Ofel Office of Telecommunications

Directions 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 Controls

Issued by the Director General of Telecommunications

1 March 2002

50 Ludgate Hill
London EC4M 7JJ
Switchboard 020 7634 8700
Fax 020 7634 8943
Textphone 020 7634 5370
Web www.oftel.gov.uk

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(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 17 January 2002. Comments were invited by 14 February 2002 and all responses have been considered in reaching a final decision;

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.

Chris Kenny
Director of Compliance

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

1 March 2002

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 17 January 2002. Comments were invited by 14 February 2002 and all responses have been considered in reaching a final decision;

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.

Chris Kenny
Director of Compliance

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

1 March 2002

Explanatory Memorandum

1. Summary

1.1 The Director General of Telecommunications ("the Director General") has issued Directions 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 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 Operator Charge Change Notices ("OCCNs") to 96 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 being 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 sought the views of all parties to the disputes and considered the submissions made by BT and Operators and issued a draft Direction in respect of these disputes on 17 January 2002 to the industry as a whole for consultation. Comments were requested and have been taken into account in making a final Direction.

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

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

(ii) Inclarity plc and each of the Operators listed at Annex B to this Direction shall be required to apply and implement those call termination charges proposed to each in BT's OCCN of 13 July 2001. This Direction provides that the Operators which, 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 per cent. If, conversely, the net amount payable by BT is greater than that previously payable under such charges, 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.

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 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.

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 as 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, which 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 the 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”), i.e. the mix of Digital Local Exchanges (“DLEs”) and Digital Main Switching Units (“DMSUs”), also known as tandem exchanges. Operators which interconnected only at the 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 DLE and DMSU.

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 more than a certain proportion of calls terminating via multi-switched routes could 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, which are 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 the Director General. On referral of a dispute, the Director General 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 Operators setting out the proposed reciprocity agreement, the methodology of calculating individual Operator call termination charges, and the proposed charges for each Operator 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 in the OCCN and then apply for MSO status. 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 objected to BT's proposed charges as Inclarity stated they had 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 disputes with those Operators failing to sign the 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 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 consulted the parties concerned. Relevant submissions were outlined in the draft Direction issued on 17 January 2002. The parties to this dispute set out in Annex B, however, have failed to provide reasons for failing to accept BT’s proposals as set out in its OCCN of 13 July 2001. Oftel issued four information requests in advance of publication of the draft Direction in an attempt to secure a response from such Operators. Oftel wrote to all Operators referred by BT as being in dispute on these matters on 6 September 2001. On 28 September 2001 Oftel wrote again, by recorded delivery, to those Operators failing to provide a response to the initial letter. On 1 November 2001 Oftel issued a third letter by recorded delivery to the registered office address of those Operators from which there had been no reply. On 3 January 2002 Oftel issued a further request for information by recorded delivery. 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 conclusions outlined in the Direction and accompanying explanatory memorandum.

3. Responses to the draft Direction

BT

3.1 BT welcomed the Director General's proposal to require Inclarity and the Operators at Annex B to sign BT's OCCN of 13 July 2001 implementing charges effective from 1 October 2001.

3.2 BT stated that negotiations were continuing with those Operators that had requested MSO status. BT said it was endeavouring to bring such discussions to a satisfactory and speedy conclusion.

Inclarity

3.3 Inclarity argued that the Director General erred in reaching his conclusions in the draft Direction. Inclarity believed that BT's proposals in its OCCN of 13 July 2001 did unduly favour BT. Although call termination charges for both BT and Inclarity fall in line with RPI-X% price controls as a result of reciprocal charging, Inclarity stated that BT sends far more traffic to Inclarity than Inclarity sends to BT. The net effect on revenues of any reduction in call termination charges was therefore of benefit to BT in terms of its relationship with Inclarity.

3.4 Inclarity further argued that BT had proposed reductions in the charges payable for call termination on Inclarity's network on weekend rates by over 20%, and, on evening rates, by over 15%. Inclarity believed there had been, however, no such reduction in charges payable by it for call termination on BT's network. Inclarity stated further that there had been no reduction either in payments Inclarity made to BT for origination of freephone calls terminating on Inclarity's network.

Telewest

3.5 Telewest welcomed the Director General's proposed decision that it should not be required to apply the charges set out to it in BT's OCCN of 13 July 2001. Telewest stated that at present it had no reason to argue against BT's proposed methodology in principle. However, Telewest said that the broad principle of reciprocity could be interpreted in different ways and that its acceptance of BT's approach in principle at this stage was without prejudice to the fact that it may wish to argue in future that an alternative approach to reciprocity is more appropriate.

3.6 Telewest stated that it continued to negotiate with BT in respect of MSO rates and had endeavoured to provide all necessary data requested by BT in accordance with that process. Telewest maintained that this process, however, demonstrated the asymmetirc position between BT and other operators in respect of what is, in fact, a Telewest service.

4. The Director General's decision and reasons

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 Long Run Incremental Cost ("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 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 services. 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 on 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 the 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 12 month periods thereafter commencing on 1 October 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, i.e. that the percentage mix of traffic between local exchange and single tandem is the same in both directions. The termination charge payable by BT to an Operator is therefore calculated on a percentage mix of BT's own charges. Operators for which insufficient traffic data exists to calculate the ratio for the relevant period are assumed to have 100% single tandem traffic 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 (see paragraph 2.3).

4.9 The Director General identified one drawback with this approach, however, in that Operators' make or buy decisions would be distorted. Call termination charges are calculated on the percentage mix of Operator to BT traffic terminating on BT's network via DLE or DMSU. 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 DLEs 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 Operator network.

Consequently, the sound pricing signals for Operators 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 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 the 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 traffic to BT.

The Director General's conclusions

(i) Dispute between BT and C&W

4.13 C&W continues 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/ DMSU 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 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. 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 therefore concludes 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 therefore concludes 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 initial argument in rejecting BT's OCCN of 13 July 2001 was 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 The Director General rejects the further arguments made by Inclarity in its response to the draft Direction (see paragraphs 3.3 and 3.4). The fact that Inclarity's revenues may be negatively affected by BT's proposal is not sufficient basis on which to argue that the proposal in itself unduly favours BT. Inclarity's termination charges are payable not only by BT but by other Operators that originate calls to Inclarity's network. Paragraphs 4.3 and 4.4 establish the Director General's reasons for supporting reciprocal call termination to ensure that Operators cannot exploit market power in call termination on their own network, and to ensure competitive neutrality.

4.24 Inclarity's call termination charges under BT's proposals are calculated on a reciprocal basis to BT's own charges under the Network Charge Controls. The charges are applied to each of the BT Daytime, Evening and Weekend rates to calculate the three corresponding Operator rates. Inclarity argues that BT's charges have not fallen in line with those proposed for Inclarity. In fact, BT's charges for call termination were revised with effect from 1 April 2001, whereas Operators' charges, including Inclarity's, were proposed to have effect from 1 October 2001. BT charges for call termination (payable by Inclarity) were therefore reduced six months before the date of the proposed equivalent reduction in Inclarity's charges.

4.25 Inclarity has proposed no alternative to reciprocal charging for call termination in its submissions to the Director General. In view of this fact and the matters considered at paragraphs 4.5 to 4.12 and 4.24 above, the Director General concludes that Inclarity should be required to implement and apply those call termination charges proposed to it in BT's OCCN of 13 July 2001.

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

4.26 BT's proposals and the charges contained in 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.

4.27 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 concludes that each of the Operators at Annex B should be required to implement and apply those call termination charges proposed to it in BT's OCCN of 13 July 2001.

Interest Charge

4.28 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 higher 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.

4.29 If, conversely, the net amount payable by BT is greater than that previously payable under such charges, 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.

OFTEL
March 2002

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
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.