination rates disputes required the parties to make repayments (plus interest) in order to implement Ofcom's determination that mobile providers are not entitled to recover their costs of terminating 3G mobile calls through their termination charges for 2G mobile calls (the costs of 3G termination having previously been included in the mobile providers' costs stacks).
- 4.60 In its redetermination of the mobile termination rates disputes, Ofcom was required by the CAT to order the parties to make repayments in order to reflect the CAT's decision that Ofcom's original decision had been incorrect. Ofcom does not consider that its redetermination of the mobile termination rates disputes is therefore a relevant precedent for the current dispute. Ofcom notes that neither its August 2005 Direction, that set the CPS charge at a level that included the disputed costs, nor its subsequent

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<sup>36</sup> See paragraphs 5.5-5.9 of the draft determination in the second NTS dispute, published at: [http://www.ofcom.org.uk/consult/condocs/deter\\_nts/nts.pdf](http://www.ofcom.org.uk/consult/condocs/deter_nts/nts.pdf), and section 5 of the final determination.

determination of the Opal dispute, which was based on the charges set in the August 2005 Direction, was appealed.

- 4.61 Ofcom considers that its proposal that BT is not required to make repayments to the CPSOs is not inconsistent with Ofcom's re-determination of the mobile termination rates disputes.

### **Relevance of disputes raised by other stakeholders: conclusion**

- 4.62 Ofcom must determine disputes based on the facts of each case in a way that supports its statutory duties and regulatory obligations and is fair and reasonable as between the parties to the dispute. This includes a consideration of Ofcom's duty to ensure consistency. Ofcom has therefore reviewed its approach in the various disputes mentioned by the parties and, in light of its conclusion on the date from which its Determination on the first two issues in dispute should apply, and for the reasons set out in this document, Ofcom does not consider that its proposal not to require BT to make any repayments to CPSOs in this dispute is inconsistent with past practice.
- 4.63 As set out at paragraph 3.270 above, one respondent (who asked not to be named) argued that there was an "established practice" by the regulator of ordering repayments or retrospective adjustment of charges to comply with:
- "new requirements around cost-orientation";
  - "new methodologies to assess appropriate cost recovery"; and
  - "new approaches to cost calculations whereby specific cost items have been excluded from calculations".
- 4.64 Ofcom does not consider that the examples considered above relate to "new requirements around cost-orientation". We do not consider that, in any of the examples considered above, "specific cost items have been excluded from calculations".
- 4.65 Ofcom agrees that in the NTS retail uplift dispute, the PRS bad debt surcharge dispute, the second NTS dispute and the WLR ISDN2 dispute, the scope of the disputes considered "new methodologies to assess appropriate cost recovery". In this case, the scope of the dispute was to determine whether BT is entitled to recover the disputed costs through the CPS set-up charge (and if so, how much the charge needs to fall and whether BT is required to make repayments to CPSOs as a result). The level of the CPS set-up charge is not (as discussed at paragraph 3.24 of the Draft Determination) within the scope of this dispute. Ofcom does not therefore consider that these examples provide applicable guidance on the appropriate date for repayments in this dispute.
- 4.66 In these examples, while Ofcom has ordered repayments (or the Director has determined disputes with retrospective effect), this has generally been to the date of the relevant pricing notification (whether issued by BT or another party), and not to some earlier date requested by the parties in dispute. For example, in the PRS bad debt surcharge dispute, the Director rejected Energis's request to him to recalculate the PRS bad debt

surcharge from 1 October 1997. The exception to this is the NTS retail uplift dispute which, as noted above, was clearly due to the exceptional circumstances of that case. Ofcom considers that none of the examples stakeholders have provided support the view of C&W and other stakeholders that BT should be required to make repayments to 2003.

- 4.67 Ofcom has also considered whether, for consistency with previous disputes, it would be appropriate to require BT to make repayments to other providers to the date of the relevant pricing notification, which is 1 November 2007, the repayment date that Ofcom originally proposed (although we note that none of the respondents to the Timing Consultation have made explicit arguments that the previous disputes mean that Ofcom should order repayments to that date).
- 4.68 None of the examples that stakeholders have given us shares the key features of the current dispute, which are that Ofcom has now directed BT to remove certain costs from the cost stack, having previously set charges at a level that enabled allowed BT to recover those costs.
- 4.69 In other words none of the disputes mentioned by the respondents seems to relate, as one respondent suggests (see paragraph 3.270 above), to “whether the regulated operator, at the time the charge was originally set, would have known that a particular cost item could not be included”.
- 4.70 C&W submits (in relation to the first NTS dispute) that “BT couldn’t have known that Ofcom would require them to calculate the charges differently at the time, yet Ofcom still considered retrospection to be appropriate, irrespective of any earlier ‘signalling’ to the contrary”. Another respondent (who asked not to be named) submits that “it has never been suggested by Ofcom that the regulated operator would have had to be explicitly told beforehand that a particular cost item should not be included in a regulated charge in order for backdating to be a possible remedy” (echoed in the same respondent’s comment that in none of the disputes we have considered above was there “any previous indication to the regulated operator that the original charges were too high”).
- 4.71 However, for the reasons as set out in paragraphs 4.42-4.464.424.46 above, Ofcom does not believe that its determination of this dispute is inconsistent with the first NTS dispute. In addition, Ofcom notes that its determination in this dispute must be viewed within the entire factual context of the dispute including the fact that the binding August 2005 Direction set charges at a level that enabled BT to recover the disputed costs, while Ofcom’s determination of the Opal dispute was based on the charges set by Ofcom in the August 2005 Direction, and did not suggest that the disputed costs should be removed from the CPS charges.

### **Wider implications of Ofcom’s proposal not to require repayments**

- 4.72 C&W argues (see paragraph 3.320 above) that Ofcom’s proposal not to require BT to make repayments places on BT an incentive to attempt to recover costs that it is not entitled to recover in the expectation that Ofcom will not require it to make repayments to other parties in the event of a dispute.

- 4.73 Ofcom's Determination confirms that BT is not entitled to recover the disputed costs through the CPS set-up charge, because the disputed costs are not "costs of providing CPS" as set out in SMP Condition AA8. As noted at paragraphs 7.19-7.20 of the Timing Consultation, Ofcom considers that its decision in this dispute may provide guidance as to the treatment of other retail costs in the context of SMP Condition AA8. However, Ofcom has not considered any other element of the CPS set-up charge or BT's other CPS charges. We do not therefore agree with the suggestion of one respondent (see paragraph 3.110 above) that Ofcom's proposals in this dispute mean that BT is only required "to adjust its CPS charges as and when Ofcom explicitly requires it to do so".
- 4.74 Ofcom is not, as one respondent suggests (see paragraph 3.340 above), saying that BT is not required to review its regulated charges until Ofcom provides explicit guidance as to what costs can and cannot be included. As discussed at paragraphs 1.11-1.23 above, BT has a duty to comply with its SMP obligations. However, in this case, Ofcom has concluded that Ofcom did not, prior to the Draft Determination, indicate that (contrary to the August 2005 Direction) it was no longer reasonable for BT to include the disputed costs in the CPS cost stack or that these costs were not costs of providing CPS facilities under SMP Condition AA8, which meant that while BT did indeed review its regulated charges, it was reasonable for it to include the disputed costs in the CPS cost stack under SMP Condition AA8.
- 4.75 The current dispute relates to a specific charge for one product that BT is required to provide as a result of SMP Condition AA8. In other cases, other regulatory obligations, Ofcom statements and guidance will be relevant, and the parties cannot therefore infer from this decision what will be a fair and reasonable outcome in relation to repayments in possible future disputes involving other SMP-related products.
- 4.76 C&W suggests (see paragraph 3.330 above) that Ofcom's proposal not to require BT to make repayments will encourage BT to review statements made by Ofcom to identify "evidence that they can use to exploit their SMP obligations and increase their charges".
- 4.77 C&W appears to be describing a hypothetical scenario in which BT attempts to increase a charge on the basis that Ofcom had not made any clear statement about what costs BT can and cannot include. Ofcom notes that the current dispute does not relate to an attempt by BT to start recovering costs that it had not previously been recovering. Ofcom must determine an appropriate outcome based on the facts of each individual dispute.
- 4.78 One respondent suggests that Ofcom's determination of this dispute will give BT an incentive to "prevaricate and delay" negotiations as long as possible. In resolving disputes, Ofcom has to consider what is fair and reasonable as between the parties. Ofcom recognises that proper commercial negotiations take time. The length of the negotiations that led to the current dispute is not a reason for requiring repayments to a date at which BT could not reasonably have been expected to remove the disputed costs from its cost stack in order to ensure consistency with its SMP obligations, as that would not, in our view, represent a fair balance between the parties.

- 4.79 As noted above, Ofcom's decision on repayments is made on the facts of this case, and communications providers cannot infer from this decision that Ofcom will not require repayments in other disputes. BT and others will not therefore have an incentive to "exploit" any opportunity (see paragraph 3.38 0above) as a result of this dispute.
- 4.80 Another respondent suggests that Ofcom's decision creates an incentive on non-SMP providers to "challeng[e] every single BT charge as soon as possible".
- 4.81 It is not clear whether the respondent means that they will have an incentive to immediately challenge BT on price changes (which we consider would be within normal commercial practice), or whether they mean that they would refer disputes to Ofcom as soon as possible. Ofcom notes that in this case C&W and others initiated negotiations only when BT changed its prices. They could in any event have initiated negotiations, or approached Ofcom to consider the issue, before that point but chose not to do so.

### **BT's comments**

- 4.82 Ofcom notes BT's ACCN 925, effective 16 February 2009, which implements the Determination by notifying a new CPS set-up charge of £1.69 (see paragraph 1.13 above). Ofcom notes that it did not, strictly speaking, direct the level of the CPS set-up charge (as BT's comment suggests) – rather, the Determination required BT to reduce the CPS set-up charge by the amount of the disputed costs.
- 4.83 Ofcom does not agree that BT had "absolutely no reason" to foresee Ofcom's decision on recovery of the disputed costs. While the August 2005 Direction allowed BT to continue to recover the disputed costs, at the same time it was clear from stakeholders' comments that the industry did not agree that BT was entitled to recover the disputed costs. In the same statement Ofcom had indicated that it considered it appropriate to look at the issue in more detail as part of its planned 2006 review of CPS charges. Ofcom has not indicated to BT, prior to this dispute, that it should have removed the disputed costs from the CPS cost stack. However, Ofcom considers that its approach to WLR could have indicated to BT that, when Ofcom came to explicitly address the recovery of the dispute costs through the CPS set-up charge, it might reach the conclusion that it has in this dispute.
- 4.84 Ofcom has not taken a view on BT's comment, as set out at paragraph 3.490 above, on Ofcom's power to "reverse" a decision already taken. In reaching this decision, we have considered our power to require repayments as set out at section 190(2)(d) of the 2003 Act. It has not been within the scope of this dispute to consider whether Ofcom can "reverse" a decision.

### **The application of Ofcom's duties**

- 4.85 Ofcom has a duty to resolve certain disputes. When Ofcom decides that it is appropriate for it to handle a dispute, it must consider the dispute and make a determination resolving it. The Determination of 13 February 2009 was made in line with this duty.

- 4.86 Ofcom's powers in resolving disputes are set out at section 190 of the 2003 Act. Ofcom has a discretion to use these powers to resolve disputes in a way that supports its statutory duties and regulatory obligations. One of these powers is a power to order the payment of sums between parties to a dispute by way of adjustment of an underpayment or overpayment.
- 4.87 In considering whether to exercise its discretion, Ofcom must consider whether on the facts of each particular dispute, it is appropriate and proportionate to do so, taking into account its general statutory duties and community obligations under sections 3 and 4 of the 2003 Act. In particular, regard must be had to its duty under section 3(1)(b) of the 2003 Act to further the interests of consumers in relevant markets, where appropriate by promoting competition, in line with its duty under section 4 of the 2003 Act to promote competition in communications markets in accordance with the policy objectives of Article 8 of the Framework Directive.<sup>37</sup>
- 4.88 Pursuant to s.3(3) of the 2003 Act, in performing its duties under s.3(1) Ofcom must have regard in all cases to the principles under which regulatory activities are transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed, and any other principles which appear to Ofcom to represent the best regulatory practice.
- 4.89 In addition, the CAT (in its TRD core issues judgment) gave further guidance that:
- “Ofcom must have regard to what is fair as between the parties and what is reasonable from the point of view of the regulatory objectives set out in the Common Regulatory Framework Directives and in the 2003 Act.”
- 4.90 It is in the context of these duties and principles that we have considered the third of the issues in dispute, namely the date from which Ofcom's determination of the first two issues in dispute should apply, and whether BT is required to make repayments to the other parties in dispute by way of adjustment for overpayments.
- 4.91 Ofcom considers that the Determination supported its obligation to further the interests of consumers, where appropriate by promoting competition, since, in the Determination, Ofcom has now confirmed that BT's retail costs should be removed from the CPS cost stack. Ofcom's determination of this dispute therefore supported Ofcom's principal duty at section 3(1)(b) of the 2003 Act, as well as its duty under section 4 of the 2003 Act to promote competition in communications markets in accordance with the Framework Directive.
- 4.92 Ofcom considers that, by providing guidance that BT's retail costs should be removed from the CPS cost stack (and by requiring BT to remove those costs from the CPS set-up charge with immediate effect, which BT has now done), its conclusion of this dispute was in line with the policy objectives of Article 8 of the Framework Directive.

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<sup>37</sup> Directive 2002/21/EC of the European parliament and of the Council of 7 March 2002 on a common regulatory framework for electronic communications networks and services.

- 4.93 Ofcom considers that this will also help to level the playing field for BT's competitors. This supports Ofcom's obligations at section 3(2)(b) of the 2003 Act to secure the availability of a wide range of communications services, as well as its duty under section 4 of the 2003 Act to encourage the provision of network access (here, CPS) for the purposes of securing efficiency and sustainable competition for the benefit of consumers.
- 4.94 By providing clarity as to how BT's regulatory obligations will operate in practice, Ofcom considers that its conclusion of this dispute, by supporting the competition-related duties set out above, also supported Ofcom's principal duty to further the interests of consumers. By clarifying BT's SMP obligations for all parties, Ofcom's determination of this dispute increased regulatory certainty which will support competition between communications providers, benefiting consumers in the form of greater competition, leading to downward pressure on prices, availability of a wider range of services, and improved quality of service.
- 4.95 Ofcom considers that the Determination was fair and reasonable as between the parties to the dispute, and that this was in line with Ofcom's duty to ensure that its regulatory activities are transparent, accountable, proportionate, consistent and targeted.
- 4.96 Finally, Ofcom considers that the Draft Determination, the Determination, the Timing Consultation and this statement clearly set out the parties' arguments, Ofcom's response to stakeholders' responses, and Ofcom's reasoning that leads to its conclusion. In particular, in the Timing Consultation, Ofcom gave the parties an additional opportunity to comment on its proposals regarding repayments, in the interests of fairness. Ofcom considers that this supported its duty to ensure that its regulatory activities are transparent, accountable, proportionate, consistent and targeted.
- 4.97 Ofcom has carefully considered the representations made by stakeholders in response to the Timing Consultation in relation to the date from which its Determination of the first two issues in dispute should apply, and whether BT is required to make repayments to CPSOs. Ofcom has set out above both those representations and Ofcom's response. Ofcom has also considered the approach it has taken to repayments in previous disputes.
- 4.98 In light of the analysis of previous disputes set out at paragraphs 4.15-4.714.15-4.71 above, and the specific facts of this case, Ofcom is satisfied that its proposals are consistent with the approach it has taken in previous disputes, and that it has met its statutory duty to ensure consistency in its regulatory approach.
- 4.99 C&W and others have suggested that Ofcom's proposals do not fulfil Ofcom's competition related duties, first, because they "create uncertainty" in the market, and second, because the sums that CPSOs have paid to BT has led to a "competitive distortion".
- 4.100 The Determination specified changes that BT needed to make to its charges on a forward looking basis, which BT has now made. Ofcom considers that the resolution of this dispute was in line with its earlier positions (the August 2005 Direction and the Opal dispute determination) and made a clear statement of Ofcom's view on recovery of the disputed charges for the future. Ofcom had not previously made a clear statement

on the disputed costs prior to the publication of the Draft Determination and the subsequent Determination. The current dispute related to a specific charge for one product that BT is required to provide as a result of SMP Condition AA8. In other disputes, other regulatory obligations, Ofcom statements and guidance will be relevant, and the parties cannot therefore infer from Ofcom's determination of this dispute what will be a fair and reasonable outcome in relation to repayments in possible future disputes involving other SMP-related products. Ofcom does not therefore agree that its resolution of this dispute leads to "uncertainty" in the market. Rather we consider our approach promotes regulatory certainty in the market and encourages and promotes competition, consistent with our duties.

- 4.101 On the second point – that existing payments have led to “competitive distortion” – as noted at paragraph 4.134.13 above, an assessment of whether BT's historic recovery of the disputed costs constituted discrimination (and thereby lead to “competitive distortion”) was not within the scope of this dispute, and Ofcom has not made any assessment of, or reached any conclusions in relation to this question. *[We have now considered this question as part of our decision whether to exercise our discretion under section 190(2)(d)]*
- 4.102 Ofcom does not agree with one stakeholder's comment that its proposals for resolving this dispute contradict its duty “to act in a proportionate and transparent manner”. The Timing Consultation and this document clearly set out the parties' arguments and Ofcom's reasoning that leads to its conclusion that BT is not required to make any repayments to CPSOs. Ofcom notes that the parties had an opportunity to comment on Ofcom's original proposals, and a further opportunity to comment on Ofcom's proposals on repayments, and that this supported Ofcom's duty to ensure that its regulatory activities are transparent, accountable, evidence-based and consistent. Further, Ofcom considers that its decision not to require BT to make any repayments to CPSOs is proportionate, in that it strikes a fair balance between the parties to the dispute.

## Section 5

# Submissions of the parties in response to Ofcom's invitation of 27 November 2009 for further submissions

## The submissions

- 5.1 On 27 November 2009, Ofcom invited further submissions from the parties to the Dispute. In accordance with the agreed timetable we received a submission from Olswang acting on behalf of Cable & Wireless UK, Carphone Warehouse Group plc and Gamma Telecom Limited (the CPSOs) on 24 December 2009; and one from BT on 4 January 2010. Summaries of the submissions are set out below.

## The submission from BT

- 5.2 BT submits that the CPSOs have provided no evidence to substantiate their claims of competitive distortion raised in the original complaint, in the responses to Ofcom's draft determination and in the Notice of Appeal. BT considers that this makes it difficult to make any meaningful comments at this stage. BT considers that the growth of CPS since 2003 and the thriving competition in the market for retail calls as a result of which BT Retail no longer has Significant Market Power ("SMP"), means that it cannot see how the CPSOs high level statements on competitive distortion made so far have any substance.

## The submission from C&W, CPW and Gamma

- 5.3 The CPSOs' submission notes that Ofcom's admission in respect of competitive distortion only relates to one discrete part of the CPSOs' fourth ground of appeal. Therefore, the CPSOs repeat the submissions which they have already made in this Dispute, including those relating to matters other than competitive distortion, and in particular to all of the matters raised in their Notice of Appeal. The CPSOs consider that any determination (including the re-determination) should address all of the matters raised in the Notice of Appeal.
- 5.4 The CPSOs consider that Ofcom should clearly address the question of whether or not to exercise its discretion under section 190(2)(d) of the Act to order repayment of BT's historic overcharges in respect of the CPS set-up charge.

## Consistency with the PPC Determination

- 5.5 The CPSOs note that subsequent to their Notice of Appeal Ofcom published its determination of a dispute relating to historic over-charging for partial private circuits (the "PPC Determination")<sup>38</sup>. The CPSOs consider that this Determination makes a number of statements which are universally applicable. Ofcom's re-determination should be consistent with these statements, or explain why they are displaced in this Dispute.

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<sup>38</sup> Ofcom, Determination to resolve dispute between each of Cable & Wireless, THUS, Global Crossing, Verizon, Virgin Media and COLT and BT regarding BT's charges for partial private circuits – Determinations and Explanatory Statement, 14 October 2009.

- 5.6 The CPSOs note that the first principle proposed by Ofcom in the PPC Determination is that there is no need to demonstrate actual economic harm in order to conclude that it is appropriate under section 190(2)(d) to direct BT to repay an overcharge<sup>39</sup>.
- 5.7 The CPSOs note that second, where Ofcom has found that BT has overcharged in non-compliance with an SMP obligation, it is appropriate to require a repayment of the amount of overcharge, even if that charge may have been passed onto customers<sup>40</sup>.
- 5.8 The CPSOs note that third, any level of overcharge that BT is allowed to keep could act as an incentive not to comply with cost orientation obligations in the future. The CPSOs believe that if Ofcom were to reach a determination which incentivises non-compliance by BT with its regulatory obligations, it should explain how doing so accords with, or outweighs, its duties under section 3(3) of the Act, in particular that to have regard to the principles of best regulatory practice. The CPSOs also argue that Ofcom should also set out how its Determination satisfies the requirements to further the interests of consumers by promoting competition.

### **Absence of indications to BT**

- 5.9 The CPSOs consider that Ofcom's arguments regarding a lack of indication to BT, or that BT never had a reasonable appreciation that the retail costs were not legitimately included in the CPS setup charge, is irrelevant. This was set out in their previous submissions and the Notice of Appeal. They also consider there to be other reasons why that argument is misconceived.
- 5.10 The CPSOs argue that Ofcom's presumption does not reconcile with SMP Condition AA8.4 which states that "*The dominant provider shall ensure that ... subject always to the requirement of reasonableness, charges shall be based on the forward looking long-run incremental costs ...*" The CPSOs note that Ofcom's presumption is also not supported by SMP Condition AA3.1 which states that "*Unless the Director directs otherwise ..., the Dominant Provider shall secure, and shall be able to demonstrate to the satisfaction of the Director, that each and every charge offered, payable or proposed for Network Access covered by Condition AA1(a) is reasonably derived from the costs of provision...*"
- 5.11 The CPSOs argue that the SMP conditions clearly place the onus on BT to ensure compliance with its cost orientation obligations. They therefore consider that it would require a strong statement to the contrary from Ofcom to rebut that presumption. The CPSOs note that in neither the Determination nor the Defence has Ofcom addressed the effect and significance of Condition AA3. They consider that Ofcom has therefore not properly recognised, understood, or discussed the onus on BT by reference to that Condition.

### **November 2003 to August 2005**

- 5.12 The CPSOs consider that prior to the direction in August 2005<sup>41</sup> Ofcom was silent on the issue of the reasonableness of including retail costs and that Ofcom construed the default position in 2003 to be that BT should be considered compliant until Ofcom made a statement on the matter. However, they argue that this does not negate the

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<sup>39</sup> PPC Determination, paragraph 8.36.

<sup>40</sup> PPC Determination, paragraph 8.37.

<sup>41</sup> Ofcom, Per-Provider and per-customer line costs and charges for Carrier Pre-selection, A direction by Ofcom, 18 August 2005.

strong onus and presumption set out in paragraph to 5.11 above. The CPSOs believe that Ofcom should reconsider its position in the context of its section 3(3)(b) duty to have regard in all cases to the principles of best regulatory practice.

- 5.13 The CPSOs note that the Defence seeks to correct this error by characterising the pre-2003 regulatory regime as having provided the claimed indication to BT<sup>42</sup>. However, the CPSOs argue that between 2003 and 2005 BT was subject to no legal obligation in relation to the CPS charges other than the relevant SMP conditions. The CPSOs submit that the suggested continuity between the pre-2003 and the post 2003 regulatory regimes is not accurate. The CPSOs wish Ofcom to reconsider its view that BT was subject to continuing obligations between 2003 and 2005 in light of its section 3(3) duties as regards regulatory best practice and transparency.

### **August 2005 to February 2009**

- 5.14 The CPSOs contend that Ofcom's justification of BT's charges after August 2005 focuses on the 2005 Direction. This directed BT to set a specific CPS charge which "*was binding on BT and had an ongoing effect*"<sup>43</sup>. The CPSOs, however, consider that the 2005 Direction did not impose an ongoing obligation on BT to maintain the charge at that level. They argue that Ofcom did not envisage the 2005 Direction as an ongoing obligation on BT and that under SMP Condition AA6(a) BT has a right to change its prices through the relevant modification procedures and that this is not consistent with an ongoing and binding obligation.
- 5.15 The CPSOs argue that Ofcom expressed concern in the 2005 Direction as to the inclusion of retail costs, but chose not to consider them, reserving the issue for a review planned for 2006. The CPSOs believe that this explicit reservation makes it impossible to read the 2005 Direction as an indication to BT that the retail costs were legitimately included in the setup charge.

### **Presumption of repayment**

- 5.16 The CPSOs note that Ofcom considers that the comments of the CAT in the TRD Judgement were made in the specific circumstances of that case, i.e. that they are restricted to circumstances in which an OCCN has been issued and overpayments made. The CPSOs argue that Ofcom's powers to order repayment under section 190(2)(d) are not constrained by the technicalities of an OCCN procedure. They contend that this is not supported by Article 20 of the Framework Directive or by the operative sections 180 to 185 of the Act. The CPSOs maintain that the law provides for the resolution of disputes, not for the resolution of disputes concerning OCCNs, and that the CAT would not have restricted itself only to the circumstances of an OCCN.
- 5.17 The CPSOs believe that once Ofcom had concluded that an amount which is in breach of a SMP condition cannot be a proper amount it should have recognised the presumption that a repayment be ordered. The CPSOs argue that Ofcom should explain why it has rebutted this presumption, by reference to its regulatory obligations.

### **Fairness as between the parties**

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<sup>42</sup> Defence, paragraphs 15(i) and 23(i).

<sup>43</sup> Determination, paragraph 1.15.

- 5.18 The CPSOs maintain that the TRD Judgement sets out clear guidance on the need to resolve a dispute in a manner which is both fair as between the parties and reasonable from the point of view of Ofcom's regulatory objectives. The CPSOs maintain that while Ofcom did discuss fairness between the parties in the Determination, this principle is not properly applied to the facts of this Dispute, since in not considering competitive distortion Ofcom considered fairness only from the perspective of BT. The CPSOs consider that in applying the test now, Ofcom should find that it is fair that the CPSOs be awarded repayment of overcharges, so as to return BT to a position it would otherwise have had.

### Competitive distortion

- 5.19 The CPSOs engaged RBB Economics to produce a report (the "RBB Report") on the competitive distortion resulting from BT's overcharging through the CPS setup charge). It constitutes the CPSOs' principle evidential submission on the question of competitive distortion. In considering the RBB report the CPSOs emphasise that Ofcom should have regard to the points summarised below. .

- 5.20 The CPSOs argue that only potential economic harm (and therefore competitive distortion) need be shown. In the PPC Determination, Ofcom considered economic harm primarily in relation to the question of whether BT had overcharged the disputing parties, although it did also address the significance of economic harm to the separate, subsequent question of whether to order repayment of overcharges.<sup>44</sup> The CPSOs argue that Ofcom clearly set out that competitive distortion is a subset of economic harm

*"... BT's overcharging for 2Mbit/s trunk services may also have caused economic harm by distorting competition"*<sup>45</sup>

- 5.21 The CPSOs argue that if actual economic harm is not a pre-requisite to the determination of a dispute, then neither is actual competitive distortion. Ofcom confirmed the former when it stated:

*"We agree that it is not essential to demonstrate that economic harm has in fact occurred in order to determine whether there has been overcharging. It is sufficient to establish that the overcharging could potentially cause economic harm."*<sup>46</sup>

- 5.22 The CPSOs contend that accordingly competitive distortion only needs to be shown potentially. The CPSOs note that where the PPC Determination addresses the issue of competitive distortion it does so on the language of possibility and risk.

- 5.23 The CPSOs argue that the requirement only to show potential economic harm (and therefore potential competitive distortion) to establish infringement by BT is consistent with the position in EU competition law that a potential prevention, restriction or distortion of competition can give rise to an infringement of Article 101 TFEU, and likewise a potential effect on trade can give rise to an infringement of Article 102 TFEU.

*"Article [101(1)] of the Treaty does not require proof that such agreements have in fact appreciably affected such trade, which would moreover be difficult in the majority*

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<sup>44</sup> PPC Determination, paragraphs 7.32 to 7.72 in particular.

<sup>45</sup> PPC Determination, paragraphs 7.58 to 7.59. See also paragraph 7.36.

<sup>46</sup> PPC Determination, paragraph 7.34.

*of cases to establish for legal purposes, but merely requires that it be established that such agreements are capable of having that effect.”<sup>47</sup>*

- 5.24 The CPSOs submit that the matters identified in the RBB Report fulfil any need to show potential competitive distortion in this Dispute. The CPSOs consider that in the discharge of its duty to have regard to regulatory consistency, Ofcom should apply the same reasoning as it did in the PPC Determination to the facts of this Dispute, which are materially the same, in that overcharging has occurred as a result of the breach by BT of a cost orientation condition, with potential distortions occurring as a result.

### **The test for repayment under section 190(2)(d)**

- 5.25 The CPSOs argue that it is important to the correct re-determination of this Dispute to understand the nature of the question at issue, by contrast to that primarily concerned in Ofcom’s assessment of potential economic harm (and therefore potential competitive distortion) in the PPC Determination. In that dispute, the assessment was primarily made with regard to the question of whether overcharging had taken place.<sup>48</sup>

- 5.26 The CPSO contend that in this Dispute, it is the case that the overcharging has already been identified and the question at issue is whether repayment should take place as a result. The CPSOs state that it is clear from a reading of the PPC Determination that only potential economic harm need be shown in any order for repayment under section 190(2)(d). As Ofcom states:

*“BT’s main argument appeared to be that it was not reasonable or proportionate to require it to make repayments when there was no evidence of economic harm having occurred. We rejected this argument and considered that was unnecessary to show that economic harm had actually occurred to the Disputing CPs. In any event, we thought that there was a likely risk that economic harm had arisen and that it was appropriate for us to exercise our discretion and require repayments to be made.”<sup>49</sup>*

- 5.27 The CPSOs believe that further economic harm other than competitive distortion has resulted which is directly comparable to that which Ofcom identified in the PPC Determination. Most obviously, in response to BT’s contention that repayment would constitute a ‘windfall’ to the disputing parties, their having suffered no loss, Ofcom stated:

*“BT argues that we need to demonstrate that the Disputing CPs have suffered economic harm in order to conclude that it is appropriate to direct BT to repay the overcharge. We do not accept this.*

*We consider that in this case, where we have found that BT has overcharged in non-compliance with an SMP obligation, it is appropriate to require a repayment of the amount of overcharge, even if the Disputing CPs may have passed on that charge to their customers.*

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<sup>47</sup> Miller International Schallplatten GmbH v Commission of the European Communities, Case 19/77 [1975] ECR 1491, [1976] 1 CMLR 589, at para. 15. In the context of Article 102 see also NV Nederlandsche Banden Industrie Michelin v Commission of the European Communities, Case 322/81 [1983] ECR 3461, [1985] 1 CMLR 282:

*“104 ... It must also be remembered that Article [102] does not require it to be proved that the abusive conduct has in fact appreciably affected trade between Member States but that it is capable of having that effect”.*

<sup>48</sup> PPC Determination, paragraphs 7.32 to 7.72.

<sup>49</sup> PPC Determination, paragraph 8.7.

*We additionally note that a similar situation arose in the TRD Decision, where the CAT concluded that it was appropriate to require repayments to be paid to BT regardless of whether or not BT had passed on the overcharges to its customers.”<sup>50</sup>*

and

*“Similarly, we do not consider that the potential passing on of economic harm is a ‘mitigating factor’ for reducing the level of repayment. We conclude that it is appropriate to direct that BT should repay the overcharge in full.”<sup>51</sup>*

- 5.28 The CPSOs state that whether or not in this dispute any overcharge has been passed through to the CPSOs’ customers is irrelevant to the question whether to order repayment. The CPSOs note that Ofcom’s rationale for this position, that overcharging by BT leads to economic harm at some point in the value chain, is clear.

*“BT’s 2Mbit/s trunk charges have resulted in the Disputing CPs and/or their retail customers paying BT too much for these services, and therefore generating financial loss or harm to them.”<sup>52</sup>*

*“The exact extent to which the increased 2Mbit/s trunk charges the Disputing CPs were passed-on to end users depends on the demand and competitive conditions in the retail market. Regardless of the exact level, as long as some level of passing-on occurred (and we note that BT suggests that this is the case), it is likely that economic harm would have been suffered as a result, because the inflated retail prices are likely to have suppressed retail demand.”<sup>53</sup>*

*“To the extent that not all of the higher 2Mbit/s trunk charges were passed-through to end users, the Disputing CPs would have incurred some form of financial loss from BT’s 2Mbit/s trunk charges. As regards the extent of the higher charges that were passed-on, elevated costs will have been borne by end users and they too will have faced financial loss from BT’s charges.”<sup>54</sup>*

- 5.29 The CPSOs argue that the whether the loss is borne directly by the CPSOs, or indirectly by their customers, some party suffers economic harm. They argue that this Dispute is directly analogous to the PPC Dispute and it necessarily follows from a finding of overcharging that economic harm is likely, and Ofcom should order repayment.

### **RBB Report**

- 5.30 This section summarises the key points raised in the RBB report commissioned by the CPSOs.

### **Sources of competitive distortion**

- 5.31 RBB has identified sources of competitive distortion. It considers that the additional CPS set-up charge can be viewed as a tax imposed on the initial set-up of each CPS line. RBB argues that the competitive distortion arising from this tax depends upon who bears it and how it affects decisions of the affected parties. The CPSOs have

<sup>50</sup> PPC Determination, paragraphs 8.36 to 8.38.

<sup>51</sup> PPC Determination, paragraph 8.77.

<sup>52</sup> PPC Determination, paragraph 7.36.

<sup>53</sup> PPC Determination, paragraph 7.38.

<sup>54</sup> PPC Determination, paragraph 7.39.

informed RBB that vertically integrated CPS providers always absorb the full set-up charge and contractual terms between separate wholesalers and retailers determine which party incurs the charge. RBB found no evidence that the CPS set-up charge has been passed on to end consumers in the form of higher call charges.

5.32 RBB argues that since the overcharge is a per-line phenomenon, it should impact on the number of CPSO lines that were set up using CPS; and this will have led to two distinct competitive distortions, both of which will have reduced the competitive pressure BT faces:

- first, a higher CPS set-up charge will have reduced the returns from CPS and therefore reduced the incentive to invest in and market CPS services; and
- second, by discouraging take-up of CPS, it reduced the CPSOs' contact with customers, which contributes considerably to selling other communications services. Thus, the overcharge will also have blunted the competition BT faces in other communications services markets.

### Evidence of distortions

5.33 RBB note that the CPSOs have not retained much information which could be used to demonstrate distortion or retained it in a format that is readily useable. However, from the information available, RBB submit that it is clear that the set-up charge was an important factor for the CPSOs, and that it would have had the effect of discouraging them from attracting additional CPS volumes.

5.34 RBB points out that inflating the per-line costs reduced the returns the CPSOs made from investing in CPS. The effect of the overcharge will have been greatest where margins were slimmest and where CPS opportunities were transformed from profitable into unprofitable propositions.

5.35 RBB found that the average gross CPSO margins were lowest in the provision of [X] services. In terms of pence per line per month [X] reported an average gross margin of [X] and [X] a margin of [X]. Therefore, the overcharge of 60-78 pence would have cost each CPSO around [X].

5.36 RBB reported that the average gross margins at the [X] level are higher than in [X] provision. [X] reported a margin of [X] per line per month, and [X] reported a margin of between [X] and [X].

5.37 RBB notes that it is not possible to make precise estimates of the impact of the overcharge on the competitive conduct of the CPSOs on the basis of these figures. However it argues that three factors should be borne in mind when assessing the likely impact:

- First, CPS aimed to reduce switching costs, so a CPSO could not be confident of retaining a customer over the long term. For example, the average duration of a CPS customer contract for the CPSOs is around [X] months. The shorter the expected contract duration the greater the impact of the of the up-front charge on the incentive to win new CPS business;
- Second, the additional infrastructure costs associated with servicing an increasing number of customers means that a focus on gross margins will over-estimate the profit contribution of each additional CPS customer. Net margins were much slimmer than gross margins. For example, in the period 2003-2005

when [X] was predominantly a CPS provider, each line contributed some [X] per month towards profits. The CPS set-up charge would eradicate [X] profit contribution. The impact of fixed costs on gross margins is clear in the case of [X]. Between 2005 and 2007 [X] made positive total gross margins across its entire communications business ([X]) but its total net margins over the period were negative (i.e. losses of [X]). RBB argues that relatively small overcharges could have an important impact on profitability, and hence discourage CPSOs from seeking such incremental traffic;

- Third, RBB argues that the overcharge would have discouraged marginal customers; and that a focus on the average margin per customer will understate the impact on customer volumes. The large customers of the CPSOs (for example, large [X] such as [X]) hold considerable bargaining power over the CPSOs and are able to demand large discounts, further depressing the margin that [X] make. For example, [X] gross margin for its entire business was between [X] and [X] of revenue, whereas [X]. As such, the set-up charge would have limited the ability of the CPSOs to compete with BT, since it effectively shifted the break-even point of each contract.

- 5.38 RBB has also provided evidence from a CPSO's internal documents showing the impact of the CPS set-up charge. Notably, in 2005 [X] RBB notes that both of these decisions would have materially reduced the infrastructure competition BT faced from the CPSOs.
- 5.39 RBB argue that competition for individual elements of customers' communications services envisaged by Oftel never materialised. A lower set-up charge could have been sufficient to induce entry of international and national-only call packages, thus increasing the competition faced by BT.
- 5.40 RBB also argues that higher set-up charges will also have blunted competition in the retail markets for complementary and/or follow-on services. RBB's analysis shows that [X].

### **Economic incentives of requiring re-imburement**

- 5.41 RBB argues that allowing BT to retain the revenues from overcharging will create dynamic incentives towards further exploitative behaviour. However, requiring repayment following a finding that a charge has been set excessively (irrespective of whether that charge was previously subject to regulatory control) will help align BT's incentives with Ofcom's regulatory principles. It will provide an incentive for BT to reduce the asymmetry of information between itself and Ofcom, make more transparent its method of modelling charges (where Ofcom subsequently relies on that modelling), and to ensure that its own procedures effectively identify charges which are out of line with regulatory principles. RBB also considers that failure to order repayment will provide an incentive for BT to use other opportunities to overcharge where it enjoys an informational advantage over Ofcom.

## Section 6

# Ofcom's assessment of the parties' submissions and provisional conclusions

- 6.1 This section sets out Ofcom's provisional assessment of the parties' submissions (as summarised in section 5 above). Where appropriate, it refers back to the parties' earlier submissions, as set out in Section [3], and Ofcom's earlier analysis set out in Section [4].
- 6.2 It goes on to set out Ofcom's provisional conclusions in relation to whether it would be appropriate for it to exercise its power under section 190(2)(d) of the Act to direct BT to make any payments to the CPSOs by way of an adjustment for an overpayment in relation to the disputed costs.
- 6.3 For the avoidance of doubt, Ofcom is not in this draft re-determination revisiting or revising the conclusions which it reached in the February Determination, namely that BT was not entitled to recover the disputed costs through the CPS set-up charges, and that BT would be required prospectively to reduce its CPS set-up charge by 78 pence in order to give effect to that finding.
- 6.4 As agreed in correspondence with the parties in relation to the litigation, following the CAT's order to stay those proceedings, Ofcom invited submissions from the parties on whether the existing payments made by the CPSOs for CPS might have led to competitive distortion in the relevant markets. The CPSOs addressed both this and a number of further issues in their submission. BT provided a short response setting out its view that the CPSOs have provided no evidence to substantiate their claims of competitive distortion to date, and that as a result BT considers that this makes it difficult to make any meaningful comments at this stage. In consequence, the focus of our assessment below is on the submissions made by the CPSOs.
- 6.5 We first address the CPSOs' submissions on competitive distortion, including the report prepared for them by RBB, before going on to consider their other submissions in support of their view that Ofcom should exercise its discretion to order BT to make payments to them.

### Competitive distortion resulting from the CPS set-up charge

- 6.6 Ofcom has considered the RBB Report on competitive distortion submitted by the CPSOs, a summary of which is set out above in section 5. The following paragraphs set out Ofcom's provisional view of the likely nature and scale of any competitive distortion resulting from BT's recovery of the retail element associated with CPS and considers whether and how this analysis could impact our re-determination.
- 6.7 Until our February Determination, BT was able to recover the disputed costs via the CPS set-up charge while CPSOs have not been able to recover their equivalent costs. The CPS set-up charge is payable by CPSOs for all migrations where CPS is provided, including transfers from one CPSO to another, where BT is neither the gaining service provider nor the losing service provider. Consequently, CPSOs have been paying a higher cost for

acquiring a new CPS customer than BT, potentially putting them at a competitive disadvantage relative to BT Retail.

- 6.8 We have previously set out that the current charge was putting CPSOs at a competitive disadvantage relative to BT. Specifically, we said:

*'While BT currently recovers retail costs from CPSOs, CPSOs are not reimbursed (by BT or by other CPSOs as appropriate) for their equivalent costs. Therefore, CPSOs are paying a higher cost for CPS transfers than BT, putting them at a competitive disadvantage relative to BT (although Ofcom does not consider that it is within the scope of this dispute to undertake a detailed assessment of the impact of the current arrangement on competition). Ofcom therefore proposes to conclude that the current arrangement is not consistent with this principle, as it puts CPSOs at a competitive disadvantage relative to BT.'*<sup>55</sup>

- 6.9 This potential for competitive distortion was taken into account when assessing whether BT should continue to recover the disputed costs as part of the set-up charge, and helped inform Ofcom's decision in the February Determination to remove those costs from the CPS set-up charge.

### **Evidence of the scale of any competitive distortion**

- 6.10 The disputed costs element of the CPS set-up charge was 60p from November 2003 to October 2007 and 78p from November 2008. These costs are a very small proportion of the overall costs and revenues of competition as a CPSO and we consider that it is unlikely that their inclusion in the set-up charge had a significant impact on the competitive landscape for CPS. We explore the reasons for this in more detail below which in summary include:

- 6.10.1 Our view that the CPSOs' estimate of the amount paid for the disputed costs since 2003 is not significant when compared to the amount the CPs paid in call origination charges to BT and CPS related revenues over the relevant period;
- 6.10.2 The evidence we have seen suggests that typical acquisition costs of customers were far greater than either CPS transaction charges or the disputed costs;
- 6.10.3 Given the size of the disputed costs relative to the customer acquisition costs, it is unlikely that company entry and acquisition strategies were influenced in any meaningful way by those disputed costs; and
- 6.10.4 the size of the disputed costs is small when compared to the average revenue per user (ARPU) per month for CPS.

- 6.11 The CPSOs estimate that the total paid in relation to the disputed costs since November 2003 was around £8 million in total. Over the same period, CPs

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<sup>55</sup> 'Dispute about per-customer line transaction charges for Carrier Pre-Selection', 30 December 2008. Para5.34

paid about £800<sup>56</sup> million in call origination charges to BT (CPS would have accounted for most of this). CPS related revenues over the relevant period are estimated to be around £2,700 million (See *Ofcom's Telecoms Market data*).

6.12 Also, typical acquisition costs of customers were far greater than either CPS transaction charges or the disputed costs. In its 29 April 2004 response to a Section 26 Notice in the Ofcom own-initiative investigation into BT Consumer Pricing, Centrica Telecoms Ltd (which at that time operated two CPS services – OneTel and British Gas Communications<sup>57</sup>) stated that its acquisition costs were [redacted] per customer<sup>58</sup>. These costs include “the costs of telephone sales operations, customer marketing, free offers (such as first three months of service for free etc.), third party commissions and the equipment and administrative costs of processing new customers.” Carphone Warehouse said in November 2004 that its customer acquisitions costs were £23.10 per customer<sup>59</sup>.

6.13 Furthermore, Centrica's 2003 preliminary results stated:

“Investment in our brand campaign has increased by £1.7 million to £3.6 million”  
*One.Tel, Segmental Business Commentary, Centrica plc 2003 Preliminary results.*

6.14 Carphone Warehouse's results statements contain similar statements:

“All customer acquisition costs ('SAC') and marketing costs to be written off as incurred giving start-up losses of £7-8m in a current financial year ... [T]he group has decided to pursue a more aggressive recruitment strategy for talktalk using additional distribution channels and supported by further marketing spend.”  
*Carphone Warehouse Group, Second Quarter Trading Update, October 2003*

“We expect to spend more on marketing this year than in the previous year”,  
*Carphone Warehouse Group, Fourth Quarter Trading Update, April 2004*

“Total marketing and customer acquisition costs were £18.8m and the acquisition cost ('SAC') per customer was £23.10”, *Carphone Warehouse Group, Interim results for the 26 weeks to 25 September 2004, November 2004*

6.15 If we assume that Centrica and Carphone Warehouse included the disputed costs of 60-78p in their calculations of customer acquisition costs, then the disputed costs account for [redacted]% to [redacted]% of the customer acquisition cost for Centrica and 2.6% to 3.4% of Carphone Warehouse's customer acquisition cost. Given the size of the disputed costs relative to the customer acquisition costs, it is unlikely that these companies' entry and acquisition strategies were influenced in any meaningful way by those disputed costs.

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<sup>56</sup> Source: derived from BT's regulated accounts, “*Call origination on FPN networks*”

<sup>57</sup> British Gas Communications was integrated into OneTel in the first half of 2005, and Centrica sold the OneTel business to Carphone Warehouse (one of the CPSOs in this dispute) in December 2005.

<sup>58</sup> Response from Centrica to Section 26 notice, 29 April 2004.

<sup>59</sup> Carphone Warehouse press release, 3 November 2004.

6.16 Finally, the size of the disputed costs is small when compared to the average revenue per user (ARPU) per month for CPS, which was somewhere in the region of £10-£16.<sup>60</sup> Carphone Warehouse<sup>61</sup> and One.Tel reported monthly ARPU figures of about of £15-16 while British Gas Communications reported ARPUs of around £10-£12. This range reflects the different segments of the market being served, with One.Tel and Carphone Warehouse serving higher-value customers than British Gas Communication (see below, historic ARPU figures from Centrica's half-yearly statements).

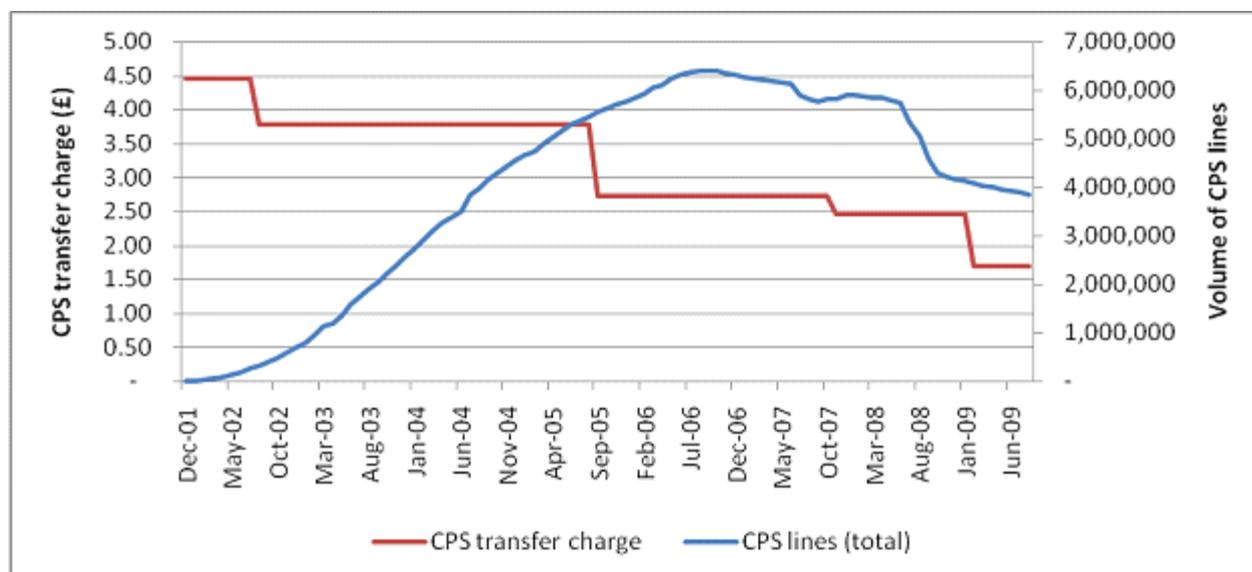
	H2 2002	H1 2003	H2 2003	H1 2004	H2 2004	H1 2005 (One.Tel includes BGC)
<b>One.Tel</b>						
ARPU (£/month)	16.01	15.63	16.72	16.83	16.65	13.54
<b>British Gas Communications</b>						
ARPU (£/month)	10.55	11.23	12.49	13.03	12.91	

6.17 The size of the disputed costs element of the CPS charge, relative to the overall costs of competing as a CPSO, means it is unlikely to have had a material impact on the competitive outcome of the market. Nevertheless, in a highly competitive market, it is possible that a small cost advantage to BT could distort the competitive outcome at the margins. However, the extent to which an equally efficient operator was losing out to BT as a result of the charge would depend on the way in which the 78p fed through to consumer prices. Also, since CPSOs incur the one-off CPS set-up charge irrespective of how long they retain a customer, any competitive disadvantage to CPSOs would have been greater where the expected duration of any new CPS customer contract was shorter.

6.18 In order to establish whether there was a significant relationship between CPS activity and the disputed costs it is helpful to consider whether changes to the overall CPS transfer charge had an impact on growth in CPS lines.

<sup>60</sup> NB these figures measure ARPU at the retail level. Margins at the wholesale level will inevitably be lower.

<sup>61</sup> Carphone Warehouse Group Pre-Close Period Statement and Presentation to Analysts: "talktalk, [Carphone Warehouse's] new residential fixed line service, was launched ... on 3 February 2003. ... Early indications suggest monthly ARPU of £15 per customer." Carphone Warehouse Group, Second Quarter Trading Update, October 2003: "For the year to March 2005, we anticipate an average monthly customer ARPU of £15-16."



Source: BT Wholesale publicly available information

6.19 The chart above maps the CPS transfer charge against the volume of CPS lines. If CPS transaction charges and CPS growth had a significant relationship, we might expect a reduction in the CPS transaction charge to have a significant impact on growth. We do not see this in this chart. In August 2005 the CPS transfer charge decreased by over £1 (28%). The reduction in the charge appears to have had no appreciable impact on the growth of CPS with the vast majority of CPS growth (up to a base of approx 5.5m lines) occurring during the period before the reduction in charge. In fact, the chart exaggerates the continued growth of CPS, as over half the CPS transactions in the period August 2005-July 2006 are WLR+CPS charges, which did not include the disputed costs.

6.20 However, the lack of correlation between CPS transaction charges and growth in CPS lines is not enough to rule out the possibility that the disputed costs led to some distortion of competition in favour of BT. The decline in CPS volumes shown in the graph was probably largely driven by take-up of alternative services, such as LLU and WLR.

6.21 BT launched the first mass market WLR product (called WLR2) in April 2004. Take-up was initially very slow, particularly in the residential market, but in the first half of 2005 WLR began to grow significantly, from 87,595 lines at January 2005 to 507,831 lines by July 2005. By December 2005, there were over one million lines of residential WLR; by July 2006, over two million. Full LLU / MPF existed before WLR. However, by the end of 2004 there were only 10,205 lines of MPF. MPF began to grow significantly in the second half

of 2006, from 163,086 lines in June 2006 to 309,957 lines by January 2007. MPF reached one million lines in December 2007<sup>62</sup>.

- 6.22 It may be possible that, absent the reduction in the CPS set-up charge, the decline in CPS volumes would have been more pronounced in response to the introduction of these new services. However, in practice it is not possible meaningfully to quantify the extent of any impact from the set-up charge, while controlling for other relevant factors - particularly since the impact would have been very small relative to other drivers of CPS demand.
- 6.23 Overall, we therefore consider that whilst it is possible that there may have been some competitive distortion from allowing BT to recover the disputed costs through the CPS transaction charge, given the size of those costs relative to the market and the lack of any discernable link between the charge and CPS volumes, any competitive distortion was unlikely to be material.

### **Response to CPSO arguments on competitive distortion contained in the RBB Report**

- 6.24 RBB's key point is that a "higher CPS set-up charge will have reduced the return the CPSOs would make from CPS and therefore reduce the incentive to invest in and market CPS services". RBB's subsidiary point is that "the overcharge will also have blunted the competition BT faces in other communications services markets (e.g. broadband)" because there will be customers that did not experience CPS services (and therefore become customers for other services) as a result of the reduced investment and marketing of CPS services. This second point clearly only comes into play if the first point is correct, i.e. if investment and marketing of CPS services was reduced as a result of the disputed costs.

#### **1. Recovery of the disputed costs through the CPS set up charge will have deterred investment in CPS and blunted competition**

- 6.25 The CPSOs argue that, by reducing the returns made from CPS, the recovery of the disputed costs through the set-up charge will have deterred investment in CPS. Having to absorb higher CPS set-up charges will have reduced CPSOs' incentive to market CPS services and may have prevented the entry of potential competitors. A lack of investment in CPS will have reduced the competitive pressure BT faced from the CPSOs and therefore reduced the benefits to consumers of CPS.
- 6.26 Our analysis supports the argument that inclusion of the disputed costs in the CPS set-up charge would have reduced the returns made from acquiring a CPS customer for CPSOs. However, we do not consider that it is the inclusion of the disputed costs in the set-up charge itself that potentially distorts competition. Allowing all providers to recover the disputed costs associated with acquiring a CPS customer from the losing provider in the same way would not distort competition. It is the fact that only BT can recover these costs through the set-up charge (and does not have to pay the costs when winning a new CPS customer) which creates a competitive advantage in favour of BT and the potential for competitive distortion.

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<sup>62</sup> Source: BT Openreach

6.27 Therefore, in principle, the recovery of the disputed costs through the CPS set-up charge could have had an impact on competition, by putting CPSOs at a competitive disadvantage relative to BT. However, given the size of the disputed costs relative to the market and the lack of any discernable link between the charge and CPS volumes, we consider that it is unlikely that any competitive distortion was material.

## **2. The CPS set-up charge has discouraged take-up of other communications services**

6.28 The CPSOs argue that, by hindering the take-up of CPS services, the inclusion of the disputed costs has impeded competition in the provision of related services. This is because CPS helped CPSOs establish a customer relationship with BT's customers, acting as a gateway to complementary services. Therefore, by hindering the take-up of CPS, the set-up charge will have distorted competition in the retail market for complementary or follow-on services, reinforcing BT's incumbency advantage.

6.29 We accept that there may be some complementarity between CPS and demand for follow-on services. However, since it is unlikely that the recovery of the disputed costs through the CPS set-up charge had a significant impact on CPS take-up, we do not expect there to have been any material negative knock-on consequences for the effectiveness of competition in complementary services.

## **3. The CPS set-up charge has discouraged CPSOs from pursuing opportunities for business expansion**

6.30 The CPSOs argue that recovery by BT of the disputed costs associated with CPS through the set-up charge has effectively acted like a tax on acquiring new customers. They suggest the higher per-line charge has discouraged them from pursuing otherwise profitable opportunities for business expansion. Profits from customers with relatively low spend per line might have been insufficient to offset the inflated set-up cost, even if they would have been marginally profitable at the "competitive" CPS set-up cost.

6.31 We have not seen evidence to support the view that CPS transaction charges dissuaded any operators from entering the CPS market. On the contrary between 2000 and 2004 nearly all companies active in the telecoms sector launched CPS services. At this time, the CPS transaction charges were far higher than they are currently. Furthermore, once they had entered the market, different CPs targeted different market sectors. For example:

- Telco Global, COLT, Verizon (then MCI WorldCom), Thus, Your Communications and others focused on the business sector;
- British Gas Communications, Tesco, Post Office and others targeted lower value residential consumers;
- OneTel, TalkTalk, Toucan IDT, Caudwell Communications and others targeted the higher-value residential consumer (especially those with higher international usage);

- Telewest and NTL (now merged as Virgin Media) used CPS to offer services outside of their cable coverage; and
- Cable & Wireless, Gamma Telecom and Thus focused on the intermediate market of selling CPS-based services to resellers.

6.32 In the residential market, CPS providers used mass market customer acquisition approaches: advertising (press, billboard, TV, sponsorship, etc.), doorstep selling campaigns and outbound telesales (see further above where we examine customer acquisition costs).

6.33 The contemporaneous statements of CPs are positive about the business benefits of CPS, in particular, lower churn, higher usage and more revenue compared to IDA-based services.

“further uptake of CPS has enabled us to largely offset these [competition-related] price reductions. 37% of the fixed line customer base is now on CPS tariffs with the average revenue per user on these tariffs being more than 35% higher than non CPS tariffs. The average minutes of use per month increased by 21% to 345 minutes”. *One.Tel, Segmental Business Commentary, Centrica plc 2003 Preliminary results*

“This [customer churn] has reduced by nine percentage points driven primarily by the promotion of the enhanced Carrier Pre-Selection (CPS) product that was introduced in July 2002. 91% of our fixed line customer base is now on CPS.” *British Gas Communications, Segmental Business Commentary, Centrica plc 2003 Preliminary results*

“Fixed line ARPU has risen by 8% to £16.83 (2003: £15.63) while average minutes per user has grown by 34% to 415 (2003: 309) due mainly to the take-up of fixed price calling plans and the increase in the number of CPS customers, who now form 45% of the fixed line base (2003: 20%).” *One.Tel, Segmental Business Commentary, Centrica plc 2004 Interim results for the six months ended 30 June 2004*

“Turnover increased by 19% to £31 million (2003: £26 million) as a result of growth in fixed line customer numbers and an increase in the [ARPU] due mainly to the continued take-up of fixed price calling plans and the growth in the [CPS] base, with 20% of the fixed line base now on a CPS tariff.” *British Gas Communications, Segmental Business Commentary, Centrica plc 2004 Interim results for the six months ended 30 June 2004*

“The advent of automated CPS and the acquisition of Opal have presented the group with a unique opportunity to become a credible alternative to BT in the residential fixed line market and to build a substantial new profits stream.” *Carphone Warehouse Group, Second Quarter Trading Update, October 2003*

6.34 In light of the above, we do not consider it likely that the inclusion of the disputed costs in BT's CPS charges discouraged the CPSOs to any material extent from pursuing opportunities for business expansion.

### **Provisional conclusion on competitive distortion**

- 6.35 We have considered carefully the CPSOs' submissions on the impact of the disputed costs on competition in the market. We acknowledge that it is possible that allowing BT to recover the disputed costs through the CPS transaction charge may have resulted in some competitive distortion in the market.
- 6.36 However, given the size of the disputed costs relative to the market and the lack of any discernable link between the charge and CPS volumes, we provisionally consider that it is unlikely that the competitive distortion, if any, was material.
- 6.37 We consider that this provisional conclusion on the likelihood and nature of any competitive distortion is a relevant consideration which we must take into account when exercising our discretion as to whether or not to use our power in section 190(2)(d) of the Act to direct BT to make any payments to the CPSOs.

### **Economic incentives of requiring re-imburement**

- 6.38 As set out above in paragraph 5.41, the RBB argues that allowing BT to retain the revenues from overcharging will create dynamic incentives towards further exploitative behaviour.
- 6.39 On balance, we are not convinced by the CPSOs' arguments that a decision not to require repayments would generally incentivise BT to breach its regulatory obligations. It is an exceptional feature of the present case that Ofcom had imposed a legal obligation on BT in August 2005 to charge a CPS set-up charge which included the disputed costs, and that BT had been subject to similar obligation between January 2001 and November 2003. Further, Ofcom had not given BT any reason to suppose that the legal obligation which it imposed under SMP condition AA8.4(d) failed to comply with the general principle expressed in SMP condition AA8.4(a). In the circumstances, Ofcom did not undermine the pro-competitive objectives pursued by the SMP condition, nor did it incentivise non-compliance with those conditions, by refraining from requiring BT to make a repayment in respect of the historical period.
- 6.40 The onus remains on BT to charge in compliance with its regulatory obligations, and to be able to demonstrate the same. Any decision in this case not to require BT to make repayments would be made on the basis of the specific facts of this case, and would not in our view have general application.

### **Further submissions of the CPSOs**

- 6.41 The CPSOs made a number of further points in their submission of 24 December 2009, relating to:
- 6.41.1 the scope of the re-determination;
  - 6.41.2 consistency with Ofcom's recent PPC Determination;
  - 6.41.3 the absence of any indications to BT in relation to the legitimacy of its charges;
  - 6.41.4 an alleged presumption of repayment under section 190 (2) (d) of the Act;
  - 6.41.5 fairness as between the parties;

- 6.41.6 some further comments on competitive distortion and the principles which Ofcom set out in its recent PPC Determination in this regard.
- 6.42 We address each of these points in turn, before setting out Ofcom's provisional conclusions on the exercise of its discretion in relation to its powers under section 190(2)(d) of the Act.

### **The Scope of the Re-determination**

- 6.43 The CPSOs state that Ofcom should proceed clearly to address the question of whether or not to exercise its discretion under section 190(2)(d) of the Act to order repayments. The CPSOs repeat their allegation as set out in their notice of appeal that Ofcom failed to do this in its July determination.
- 6.44 Ofcom set out its response to those allegations in its Defence. In any event, Ofcom has set out above that this re-determination sets out the exercise of its discretion in relation to its powers under section 190(2)(d) of the Act, taking into account all the factors that Ofcom considers to be relevant. Ofcom's provisional conclusions in this regard are set out below.

### **Consistency with PPC determination**

- 6.45 The CPSOs have argued (as set out at paragraph 5.5 above) that Ofcom's re-determination of this dispute should be consistent with the statements made in the PPC determination, or explain why they are displaced in this Dispute by other considerations which are taken into account in the discharge of Ofcom's regulatory obligations.
- 6.46 Ofcom considers that each of the three statements of principle referred to by the CPSOs from the PPC determination (as set out at paragraphs 5.6 to 5.8 above) remain entirely valid. However, those principles can not be considered in isolation, but must properly be considered in the context of all of the relevant considerations in a particular case. In Ofcom's view, there are significant and relevant differences in the factual position in the PPC dispute, and this dispute, relating to the reasonable appreciation of BT and whether or not Ofcom had given BT any cause to consider that the disputed costs were being levied properly.
- 6.47 In the PPC dispute, Ofcom found that it had given BT no such cause, and concluded that BT should reasonably have known that its charges were in breach of its regulatory obligations. That determination is currently the subject of an appeal by BT to the CAT.
- 6.48 In this dispute, as set out above in section [4] at paragraph 4.6, Ofcom considers that it did prior to the February Determination, give BT cause reasonably to assume that the disputed costs were being levied properly. Ofcom's position on this regard is set out above at paragraphs 4.2 to 4.11, which are taken from Ofcom's July determination, and which Ofcom considers remain valid for the purposes of this draft re-determination.
- 6.49 As a result, Ofcom remains of the view that the reasonable appreciation of BT was and is a relevant consideration for it to take into account when deciding whether to exercise its discretion under section 190(2)(d) of the Act. Ofcom is aware that the CPSOs disagree with this view, for the reasons set out in support of their second ground of appeal in their notice of appeal, to which Ofcom has already responded in its Defence.

6.50 In light of Ofcom's view that BT's reasonable appreciation is a relevant consideration, Ofcom provisionally considers that the factual differences in this regard between the position in the PPC dispute and this dispute mean that the two can be distinguished on that basis. That does not in Ofcom's view render inapplicable the principles in the PPC dispute which the CPSOs have highlighted, nor does it mean that this draft re-determination is inconsistent with those principles. It simply means that other considerations are relevant in this dispute which were not present in the PPC dispute.

### **Absence of indications to BT about the legitimacy of its charges**

6.51 The CPSOs submit (as set out at paragraphs 5.9 to 5.15 above) that the relevant SMP conditions, in particular Condition AA3.1 created a particularly strong onus and presumption on BT itself to ensure, secure and demonstrate that its charges were cost oriented, and in summary that:

- a) Ofcom was silent on the subject of the disputed costs between 2003 and August 2005;
- b) the onus was not displaced by indications given prior to 2003 by a different regulatory regime;
- c) the 2005 Direction did not impose an ongoing obligation on BT to maintain disputed costs at the level set in the Direction, and therefore, BT could not assume that if it complied with the Direction then it was in compliance with its SMP obligations, and
- d) in any event, Ofcom reserved its position on these costs in 2005, and so there was no basis for BT to assume its costs were appropriate.

6.52 As set out in the July determination (see paragraph 4.6 above) we agree that there is an onus and presumption on BT to comply with its SMP obligations and to show such compliance. However, we also consider that Ofcom's statements, and BT's reasonable appreciation are relevant.

6.53 In making the points summarised at a) and b) above, the CPSOs suggest that the change in the regulatory regime in 2003 was so significant that what happened before this change (namely that the Director General of Telecommunications had previously directed BT in 2001 and 2002 to charge in a way that included the disputed costs is irrelevant.

6.54 It is clearly correct that there was a change in the regulatory regime in November 2003 when condition 50A of BT's licence was replaced and replicated by SMP condition AA8, and we agree that the CPSOs' contention that the Director General of Telecommunications' previous directions regarding CPS charges ceased to have legal effect in November 2003. However, we note that the wording of SMP condition AA8 is materially similar to condition 50A, which it replaced.

6.55 Condition AA8.4(a) requires charges for "CPS Facilities" to be reasonable and "*based on ... forward looking long-run incremental costs*". Condition 50A also used the terms CPS Facilities. When it introduced condition AA8, Ofcom gave no new guidance as to what was to be included within the definition of "CPS Facilities". In these circumstances, absent a statement or indication from Ofcom that it considered the position as to BT's charges had changed, we remain of the view as set out in our July Determination that it was reasonable in all the circumstances for BT to continue to

charge in the same manner in which it had then recently been directed under condition 50A, which included the disputed costs.

- 6.56 In respect of the CPSOs' point summarised at c) above, we note that the August 2005 Direction set the level of the CPS set-up charge to which BT was required to reduce its existing charges. In this regard, the 2005 Direction effectively set a ceiling for BT's charges. Had BT sought to charge above that ceiling following the direction, Ofcom would have been entitled to take enforcement action (and would no doubt have been urged to do so by affected stakeholders). We note in this regard that we agree with the CPSOs' contention that it was nonetheless open to BT to set a new lower CPS charge after the 2005 Direction was imposed. That does not in our view however mean that the August 2005 Direction had no ongoing binding effect.
- 6.57 Ofcom also notes that, as the CPSOs set out at paragraph 6.18 of their submission, the August 2005 Direction required BT to set a specific charge. Ofcom therefore considers that BT could reasonably at the time assume that if it reduced its charges to that specified level, it would be compliant with its regulatory obligations. That does not in itself remove the onus and obligation on BT to ensure that its charges for CPS remain compliant with its regulatory obligations on an ongoing basis, but Ofcom considers that the August 2005 Direction nonetheless remains a relevant factor in any assessment of BT's charges and reasonable appreciation.
- 6.58 In respect of the CPSOs' point summarised at d) above, we re-iterate that the 2005 Direction effectively set a ceiling price of £2.72 which included the disputed costs. That direction was not appealed by any party. Ofcom did state that it thought it was appropriate to consider certain costs of CPS in a 2006 review, but Ofcom was not specific as to what the precise subject matter of any such review in 2006 might be. In any event, it would not be reasonable for any party to assume that because Ofcom was going to review something, that the outcome was a foregone conclusion. As a public body, Ofcom is not permitted to fetter its discretion, and so any review would be assessed on its merits, based on the evidence and all relevant considerations at the time.
- 6.59 Ofcom does not therefore agree with the CPSOs' contention that because Ofcom indicated that it would undertake a future review of CPS pricing, "it is impossible to read the 2005 Direction as any kind of indication to BT that those costs were legitimately included in the CPS setup charge". Ofcom does consider that the August 2005 Direction is a relevant factor to take into account in assessing BT's reasonable appreciation in relation to the disputed costs.

### **Presumption of repayment**

- 6.60 The CPSOs submit that the TRD judgment provides a presumption in favour of repayment of an overcharge under section 190(2)(d) of the 2003 Act, and that in exercising its discretion under section 190(2)(d), Ofcom considers it appropriate to rebut that presumption, if should explain why, by clear reference to its duties..
- 6.61 Ofcom disagrees that there is a presumption to order repayment, for the reasons set out in its Defence. The CPSOs have made a number of points in their submission which challenge the points in Ofcom's Defence,
- 6.62 Ofcom considers that the CPSOs appear to have misread or misunderstood Ofcom's position as set out in its Defence. Ofcom has not and does not suggest that its dispute resolution function in general, or its specific powers under section 190(2)(d) of the Act, are constrained by "the technicalities of an OCCN procedure" (the

procedure which applied in the context of the TRD case). Ofcom also agrees that the law as set out in the Act, and the underlying European directives, provides for the resolution of disputes, and not only for the resolution of disputes concerning OCCNs.

- 6.63 The simple point which Ofcom made in its Defence, was that the CAT's judgment in the TRD case, including the obiter remarks to which the CPSOs refer, was specific to the facts of that case. That is not the same as saying that the entire dispute resolution process set out in the Act and the directives is limited to those facts.
- 6.64 Ofcom therefore remains of the view that neither the TRD judgment nor any part of the statutory framework provides a presumption in favour of repayment, that Ofcom needs to rebut in particular categories of case. Ofcom has a discretion under the Act which it must exercise in accordance with its statutory duties and cannot fetter that discretion by the application of presumptions one way or the other.

### **Fairness as between the Parties**

- 6.65 The CPSOs submit that in not considering *the question of competitive distortion* in the July Determination, Ofcom considered fairness only from the perspective of BT and ignored that of the CPSOs (see paragraph 5.18 above for further details). We disagree as Ofcom clearly considered the issue of fairness from the perspective of both BT and the CPSOs in the July Determination as demonstrated at paragraphs 4.89 and 4.95.
- 6.66 The CPSOs set out two passages from Ofcom's PPC determination, in which Ofcom set out the important distinction between correcting behaviour and penalising it, and that fact that the purpose of requiring BT in that case to make repayments was to correct its behaviour, not to punish it. Ofcom considers that these statements are correct, and remain equally valid today.
- 6.67 However, as set out above, there are a number of relevant considerations in this dispute, pertaining to BT's reasonable appreciation, which apply in this dispute and which did not apply in the PPC dispute. Ofcom must take those considerations into account when exercising its discretion under section 190(2)(d). The PPC determination can and should therefore be distinguished from the position in this case, and it does not therefore follow either that Ofcom is resiling from the position it took in the PPC determination, nor that Ofcom should automatically require repayments to be made in this case, because it decided to require BT to make repayments in the PPC case.
- 6.68 In deciding how to exercise its discretion with regard to repayments in this draft re-determination, Ofcom must take into account all relevant considerations in this case. The CPSOs maintain that not to require BT to make repayments in this case would be manifestly unfair to them. Ofcom must, balance fairness considerations arising on all sides of a particular matter. In this case there are powerful fairness arguments which arise on BT's part due to the way in which CPS charges were set by Ofcom previously, as set out above.

## Further comments on Competitive Distortion

- 6.69 The CPSOs make a number of comments in relation to competitive distortion which are in addition to the points made in the RBB Report, which we have addressed above. These relate to the need to be consistent with Ofcom's recent PPC decision, and in particular the conclusions there that (i) only potential economic harm (and hence competitive distortion) needs to be shown, and (ii) that it is irrelevant to the question of repayment as to whether or not the charges have been passed on to customers.
- 6.70 To the extent relevant, our comments above in relation to consistency with the PPC determination apply. Ofcom accepts that both of the conclusions set out above apply equally to the assessment which it must undertake in this case in relation to the exercise of its discretion as to its powers under section 190(2)(d). However, for the reasons set out above, there are further relevant considerations which Ofcom considers it must also take into account in this case. Ofcom does not consider that the conclusions set out above override all other relevant considerations – they simply form part of the overall considerations which Ofcom must take into account when exercising its discretion under section 190(2)(d) of the Act.

## Provisional Conclusions

- 6.71 Ofcom has considered carefully all the representations made to it, both prior to the July Determination as set out in section 3 above, and now specifically in respect of this draft re-determination.
- 6.72 In contrast to the July Determination, Ofcom has now also considered the question of competitive distortion. It has provisionally concluded above that BT's charges may have given rise to a competitive distortion, but that such a distortion, if any, is likely not to have been material.
- 6.73 Ofcom remains of the view that BT's reasonable appreciation as to its charges, based on the directions given it by the Director General of Telecommunications in 2001 and 2002, and Ofcom in August 2005, and the lack of any other guidance from Ofcom as to its proper charges in this regard, is a relevant consideration which Ofcom must take into account.
- 6.74 Ofcom notes its conclusions in the PPC determination, and considers that the various principles which it set out in that determination, and which have been considered above, remain valid. However, for the reasons set out above, Ofcom considers that the facts of this case are significantly different to those in the PPC determination as regards BT's reasonable appreciation, and that as a result, the PPC case can and should be distinguished from this case.
- 6.75 The exercise of Ofcom's discretion under section 190(2)(d) requires it to consider all relevant considerations, including those in favour of and those against a direction to make payments, and make a judgment call based on those considerations.
- 6.76 The main considerations in favour of requiring BT to make payments to the CPSOs are the fact that we have already found that BT is not entitled to recover the disputed costs, that it is not relevant that the CPSOs may have passed those costs on to their own customers, and that the inclusion of the disputed costs may have given rise to a competitive distortion in the market, although our analysis suggests that if any such

competitive distortion did arise, it is likely to have been immaterial. There is also a question of whether it would be unfair to the CPSOs not to require BT to repay

- 6.77 The main considerations against requiring BT to make payments to the CPSOs are the fact that both the Director General of Telecommunications and Ofcom gave directions to BT which required BT to reduce its charges to set levels, and those levels were calculated on the basis of the inclusion of the disputed costs, and that there is a question here of whether in light of this it would be unfair to BT to require it to make repayments to the CPSOs.
- 6.78 Ofcom is also mindful of the competing arguments made by the parties as to the incentives which Ofcom's decision on repayments might give. The CPSOs argue that a decision not to require BT to repay would incentivise BT to charge in breach of its regulatory obligations unless and until it was told to do otherwise by the regulator. On the other hand, requiring BT to repay costs which it can reasonably argue were sanctioned or even required by regulatory directions, provides little guarantee of regulatory certainty that regulatory decisions can be relied upon.
- 6.79 On balance, we are not convinced by the CPSOs' arguments that a decision not to require repayments would generally incentivise BT to breach its regulatory obligations. The onus remains on BT to charge in compliance with its regulatory obligations, and to be able to demonstrate the same. Any decision in this case not to require BT to make repayments would be made on the basis of the specific facts of this case, and would not in our view have general application.
- 6.80 Except as amended by this draft re-determination, we continue to rely on the reasoning and conclusions in our July Determination.
- 6.81 Taking all relevant considerations into account, we are minded to conclude that we should exercise our discretion under section 190(2)(d) of the Act not to require BT to make any payments to the CPSOs. In particular, we do not consider that the evidence we have seen on competitive distortion suggests that the potential for a non-material distortion in the relevant market is such that we should reach a different provisional conclusion.

### **The application of Ofcom's duties**

- 6.82 We have considered whether our provisional conclusion is consistent with Ofcom's duties.
- 6.83 We consider that given our provisional conclusion that the evidence we have seen on competitive distortion suggests that if distortion arose as a result of the historic inclusion of the disputed costs, that distortion (if any) was likely not to be material, our provisional overall conclusion not to require any repayments is consistent with our principal duty at section 3(1)(b) of the Act to further the interests of consumers, where appropriate by promoting competition, and our duties under section 4 of the Act to promote competition in communications markets in accordance with the Framework Directive. and specifically Article 8(2)(d) in particular .
- 6.84 We remain of the view as stated at paragraph 4.92 of our July Determination, that requiring that the disputed costs should be removed by BT from the CPS cost stack (which BT has now done) was consistent with the policy objectives of Article 8 of the Framework Directive.

- 6.85 We also remain of the view as set out at paragraph 4.93 of the July Determination, that the February Determination helped to level the playing field for BT's competitors. This supports Ofcom's obligations at section 3(2)(b) of the 2003 Act to secure the availability of a wide range of communications services, as well as its duty under section 4 of the 2003 Act to encourage the provision of network access (here, CPS) for the purposes of securing efficiency and sustainable competition for the benefit of consumers.
- 6.86 In accordance with section 3(3)(b), Ofcom must have regard to any principles which it considers represent best regulatory practice. We consider that our provisional conclusion supports the principle that stakeholders should have regulatory certainty in decisions made by the regulator, and that this is a principle which does represent best regulatory practice and which Ofcom should support.
- 6.87 We have set out above that we consider our provisional conclusion not to require repayments is consistent with the principles set out in previous decisions, including in the PPC dispute, and so consistent with our duties under section 3(3) of the Act. The fact that, in taking into account all considerations which are relevant on the specific facts of this case, we propose not to require repayments, does not affect the continued validity of those principles.
- 6.88 Ofcom considers that on balance, on the basis of all relevant considerations in this case, its provisional conclusion not to require BT to make repayments is fair as between the parties to the dispute and reasonable in light of its statutory duties.

Draft re-determination to resolve a dispute between C&W, CPW and Gamma against BT about Carrier Pre Selection set-up charges

Draft re-determination to resolve a dispute between C&W, CPW and Gamma against BT about Carrier Pre Selection set-up charges

## Annex 1

# Responding to this consultation

## How to respond

- A1.1 Ofcom invites written views and comments on the issues raised in this document, to be made **by 5pm on 22 February 2010**.
- A1.2 Ofcom strongly prefers to receive responses using the online web form at [https://www.ofcom.org.uk/consult/condocs/draft\\_redeter\\_against\\_bt/howtorespond/form](https://www.ofcom.org.uk/consult/condocs/draft_redeter_against_bt/howtorespond/form), as this helps us to process the responses quickly and efficiently. We would also be grateful if you could assist us by completing a response cover sheet (see Annex 3), to indicate whether or not there are confidentiality issues. This response coversheet is incorporated into the online web form questionnaire.
- A1.3 For larger consultation responses - particularly those with supporting charts, tables or other data - please email [phil.jones@ofcom.org.uk](mailto:phil.jones@ofcom.org.uk) attaching your response in Microsoft Word format, together with a consultation response coversheet.
- A1.4 Responses may alternatively be posted or faxed to the address below, marked with the title of the consultation.
- Phil Jones  
4<sup>th</sup> Floor  
Competition Group  
Riverside House  
2A Southwark Bridge Road  
London SE1 9HA
- Fax: 020 7783 4109
- A1.5 Note that we do not need a hard copy in addition to an electronic version. Ofcom will acknowledge receipt of responses if they are submitted using the online web form but not otherwise.
- A1.6 It would be helpful if you can explain why you hold your views and how Ofcom's proposals would impact on you.

## Further information

- A1.7 If you want to discuss the issues and questions raised in this consultation, or need advice on the appropriate form of response, please contact Phil Jones on 020 7981 3641.

## Confidentiality

- A1.8 We believe it is important for everyone interested in an issue to see the views expressed by consultation respondents. We will therefore usually publish all responses on our website, [www.ofcom.org.uk](http://www.ofcom.org.uk), ideally on receipt. If you think your response should be kept confidential, can you please specify what part or whether all of your response should be kept confidential, and specify why. Please also place such parts in a separate annex.

- A1.9 If someone asks us to keep part or all of a response confidential, we will treat this request seriously and will try to respect this. But sometimes we will need to publish all responses, including those that are marked as confidential, in order to meet legal obligations.
- A1.10 Please also note that copyright and all other intellectual property in responses will be assumed to be licensed to Ofcom to use. Ofcom's approach on intellectual property rights is explained further on its website at <http://www.ofcom.org.uk/about/accoun/disclaimer/>

### Next steps

- A1.11 Following the end of the consultation period, Ofcom intends to publish a final determination by 23 October 2009.
- A1.12 Please note that you can register to receive free mail updates alerting you to the publications of relevant Ofcom documents. For more details please see: [http://www.ofcom.org.uk/static/subscribe/select\\_list.htm](http://www.ofcom.org.uk/static/subscribe/select_list.htm)

### Ofcom's consultation processes

- A1.13 Ofcom seeks to ensure that responding to a consultation is easy as possible. For more information please see our consultation principles in Annex 2.
- A1.14 If you have any comments or suggestions on how Ofcom conducts its consultations, please call our consultation helpdesk on 020 7981 3003 or e-mail us at [consult@ofcom.org.uk](mailto:consult@ofcom.org.uk) . We would particularly welcome thoughts on how Ofcom could more effectively seek the views of those groups or individuals, such as small businesses or particular types of residential consumers, who are less likely to give their opinions through a formal consultation.
- A1.15 If you would like to discuss these issues or Ofcom's consultation processes more generally you can alternatively contact Vicki Nash, Director Scotland, who is Ofcom's consultation champion:

Vicki Nash  
Ofcom  
Sutherland House  
149 St. Vincent Street  
Glasgow G2 5NW

Tel: 0141 229 7401  
Fax: 0141 229 7433

Email [vicki.nash@ofcom.org.uk](mailto:vicki.nash@ofcom.org.uk)

## Annex 2

# Ofcom's consultation principles

A2.1 Ofcom has published the following seven principles that it will follow for each public written consultation:

### Before the consultation

- A2.2 Where possible, we will hold informal talks with people and organisations before announcing a big consultation to find out whether we are thinking in the right direction. If we do not have enough time to do this, we will hold an open meeting to explain our proposals shortly after announcing the consultation.
- A2.3 We will be clear about who we are consulting, why, on what questions and for how long.
- A2.4 We will make the consultation document as short and simple as possible with a summary of no more than two pages. We will try to make it as easy as possible to give us a written response. If the consultation is complicated, we may provide a shortened Plain English Guide for smaller organisations or individuals who would otherwise not be able to spare the time to share their views.
- A2.5 We will consult for up to 10 weeks<sup>63</sup> depending on the potential impact of our proposals.
- A2.6 A person within Ofcom will be in charge of making sure we follow our own guidelines and reach out to the largest number of people and organisations interested in the outcome of our decisions. Ofcom's 'Consultation Champion' will also be the main person to contact with views on the way we run our consultations.
- A2.7 If we are not able to follow one of these principles, we will explain why.

### After the consultation

- A2.8 We think it is important for everyone interested in an issue to see the views of others during a consultation. We would usually publish all the responses we have received on our website. In our statement, we will give reasons for our decisions and will give an account of how the views of those concerned helped shape those decisions.

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<sup>63</sup> In the case of disputes we will consult for ten working days from the publication date of the draft determination; this reflects the four month deadline for Ofcom to issue its final determination.

## Annex 3

# Consultation response cover sheet

- A3.1 In the interests of transparency and good regulatory practice, we will publish all consultation responses in full on our website, [www.ofcom.org.uk](http://www.ofcom.org.uk).
- A3.2 We have produced a coversheet for responses (see below) and would be very grateful if you could send one with your response (this is incorporated into the online web form if you respond in this way). This will speed up our processing of responses, and help to maintain confidentiality where appropriate.
- A3.3 The quality of consultation can be enhanced by publishing responses before the consultation period closes. In particular, this can help those individuals and organisations with limited resources or familiarity with the issues to respond in a more informed way. Therefore Ofcom would encourage respondents to complete their coversheet in a way that allows Ofcom to publish their responses upon receipt, rather than waiting until the consultation period has ended.
- A3.4 We strongly prefer to receive responses via the online web form which incorporates the coversheet. If you are responding via email, post or fax you can download an electronic copy of this coversheet in Word or RTF format from the 'Consultations' section of our website at [www.ofcom.org.uk/consult/](http://www.ofcom.org.uk/consult/).
- A3.5 Please put any parts of your response you consider should be kept confidential in a separate annex to your response and include your reasons why this part of your response should not be published. This can include information such as your personal background and experience. If you want your name, address, other contact details, or job title to remain confidential, please provide them in your cover sheet only, so that we don't have to edit your response.