Office of
Telecommunications

Draft Direction - concerning termination rates payable by BT to Operators based reciprocally upon BT's own termination charges

18 January 2002

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Contents

Draft Direction under the provisions of Regulation 6(6) of the Telecommunications (Interconnection) Regulations 1997 of disputes between British Telecommunications plc ("BT") and:

(i) Cable & Wireless Communications (Mercury) Limited ("C&W"); and
(ii) Telewest Communications plc & other Operators in the Telewest group of companies as set out in Annex A to this Direction ("Telewest");

- concerning termination rates payable by BT to Operators based reciprocally upon BT's own termination charges under the Network Charge Control Regime:

WHEREAS:

(A) the Secretary of State for Trade and Industry granted to British Telecommunications on 22 June 1984 a licence ("the BT licence") under section 7 of the Telecommunications Act 1984 ("the Act") for the running of telecommunications systems specified in the BT licence;

(B) by virtue of section 109 of, and paragraph 20 of Schedule 5 to, the Act the BT licence has effect as if granted to British Telecommunications plc ("BT");

(C) the Secretary of State for Trade and Industry has granted to Cable & Wireless Communications (Mercury) Limited ("C&W"), and to Telewest Communications plc and other Operators in the Telewest group of companies as set out in Annex A to this Direction ("Telewest"), licences under section 7 of the Act for the running of a telecommunications system as specified in that licence;

(D) Regulation 6(6) of the Telecommunications (Interconnection) Regulations 1997 (the "Interconnection Regulations"), provides that, where there is a dispute concerning interconnection between organisations, the Director General of Telecommunications ("the Director General") shall, at the request of either party, take steps to resolve the dispute within six months of the date of the request;

(E) C&W entered into a Standard Interconnect Agreement with BT on 1 May 1998 and each of the Operators in the Telewest group entered into a Standard Interconnect Agreement with BT on the dates set out in Annex A to this Direction;

(F) C&W issued an Operator Charge Change Notice ("OCCN") to BT on 5 July 2001 setting out charges payable by BT (effective 1 October 2001) for calls from the BT network terminating on the C&W network. Telewest issued an Operator Charge Change Notice ("OCCN") to BT on 6 July 2001 setting out charges payable by BT (effective 1 October 2001) for calls from the BT network terminating on the Telewest network. BT rejected both OCCNs on 13 July 2001 when it issued its own OCCNs for the same services to C&W and Telewest respectively. Both C&W and Telewest rejected BT's OCCN within 14 days;

(G) Both C&W and Telewest are unable to agree with BT on this matter and are therefore in dispute;

(H) On 31 August 2001 both C&W and BT referred, in accordance with the provisions of regulation 6(6) of the Interconnection Regulations, this dispute to the Director General for his determination. On 26 September 2001 Telewest referred the same matter to the Director General for his determination;

(I) The Director General has considered, *inter alia*, the information provided by the parties and the matters set out in regulation 6(8) of the Interconnection Regulations. The principal points are summarised in the Explanatory Memorandum that accompanies, and is published with, this Direction. The Explanatory Memorandum also contains a full statement of the Director General's reasons for making this Direction;

(J) a draft of this Direction and the Explanatory Memorandum was issued to interested parties on [.....]. Comments were invited by [....];

NOW THEREFORE, THE DIRECTOR GENERAL, PURSUANT TO REGULATION 6(6) OF THE INTERCONNECTION REGULATIONS, AND HAVING CONSIDERED THE VIEWS OF THE PARTIES AND THOSE MATTERS SET OUT IN REGULATION 6(8) OF THOSE REGULATIONS, HEREBY MAKES THE FOLLOWING DETERMINATION TO RESOLVE THE DISPUTES BETWEEN BT AND BOTH C&W AND TELEWEST:

1. Cable & Wireless Communications (Mercury) Limited is not required to sign and return the OCCN of 13 July 2001 issued to it by BT or to apply the charges for call termination set out therein.

2. Telewest Communications plc and other Operators in the Telewest group of companies as set out in Annex A to this Direction are not required to sign and return the OCCN of 13 July 2001 issued to it by BT or to apply the charges for call termination set out therein.

Keith Long
Director of Compliance

A person duly authorised under paragraph 8 of Schedule 1 of the Telecommunications Act 1984

This direction takes affect on the date it is published.

Draft Direction under the provisions of Regulation 6(6) of the Telecommunications (Interconnection) Regulations 1997 of disputes between British Telecommunications plc ("BT") and:

(iii) Inclarity plc ("Inclarity"); and
(iv) The Operators set out in Annex B to this Direction;

- concerning termination rates payable by BT to Operators based reciprocally upon BT's own termination charges under the Network Charge Control Regime:

WHEREAS:

(A) the Secretary of State for Trade and Industry granted to British Telecommunications on 22 June 1984 a licence ("the BT licence") under section 7 of the Telecommunications Act 1984 ("the Act") for the running of telecommunications systems specified in the BT licence;

(B) by virtue of section 109 of, and paragraph 20 of Schedule 5 to, the Act the BT licence has effect as if granted to British Telecommunications plc ("BT");

(C) the Secretary of State for Trade and Industry has granted to Inclarity plc ("Inclarity") (formerly ABS Telecom plc) and each of the Operators set out in Annex B to this Direction ("the Operators") a licence under section 7 of the Act for the running of a telecommunications system as specified in that licence;

(D) Regulation 6(6) of the Telecommunications (Interconnection) Regulations 1997 (the "Interconnection Regulations"), provides that, where there is a dispute concerning interconnection between organisations, the Director General of Telecommunications ("the Director General") shall, at the request of either party, take steps to resolve the dispute within six months of the date of the request;

(E) Inclarity entered into a Standard Interconnect Agreement with BT on 27 November 1997 and each of the Operators entered into a Standard Interconnect Agreement with BT on the dates set out in Annex B to this Direction;

(F) BT issued an Operator Charge Change Notice ("OCCN") on 13 July 2001 to Inclarity and each of the Operators. Inclarity and the Operators are deemed to have rejected the OCCN by failure to sign within the agreed contractual timescales;

(G) BT is unable to agree with Inclarity and each of the Operators on this matter and is therefore in dispute with each;

(H) On 31 August 2001 BT referred, in accordance with the provisions of regulation 6(6) of the Interconnection Regulations, this dispute to the Director General for his determination;

(I) The Director General has considered, *inter alia*, the information provided by the parties and the matters set out in regulation 6(8) of the Interconnection Regulations. The principal points are summarised in the Explanatory Memorandum that accompanies, and is published with, this Direction. The Explanatory Memorandum also contains a full statement of the Director General's reasons for making this Direction;

(J) a draft of this Direction and the Explanatory Memorandum was issued to interested parties on [.....]. Comments were invited by [....];

NOW THEREFORE, THE DIRECTOR GENERAL, PURSUANT TO REGULATION 6(6) OF THE INTERCONNECTION REGULATIONS, AND HAVING CONSIDERED THE VIEWS OF THE PARTIES AND THOSE MATTERS SET OUT IN REGULATION 6(8) OF THOSE REGULATIONS, HEREBY MAKES THE FOLLOWING DETERMINATION TO RESOLVE THE DISPUTES BETWEEN BT AND INCLARITY, AND BT AND EACH OF THE OPERATORS:

1. Inclarity plc and each of the Operators listed at Annex B to this Direction is required to apply those call termination charges proposed to it in BT's OCCN of 13 July 2001.

2. The charge shall have effect from 1 October 2001.

3. If the net amount payable by BT is greater than that previously payable under charges for the same service in effect prior to BT's OCCN of 13 July 2001, BT shall pay to Inclarity or the Operator as appropriate the amount of the difference together with interest calculated in accordance with Clause 13.13 of BT's Standard Interconnect Agreement.

4. If the net amount payable by BT is lower than that previously payable under charges for the same service in effect prior to BT's OCCN of 13 July 2001, Inclarity or the Operator as appropriate shall pay to BT the amount of the difference together with interest calculated in accordance with Clause 13.13 of BT's Standard Interconnect Agreement.

Keith Long
Director of Compliance

A person duly authorised under paragraph 8 of Schedule 1 of the Telecommunications Act 1984

This direction takes affect on the date it is published.

Draft Direction under the provisions of Regulation 6(6) of the Telecommunications (Interconnection) Regulations 1997 of disputes between British Telecommunications plc (“BT”) and:

(i) Cable & Wireless Communications (Mercury) Limited (“C&W”);
(ii) Telewest Communications plc & other Operators in the Telewest group of companies as set out in Annex A to this Direction (“Telewest”);
(iii) Inclarity plc (“Inclarity”); and
(iv) The Operators set out in Annex B to this Direction;

- concerning termination rates payable by BT to Operators based reciprocally upon BT’s own termination charges under the Network Charge Control Regime:

Explanatory Memorandum

Chapter 1

Summary

1.1 The Director General of Telecommunications (“the Director General”) has issued a draft Direction pursuant to his powers under the Telecommunications (Interconnection) Regulations 1997 (“the Regulations”), for the resolution of disputes between BT and C&W, BT and Telewest, BT and Inclarity, and BT and each of the Operators listed at Annex B to this Direction under the terms of their Standard Interconnect Agreements (“SIA”). This draft Direction sets out the Director General’s proposed decision on these disputes concerning the application of call termination charges payable by BT to Operators based reciprocally upon BT’s own charges under the Network Charge Controls.

1.2 On 13 July 2001 BT issued 96 Operator Charge Change Notices (“OCCNs”) to relevant Operators setting out terms for reciprocal call termination and charges to be applied from 1 October 2001. A number of Operators either formally rejected BT’s OCCN or failed to sign and return it within agreed contractual timescales. BT therefore referred such Operators to the Director General as in dispute on this matter by letter of 31 August 2001. C&W referred the same matters to the Director General also by letter of 31 August 2001. Telewest referred the matter to the Director General by letter of 26 September 2001. The Director General has sought the views of all parties to the disputes and has considered the submissions made by BT and Operators and has issued a draft Direction in respect of these disputes and this Explanatory Memorandum on 17 January 2002 to the industry as a whole for consultation. Comments are requested and will be taken into account in making a final Direction.

1.3 The details of the Director General’s consideration of the submissions made by BT and Operators, together with the reasons for making his draft Direction, are set out in Sections 3 and 4. In summary, the Director General is minded to conclude that:

(i) Neither C&W nor Telewest shall be required to sign and implement the call termination charges proposed in BT’s OCCN of 13 July 2001; and

(ii) Inclarity and the Operators at Annex B to this Direction are required to sign and return BT’s OCCN of 13 July 2001 implementing charges for call termination services effective from 1 October 2001. This Direction provides that the Operators who, since 1 October 2001, have been receiving payments based on previously agreed termination charges, will repay to BT the amount of any difference plus interest from that date in accordance with Oftel’s applied interest rate of the London Inter Bank Offered Rate (“LIBOR”) plus 3/8 percent.

1.4 Having considered the facts specific to this dispute and the matters set out in Regulation 6(8) of the Telecommunications (Interconnection) Regulations 1997, this draft Direction, in the opinion of the Director General, represents a fair balance between the interests of the parties in each case, having regard to the Director General's wider duties to the development of the Telecommunications industry in the UK and the encouragement of adequate interconnection in a way that provides maximum economic efficiency and gives the maximum benefit to end users.

Chapter 2

Background

Call termination

2.1 The terminating network is the network to which a customer who receives a call is directly connected. Call termination on BT's network is defined from the termination switch to the customer (noting that call termination excludes all access costs).

2.2 The calling party and not the called party pays for call termination. Operators, who are competing at the retail level, need to buy call termination services from each other in order to be able to provide end-to-end calls between customers on different networks. As an interconnection service, however, call termination has particular characteristics that arise from the 'call termination externality'. An externality may be said to exist where the actions of an individual or organisation cause costs to be incurred by others (or benefits to be gained by others), but that individual or organisation has no incentive to take such effects into account. The externality in call termination arises because the retail price of a call is paid by the caller, not the call recipient. The caller has little if any influence over the call recipient's choice of network and accordingly, over the call termination charge to be paid. The characteristics of call termination that arise which are important in this context are:

> (i) charges for call termination are paid by the customers of other Operators, which will be competing with the terminating Operator in retail markets. Consequently, Operators have incentives to set high call termination charges which raise their competitors' costs; and
> (ii) operators have weak incentives to minimise costs and charges of call termination because the implications of high charges are faced by the customers of competing Operators.

Reciprocity

2.3 In a statement issued in July 1997, *Network Charges from 1997*, the Director General supported the principle of reciprocal charging for Operators' call termination charges. This principle required that Operators' charges were calculated on a reciprocal basis to BT's own call termination charges, taking into account the different network topologies. BT's own charges were regulated under the Network Charge Controls from 1997. The aim of reciprocity was to ensure competitive neutrality between BT and Operators and to remove the distortive effects of the call termination externality. The Director General, whilst publicly supporting the principles of reciprocity, believed it was a matter for industry to agree to the practical implementation of the most appropriate approach to reciprocity from a number of options identified.

2.4 In 1997 the industry reached agreement on the application of reciprocity to call termination charges. The agreement took account of the different termination charges paid to BT by Operators derived from differences in the mix of Points of Interconnection ("POIs") (ie the mix of local exchanges ("DLEs") and tandem exchanges (“DMSUs”)). Operators which interconnected only at DMSU received (and paid) single tandem rates. Those with a mix of interconnection at DLE and DMSU received (and paid) charges reflecting the proportion of Operator traffic routed via DLEs and DMSUs.

Industry negotiation of current reciprocity agreement

2.5 The reciprocity agreement implemented by the industry in 1997 ran for the period covering the Network Charge Controls until 30 September 2001. From March 2001 BT and a group representing Operators opened discussions aimed at reaching agreement on a new reciprocity agreement to run from 1 October 2001.

2.6 The proposed new agreement distinguished between Operators with single-switched status and Operators with multi-switched status. Single switched termination calls are calls that terminate on an end-user’s network termination point connected directly to the switch where BT hands over a call to the Operator. Multi-switched calls are calls that terminate on an end-user’s network termination point that is connected to a different Operator switch from that where BT hands over the call. In the case of multi-switched calls, BT agreed to pay Operators a higher termination charge to reflect the additional work undertaken in Operator networks to terminate such calls. Under the proposed agreement, Operators with a significant proportion of calls terminating via multi-switched routes would apply for Multi-Switched Operator (“MSO”) status and receive higher termination payments from BT to reflect additional work carried out in Operator networks to terminate such calls. All other Operators would receive termination payments based on their status as a Single-Switched Operator (“SSO”).

2.7 The Director General understands that broad agreement was reached between BT and the Operator Group on the proposed agreement in respect of Single-switched Operators (“SSOs”), notwithstanding some remaining issues of concern put forward by specific Operators discussed in further detail below. There remained further outstanding issues in respect of Multi-switched Operators (“MSOs”) that could not be resolved in the context of the negotiations between BT and the Operator Group. These issues were to be pursued by BT and the relevant Operators by means of bilateral negotiation.

The OCCN process

2.8 Clause 13 of BT’s SIA describes the process used by Operators, including BT, for offering and amending charges in payment for access to another Operator’s services. Where BT proposes to change the price paid to the terminating operator for terminating calls, it issues an Operator Charge Change Notice (“OCCN”). The operator receiving the OCCN has 14 days to decide whether to accept or reject the new charge and to notify the originator of the OCCN. Failure to notify within 14 days signals a rejection of the proposal. Where the proposal is rejected, both operators have a further 14 days to settle the resultant dispute. If after this second period the dispute remains unsettled, either operator may refer the dispute to Oftel. On referral of a dispute, the Director is under an obligation to carry out a full investigation and take steps to determine the outcome within six months.

2.9 On 5 July 2001 C&W issued an OCCN to BT setting out proposed charges for C&W's call termination services. On 6 July 2001 Telewest issued an equivalent OCCN to BT. Both Operators proposed charges reflecting their understanding that significant proportions of their calls were multi-switched.

2.10 On 13 July 2001 BT issued an OCCN to all relevant setting out the proposed reciprocity agreement, the methodology of calculating individual Operator call termination charges, and the proposed charges for all Operators calculated on the basis that all calls were single-switched. All Operators were required to agree to the methodology and the charges proposed in this OCCN, including those Operators which believed they would in fact qualify for MSO status and appropriately higher charges under the proposed methodology. BT proposed that such Operators should agree to the SSO rates proposed within the OCCN and then apply for MSO status, and that acceptance of the OCCN would not prohibit application of MSO rates as agreed at a later date.

Disputes referred to the Director General

2.11 A number of Operators failed to agree to BT's OCCN. C&W and Telewest have rejected the OCCN due to their desire for MSO status, remaining concerns over elements of the reciprocity agreement and unwillingness to sign up to SSO rates in a written agreement whilst negotiations on MSO rates continued. Inclarity plc ("Inclarity", formerly ABS Telecom) has objected to BT's proposed charges as Inclarity stated they have the effect of implementing lower charges for call termination (payable by BT to Inclarity). A number of other Operators are deemed to have rejected the OCCN by failure to return the signed OCCN within contractual timescales.

2.12 On 31 August 2001 BT referred its dispute with those Operators failing to sign its OCCN of 13 July 2001 to the Director General for determination. C&W also referred the matter to the Director General on 31 August 2001. Telewest referred the same matter on 26 September 2001.

2.13 The Director General is aware that negotiations continue between BT and both C&W and Telewest (as well as other Operators not in dispute with BT on this matter) in respect of agreeing MSO status and appropriate termination charges. BT has referred C&W and Telewest as in dispute in the context of this determination as neither Operator has, in the meantime, agreed to BT's OCCN of 13 July 2001. Representations have been made by BT, C&W and Telewest to the Director General in respect of the progress of MSO negotiations. The Director General considers, however, that at present the dispute he has been asked to resolve (and is required to resolve under the Regulations) relates solely to Operators' failure to agree to the OCCN (and the charges proposed therein) of 13 July 2001.

Information sought by the Director General

2.14 Following referral of these disputes, the Director General has consulted the parties concerned. The relevant submissions are outlined below in section 3. A number of parties to this dispute, however, have failed to provide reasons for failing to accept BT's proposals as set out in its OCCN. The Director General has issued four information requests in an attempt to secure a response from such Operators. The Director General wrote to all Operators referred by BT as in dispute on these matters on 6 September 2001. On 28 September 2001 he wrote again, by recorded mail, to those Operators failing to provide a response to his initial letter. On 1 November 2001 the Director General issued a third letter by recorded mail to the registered office address of those Operators from which he had heard no reply. On 3 January 2002 the Director General issued a further request for information by recorded mail. The Director General believes he has made all reasonable endeavours to solicit an understanding of Operators’ positions in respect of these disputes with BT before reaching his preliminary conclusions outlined in the draft Direction and accompanying explanatory memorandum.

Chapter 3

Submissions of the parties

3.1 BT, C&W and Telewest made submissions orally and in writing on their respective disputes. Inclarity made a written submission. A number of other Operators provided limited response to the Director General’s requests for information but failed to provide reason for rejecting or failing to agree to BT’s OCCN of 13 July 2001, or suggesting any alternative.

BT’s general submissions

3.2 BT stated that on 13 July 2001 it issued an OCCN to 96 Operators under the terms of its SIA. This OCCN sought to agree termination rates payable by BT to Operators on a reciprocal basis to BT’s own termination charges under the Network Charge Controls. BT’s proposals represented an offer to cover the period 1 October 2001 to 30 September 2005 using the principles already established under the previous reciprocity agreement.

3.3 BT stated that the Operators it referred as in dispute had either formally rejected BT’s OCCN or failed to sign and return the OCCN within the 14 days required under the terms of the SIA. Subsequent negotiations failed to reach commercial agreement within contractual timescales. BT advised that, subsequent to its initial referral, a number of Operators have since reached commercial agreement with BT. BT remained in dispute only with C&W, Telewest, Inclarity and the Operators listed at Annex B to this Direction.

3.4 BT argued that its proposals are based on the same general principles as contained in the reciprocity agreement running from 1 October 1997 to 30 September 2001. Operators are treated as having either single-switched (SSO) or multi-switched (MSO) status, based upon the work carried out in their networks in order to terminate traffic. BT said that its OCCN proposed SSO status for all Operators so that all Operators received the same reasonable offer. The proposed process then allowed Operators who felt they would qualify to apply for MSO status. BT stated that it had agreed in negotiation with the Operator Group to reduce the threshold of multi-switched traffic required in order for an Operator to qualify for MSO status.

3.5 BT stated in respect of all Operators in dispute with it on this matter that any Direction made by the Director General should endorse both the methodology and principles proposed by BT, ie that the methodology for the calculation of charges is reasonable and correctly applied, and that charges payable to Operators should be applied reciprocally, based upon BT’s LRIC call termination charges. The Director General should determine that the charges proposed by BT are reasonable and should be applied by Operators.

3.6 BT argued that its preferred course of action would have been for Operators seeking MSO status to sign the SSO OCCN without prejudice to their request for MSO status. BT stated that a number of Operators have indeed taken this option. BT confirmed that it had previously advised all such Operators that they could reject the

SSO OCCN and continue negotiations in respect of MSO status as BT had, at the time, expected to be able to reach agreement on MSO status in the near future. Consequently, those Operators that did not sign the OCCN were referred as part of the overall process as in dispute with BT over the proposed SSO charges. BT argued that a percentage of an MSO's calls would be single switched, therefore BT's OCCN had sought to agree to the relevant balance of DLE/ Single Tandem weighting for the SSO element. BT said in offering SSO rates to all Operators it had sought to treat all Operators consistently.

3.7 BT pointed out that termination charges were an issue not just between BT and any individual Operator, but for the industry as a whole. Termination charges would be paid not only by BT, but also by any other Operator originating geographic traffic that terminated on another Operator's network.

3.8 BT stated it was aware that a number of the Operators which had failed to agree to its OCCN of 13 July 2001 were either in administration or undergoing novation. BT argued, however, that such Operators must still be required to agree appropriate termination charges. BT said that when an Operator went into administration it did not cease trading immediately. In practice, BT's relationship with the Operator might continue for some time - the alternative would be that all of an Operator's customers would be cut-off immediately and left without telephony services. In terms of Operators undergoing novation, BT stated that in terms of whom BT was contracted to under its SIA, the status of an Operator might not change for a considerable period of time. It was therefore essential for BT to agree Operator termination charges with all such Operators while they retained the contractual ability to terminate geographic traffic.

C&W's submissions

3.9 C&W's initial submission to the Director General expressed surprise that BT had referred it as in dispute on the matter whilst negotiations continued between the parties. C&W said that it had made its own referral due to contractual obligations in the negotiation process, but was of the opinion that whilst commercial negotiation continued between BT and C&W there was not a genuine dispute for resolution.

3.10 C&W argued that it was misleading for BT to argue that MSO Operators should not necessarily have any concerns with the SSO OCCN issued on 13 July 2001. C&W believed that these concerns cannot be separated from its ongoing negotiations with BT in respect of MSO status. It was therefore inappropriate for BT to seek C&W to agree to the SSO OCCN in the interim. C&W argued it was irrelevant that other Operators seeking MSO status had signed BT's OCCN setting out SSO charges. Such Operators may not have the same concerns as C&W or be affected in the same way by the SSO calculation methodology.

3.11 C&W stated that BT's proposal for the SSO OCCN to be signed by Operators without prejudice to ongoing negotiations on MSO status, was not set out in the MSO registration pack sent to Operators seeking MSO status, nor in any other relevant correspondence.

3.12 C&W argued that it could not sign the OCCN agreeing to SSO charges because the MSO charge was, in part, derived from the SSO charge. BT uses the percentage mix of Operator to BT DLE/ Single Tandem egress traffic and assumes a reciprocal mix in the opposite direction to calculate appropriate charges. C&W stated that this assumption, whilst having some validity four years ago, is no longer valid following C&W's subsequent network build into the DLE layer. As C&W has been routing egress geographic traffic onto these routes, BT is benefiting (as a result of the reciprocal assumption) by way of a lower termination charge whilst undertaking no work itself in network or routing. This would discourage further network build into BT's DLE layer.

3.13 C&W raised further concerns with the reciprocity agreement as proposed and on which it continues to negotiate with BT. C&W is concerned that BT has attempted to change the definition of a multi-switched call to exclude calls where C&W has number ranges at a 1K level or below hosted on different switches. BT chooses not to route below a 10K number block. C&W believes that where the relevant information is made available to BT it should be required to pay for any resulting multi-switched call. C&W remains concerned that the reciprocity agreement may not enable C&W to exit from the four-year term of the agreement if it so wished. C&W also raised concern as to BT's intentions in respect of whether it may attempt to switch to near-end hand over from far-end hand over, with resulting implications for Operators on the cost of terminating calls. C&W also argued that the reciprocity agreement should be reciprocal upon BT's own call termination charges.

BT's submissions on its dispute with C&W

3.14 BT confirmed that it remains in commercial negotiation with C&W seeking to agree appropriate MSO rates. BT said that whether an Operator was an MSO was not black and white as it depended on the verification of appropriate traffic samples. This was the process that BT was engaged in with C&W. BT said that the process had taken longer than it had originally anticipated due to problems receiving all the necessary data from Operators.

3.15 BT stated it had advised Operators seeking MSO status that the preferred course of action would be for such Operators to sign the SSO OCCN. The MSO terms would then be subsequently documented as appropriately agreed based on the SSO OCCN. BT said that the SSO methodology for the calculation of charges to OLOs was of a generic nature and equally applied to all. C&W's concerns would be taken into account in the process of agreeing MSO rates.

3.16 BT stated it had always agreed that it should pay for multi-switched calls where numbers are hosted on switches and split below the 10K range and where C&W has made the appropriate information in respect of this available to BT. BT said it fully accepted this providing that C&W were willing to allow BT to route calls directly to the appropriate switches should BT choose to decode below a 10K block.

3.17 BT argued that the 'reciprocity agreement' refers to BT payments to Operators for call termination services, with the effect that Operators charges are based reciprocally upon BT's LRIC call termination charges. BT believed it was therefore inappropriate for the terms of the reciprocity agreement to be reciprocal upon BT's own call termination services. BT not only had multi-switched calls but Local, Single Tandem and Double Tandem segments, depending on the switch connection and its relationship in the hierarchy. The obligation on BT is more granular/complex (i.e. 5 different standard service terminating segments).

Telewest's submissions

3.18 Telewest stated it had issued its own OCCN to BT on 6 July 2001 due to concern that ongoing negotiations between BT and the Operator Group would not reach satisfactory agreement on reciprocal charging before the proposed implementation date of 1 October 2001. Telewest saw no alternative but to notify BT of its proposed pricing for the service of call termination. Telewest subsequently received BT's OCCN of 13 July 2001 and, in line with the procedural advice given to it by BT, rejected the OCCN on the basis that it wished to apply for MSO status. Bilateral negotiation and discussion continued between Telewest and BT following rejection of the OCCN, and for this reason Telewest stated it was surprised by BT's actions in referring the matter as a dispute to the Director General. Telewest did not regard its rejection of the OCCN of 13 July 2001 as bringing it into dispute with BT.

3.19 On 26 September 2001, Telewest itself referred the matters to the Director General for resolution, concerned that it had not been offered appropriate MSO rates by BT. Telewest pointed out that the OCCN issued by BT was for SSO termination charges. Telewest rejected this offer on the basis that it wished to apply for and negotiate appropriate MSO rates, a course of action recommended by BT to MSOs. Telewest was concerned that BT's failure to offer it appropriate MSO rates was linked to an allegation by BT that Telewest's status as an MSO Operator under the former reciprocity agreement was not justified, an allegation that Telewest rejected. Telewest expressed concern at the level of control BT had in setting the charges of other Operators under the reciprocity agreement. It believed the fact that BT had refused to differentiate between SSO and MSO Operators in the charges set out in its OCCN of 13 July 2001 was indicative of the extent to which BT controlled the timing and procedure of a process that set the charges of other Operators.

3.20 Telewest argued that BT had in fact failed to offer qualifying Operators call termination rates for the period 1 October 2001 to 30 September 2005 which were appropriate to their multi-switch status. Telewest believed that BT's offer of uniform call termination rates for all Operators, regardless of whether they carry out multi-switch or single-switch termination, was in fact contrary to the principles of reciprocity established in both the former and proposed agreements.

BT's submissions on its dispute with Telewest

3.21 BT confirmed that it remains in commercial negotiation with Telewest seeking to agree appropriate MSO rates, but that agreement had not been possible to date because of difficulties in verification of appropriate traffic samples. BT said that whether an Operator was an MSO was not clear-cut as it depended on this verification process. This was the process that BT was engaged in now with Telewest. BT stated that BT's query of Telewest's status under the previous reciprocity agreement was in no way related to ongoing negotiations of the current proposed agreement. BT rejected Telewest's assertion that it had failed to offer rates appropriate to its MSO status as it was still in the process of calculating what such rates might be. BT said that this process had taken longer than it had originally anticipated due to problems receiving all the necessary data from Operators. BT further rejected Telewest's allegation that it had undue control over the process of agreeing termination charges. BT said it had made an offer to all Operators in respect of SSO charges and has entered into negotiations with those Operators seeking MSO status. If there is failure to reach agreement on MSO issues then the Director General may be asked to adjudicate on the relevant issues at such time.

Inclarity's submissions

3.22 Inclarity stated that it objected to BT's proposals as Inclarity's termination charges set under the new agreement would be lower than under the previous agreement. Inclarity argued that the change would adversely affect its cash flow and revenue streams. Inclarity argued that BT's proposal favoured BT in that it cut down on the rebate due to alternative carriers whilst keeping a larger share of the initial call charge for itself.

BT's submissions on its dispute with Inclarity

3.23 BT stated that Inclarity was mistaken to assert that BT would be retaining a larger proportion of call charges for itself under the proposed new agreement. BT pointed out that the Daytime termination rate payable by BT to Operators will in fact increase under the charges proposed in BT's OCCN of 13 July 2001.

Chapter 4

The Director General’s considerations

The disputes

4.1 BT has referred C&W, Telewest, Inclarity and the Operators at Annex B as in dispute for failure to agree to call termination charges proposed in its OCCN of 13 July 2001. BT stated that any Direction issued by the Director General resolving these disputes should endorse the methodology proposed by BT, that the methodology for the calculation of charge is reasonable and correctly applied, and that the charges payable to Operators should be applied reciprocally based upon BT’s LRIC call termination charges. At the least, the Director General should determine that the charges proposed by BT are reasonable and should be applied by Operators.

4.2 For the sake of clarity, the Director General has separated, for the purpose of this Direction and Explanatory Memorandum, his conclusions into four separate issues;

(i) Dispute between BT and C&W;
(ii) Dispute between BT and Telewest;
(iii) Dispute between BT and Inclarity; and
(iv) Disputes between BT and those Operators failing to provide a substantive response outlining why they have not agreed to the OCCN of 13 July 2001 (Operators listed in Annex B);

Market power in call termination

4.3 The calling party and not the called party pays for call termination, but the calling party has little or no choice of network or Operator on which the call is to be terminated. An Operator therefore faces little competitive pressure on its call termination service. This confers market power on the providers of call termination in fixed networks. This view in terms of fixed network termination is consistent with the Director General’s conclusions in his *Review of Charge Controls on Calls to Mobiles* issued on 26 September 2001, in which he concluded that a separate call termination market for each mobile network was the most appropriate market definition.

The Director General’s view of reciprocity

4.4 The Director General reiterated the principle of reciprocity for Operator call termination charges in his *Guidelines on the Operation of the Network Charge Controls from October 2001* issued on 5 December 2001. This was to ensure competitive neutrality and to remove the distortive effects of the call termination externality (see paragraph 2.2 above).

Assessment of BT’s proposals in its OCCN of 13 July 2001

4.5 BT’s methodology for calculating SSO call termination is as negotiated between BT and an Operator Group and on which broad agreement is understood to have been reached.

4.6 The methodology for calculating SSO charges in the proposals outlined by BT is the same as that contained within the previous reciprocity agreement running from 1 October 1997 to 2001. Charges are based, for each individual Operator (or Operator ‘group’ or ‘entity’), on the measurement of total Operator to BT Local Exchange and BT Single Tandem traffic conveyed during a sample month of May, and applied for a 12 month period thereafter commencing on 1 October in each year. BT uses the percentage mix of Local Exchange and Single Tandem traffic and assumes that the percentage mix is reciprocal to traffic in the opposite direction. The termination charge payable by BT to an Operator is therefore calculated on a percentage mix of BT’s own charges. Operators for whom insufficient traffic data exists to calculate the ratio for the relevant period are assumed to have 100% single tandem for the purposes of reciprocal calculation.

4.7 BT’s proposals in its OCCN of 13 July 2001 in respect of MSO status are not relevant to the disputes in hand. Those Operators that have applied for MSO rates under the proposed agreement (C&W and Telewest) remain in commercial negotiation with BT in attempt to secure agreement of appropriate charges. These negotiations are being pursued on a bilateral basis and are outwith the generic offer made by BT to all Operators in its OCCN of 13 July 2001.

4.8 BT’s proposals, as far as SSO charges are concerned, broadly comply with one of four approaches to reciprocity identified by the Director General in his statement on *Network Charges from 1997* issued in July 1997. This approach was to calculate a charge for Operator call termination as a weighted average of BT’s local exchange segment and single tandem segment charges, using Operator to BT traffic to compute the weights. In the statement, the Director General identified this approach as one of two preferred options out of four considered as it reflected most closely the economic arguments underlying competitive neutrality.

4.9 The Director General identified one drawback with this approach, however, that Operators’ make or buy decisions would be distorted. Call termination charges are calculated on the percentage mix of Operator to BT egress traffic terminating on BT’s network via DLE or Single Tandem. As an Operator builds out to connect at BT’s DLE layer, its revenue received from BT falls even where there is no change in the actual service of termination carried out by the Operator in its own network. Operators therefore face a disincentive to interconnect at BT’s DLE since their receipts from BT would fall as would their payments to BT, but the fall in receipts would not reflect a change in costs incurred on the OLO network. Consequently, the sound pricing signals for OLOs to choose appropriate points of interconnection (the differential between the BT charges for the local exchange segment and the single tandem segment) would be adversely affected.

4.10 This disadvantage is offset to a degree in the previous and proposed agreements by the fact that the weighting of traffic is based on data from the previous year’s mix. This encourages the development of interconnection at DLEs since the benefit of reduced out payments to BT is felt immediately by the Operator, but the decreased receipts from BT are deferred.

4.11 The disincentive for Operators to connect at DLEs could be avoided if, instead of de-averaging call termination charges to the level of individual Operators, there was instead a single Operator call termination charge and all Operator interconnection traffic with BT was used to set the weights (or if Operators were grouped into a small number of categories). An Operator building out to BT's DLE layer would experience only limited reduction in the level of its receipts, unless it was sufficiently large enough for its decisions to have a significant impact on all-Operator average traffic mix. Other Operators, however, could also be affected by any Operator making changes to its POIs with BT. If any Operator undertook a significant build out to BT's DLE layer, all Operator receipts for call termination (or Operator receipts in that category of Operators) would fall in line with the change in the percentage mix of traffic, even though such Operators would not gain any benefit in terms of reduced out-payments to BT.

4.12 The Director General does not believe that a single weighted average of traffic used to calculate a single charge for call termination for all Operators (or for a small number of categories of Operators) is desirable in resolving this dispute given the disadvantages that also exist in these approaches, and the reluctance of industry to enter into such an option in the previous agreement and current proposals. The Director General is also aware that the effect of imposing a single weighted average on those Operators in dispute with BT on this matter would, for the majority of Operators in dispute, result in a decrease in the call termination charge revenue payable by BT (although this may not necessarily be the case using the more complicated approach of classifying Operators into a small number of groups). There would also be a matter of consistency with those Operators that have already agreed with BT to calculate termination rates based on a weighted average of their own individual egress traffic to BT.

The Director General's preliminary conclusions

(i) Dispute between BT and C&W

4.13 C&W is continuing to negotiate with BT in an attempt to secure MSO rates that it believes are appropriate to its MSO status. C&W argued that it could not sign the OCCN agreeing to SSO charges because the MSO charge was, in part, derived from the SSO charge. BT uses the percentage mix of Operator to BT DLE/ Single Tandem egress traffic and assumes a reciprocal mix in the opposite direction to calculate appropriate charges. C&W stated that this assumption, whilst having some validity four years ago, is no longer valid following C&W's subsequent network build into the DLE layer. As C&W has been routing egress geographic traffic onto these routes, BT is benefiting (as a result of the reciprocal assumption) by way of a lower termination charge whilst undertaking no work itself in network build or routing. C&W's argument centres on the drawback in the current reciprocity agreement outlined in paragraph 4.9. C&W's concerns in this respect remain part of its ongoing negotiations with BT in respect of MSO call termination charges.

4.14 C&W has also stated that it was not prepared to sign BT's OCCN of 13 July 2001, setting out SSO charges only, on the promise that MSO charges would be negotiated afterwards. Notwithstanding an understanding that such negotiation would proceed, C&W was not prepared to commit itself to an agreement in writing to apply the charges for call termination proposed in BT's OCCN.

4.15 BT's methodology attached to its OCCN of 13 July 2001 makes it clear that certain Operators will receive call termination payments from BT based upon the level of multi-switching that occurs in terminating traffic on their networks. BT has not made any representation that it believes that C&W will not qualify for some level of MSO payments under the methodology proposed in its OCCN of 13 July 2001. It appears unreasonable to the Director General, therefore, for BT to require C&W to agree to an OCCN setting out charges that are not intended to apply once commercial negotiation of MSO charges are complete. The Director General believes that it is more appropriate to await the conclusion of appropriate negotiations and apply the agreed rate retrospectively to the commencement date of the agreement, namely 1 October 2001.

4.16 The Director General is therefore minded to conclude that C&W should not be required to apply the charges set out in the OCCN of 13 July 2001 issued to it by BT. Should commercial negotiation of appropriate MSO charges fail then it remains open to either party to refer a dispute separately to the Director General for resolution.

(ii) Dispute between BT and Telewest

4.17 Telewest, in rejecting BT's OCCN of 13 July 2001, has not argued against the principle of reciprocal charging for call termination services. It has also not argued in principle against the methodology for calculating call termination charges set out in BT's proposals. BT's OCCN of 13 July 2001 required all Operators to agree to the SSO charges set out to it, including those Operators that sought to agree MSO status with BT on the understanding that BT and the Operator would subsequently negotiate appropriate charges.

4.18 Telewest and BT remain in commercial negotiation regarding the application of call termination charges. Telewest has stated that it is not prepared to sign BT's OCCN in the meantime as it requires Telewest to agree to SSO charges which Telewest believes are not appropriate to its status as an MSO. Telewest argued that BT had failed in its OCCN of 13 July 2001 to offer it call termination rates for the period 1 October 2001 to 30 September 2005 that are appropriate to its MSO status.

4.19 BT's methodology makes it clear that certain Operators will receive call termination payments from BT based on the level of multi-switching that occurs in terminating traffic on their networks. BT has not made any representation that it believes that Telewest will not qualify for some level of MSO payments under the methodology proposed in its OCCN of 13 July 2001. It appears unreasonable to the Director General, therefore, for BT to require Telewest to agree to an OCCN setting out charges that are not intended to apply once commercial negotiation of MSO charges are complete. The Director General believes that it is more appropriate to await the conclusion of appropriate negotiations and apply any agreed rate retrospectively to the commencement date of the agreement, namely 1 October 2001.

4.20 The Director General is therefore minded to conclude that Telewest should not be required to apply the charges set out in the OCCN of 13 July 2001 issued to it by BT. Should commercial negotiation of appropriate MSO charges fail then it remains open to either party to refer a dispute separately to the Director General for resolution.

(iii) Dispute between BT and Inclarity

4.21 Inclarity's argument in rejecting BT's OCCN of 13 July 2001 is that it favours BT to the extent that BT is paying lower termination charges to Inclarity.

4.22 BT's termination charges are regulated by the Network Charge Controls and are subject to RPI-X% controls. Operators therefore gain the benefit of reductions in termination charges payable to BT. Given that Operators' termination charges are based reciprocally on BT's costs and charges, Operators' revenues for call termination received from BT will also reduce in line with the charge controls. Since the RPI-X% price controls have a similar effect on Operator payments to BT as on Operator receipts from BT for termination, the Director General does not consider that the OCCN of 13 July 2001 unduly favours BT.

4.23 Inclarity has proposed no alternative in its submission to the Director General to the proposals set out by BT in its OCCN of 13 July 2001. In view of this fact and the matters considered at paragraphs 4.5 to 4.11 and 4.22 above, the Director General is minded to conclude that Inclarity should be required to sign and return BT's OCCN of 13 July 2001 implementing charges for call termination services effective from 1 October 2001.

(iv) Disputes between BT and Operators listed in Annex B;

4.24 BT's proposals and the charges contained within its OCCN of 13 July 2001 (in terms of SSO Operators) have been made following negotiation of the issues with an Operator Group. The Operators at Annex B have failed to explain why they have failed to agree to BT's OCCN of 13 July 2001. The Director General is aware that a number of these Operators may currently be in administration or undergoing novation. These Operators, however, remain under contract with BT in the meantime and have contractual ability to terminate geographic traffic. It is the Director General's view that all such Operators, therefore, must be subject to application of appropriate call termination charges.

4.25 Given that:

> (a) there is an absence of any substantive communication from any of the Operators at Annex B giving reason or argument as to why BT's OCCN of 13 July 2001 is unreasonable;
> (b) that the proposals in BT's OCCN of 13 July 2001 in terms of SSOs were the subject of negotiation and agreement between BT and an Operator Group;

(c) that the proposals in BT’s OCCN represent the same methodology and approach to reciprocity as agreed between BT and Operators under the previous reciprocity agreement running from 1 October 1997 to 30 September 2001; and
(d) the Director General’s considerations as outlined in paragraphs 4.5 to 4.12 above, that BT’s proposals in respect of SSOs are reasonable and broadly conform with one of the Director General’s preferred approaches to reciprocity;

the Director General is minded to conclude that each of the Operators at Annex B should be required to sign and return BT’s OCCN of 13 July 2001 implementing charges for call termination services effective from 1 October 2001.

Interest Charge

4.26 In accordance with Clause 13.13 of BT’s SIA, this Direction provides that Inclarity and the Operators at Annex B, in respect of those Operators who, since 1 October 2001, have been receiving payments based on previously agreed termination charges at a lower rate, will repay to BT the amount of any difference plus interest from that date. The applicable interest rate set in Clause 13.13 is the London Inter Bank Offered Rate (LIBOR) plus 3/8 per cent.

Chapter 5

Consultation and timetable for responses

5.1 This draft Direction has been made in response to the submissions made by the parties to this dispute and applies only to BT, C&W, Telewest, Inclarity and those Operators listed at Annex B. OFTEL seeks comments from all interested parties on the proposed decisions detailed in the Draft Direction.

5.2 Please e-mail or send comments in writing to:

Richard Thompson
OFTEL
50 Ludgate Hill
London
EC4M 7JJ

Telephone: (020) 7634 8983
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5.3 Comments on this consultation must be sent to OFTEL by Thursday 14 February 2001. OFTEL does not intend on this occasion to hold any comments-on-comments phase during which observations may be made on the representations made by others. Nevertheless, in the interests of transparency, all non-confidential representations will be published.

5.4 Confidential responses should not be sent via e-mail. Written comments will be made publicly available in OFTEL's Research and Intelligence Unit, except where a respondent indicates that a response, or part of it, is confidential. Respondents are therefore asked to separate any confidential material into a clearly marked annex. In the interests of transparency, respondents are asked to avoid confidential markings wherever possible.

5.5 The final Direction will be made as soon as possible after the end of the above mentioned consultation period.

Annex A to the Direction

Schedule of Operators in Telewest group of companies

Operator	*Date of agreement*
Telewest Communications plc	15/01/1998
Birmingham Cable Ltd	22/10/1997
Cable London	20/10/1997
General Cable TCC	24/10/1997
General Cable YCC	24/10/1997
Eurobell (South West) Limited	28/06/1997
Eurobell (Sussex) Limited	28/06/1996
Eurobell West Kent Limited	24/10/1997

Annex B to the Direction

Schedule of Operators in dispute with BT

Operator	*Date of agreement*
IDT Global Ltd	21/04/1999
Mannesmann Ipulsys UK Ltd	19/02/1999
Opera Telecom Ltd	16/02/2000
RSL Com UK Ltd	04/11/1997
Star Telecommunications Inc	15/01/1998
Starcomm Ltd	02/11/1999
Torc Europe Ltd	08/10/1997
Viatel Global Communications Ltd	21/04/1998
Worldxchange Communications Ltd	17/10/1997

Glossary

Digital Local Exchange (DLE) - the telephone exchange to which customers are directly connected.

Digital Main Switching Unit (DMSU) – a trunk exchange primarily used for connecting long distance calls.

Externality - An externality exists where the actions of an individual or organisation cause costs to be incurred by others (or benefits to be gained by others), but that individual or organisation has no incentive to take such effects into account

Long Run Incremental Costs (LRIC) **-** Costs that arise in the long run as a result of providing a given 'increment', eg, an additional amount of numbers. Long run costs assume that the supply of numbers is variable (not fixed).

Points of Interconnection (**POI)** – also known as a Switch Connections ie where an operator’s network interconnects with BT usually at a Digital Main Switching Unit (DMSU) or Wide Area Tandem (WAT).

Terminating network – the network to which a customer who receives a call is directly connected.

Terminating operator – the operator on whose network the call terminates.