

**Draft Direction under the provisions of Regulation
6(6) of the Telecommunications (Interconnection)
Regulations 1997 of a dispute between Cable &
Wireless Communications (Mercury) Limited
("C&W") and British Telecommunications plc ("BT")
over BT's average Premium Rate Service discounts.**

Issued by the Director General of
Telecommunications

18 February 2002

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Draft Direction under the provisions of Regulation 6(6) of the Telecommunications (Interconnection) Regulations 1997 of a dispute between Cable & Wireless Communications (Mercury) Limited (“C&W”) and British Telecommunications plc (“BT”) over BT’s average Premium Rate Service discounts.

WHEREAS:

(A) The Secretary of State granted to British Telecommunications plc 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 that licence;

(B) By virtue of section 109 and paragraph 20 of schedule 5 of the Act the BT licence has effect as if granted to British Telecommunications plc (“BT”);

(C) The Secretary of State has granted to Cable & Wireless Communications (Mercury) Limited (“C&W”) on 5 December 1991 a licence under section 7 of the Act for the running of telecommunications systems specified in that licence;

(D) C&W entered into a Standard Interconnect Agreement (“the Agreement”) with BT on 1 May 1998;

(E) The Agreement covers charges BT pays C&W for interconnect services and provides for BT or C&W to propose a revised charge and the date on which the variation is to become effective by way of issuing an Operator Charge Change Notice (“OCCN”);

(F) C&W proposed to BT by way of an OCCN on 20 August 2001 a revised charge for Premium Rate Services by varying the value of the discount used in calculating the charge with effect from 3 September 2001;

(G) BT rejected C&W’s proposal set out in the OCCN dated 20 August 2001 and a dispute has arisen;

(H) Regulation 6(6) of the Telecommunications (Interconnection) Regulations 1997 (“the 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. The direction which the Director General makes to resolve the dispute must represent a fair balance between the legitimate interests of the parties, and must be notified to the parties in accordance with Regulation 8(3). The parties are entitled to a full statement of the reasons on which the direction is based;

(I) On 28 September 2001, in accordance with the provisions of Regulation 6(6) of the Regulations, C&W referred the dispute to the Director General for determination;

(J) The Director General has considered, inter alia, the information provided by the parties and the matters set out in Regulation 6(8) of the Regulations. The principal points are summarised in the explanatory memorandum that accompanies, and is published with, this direction;

(K) The Director General issued a draft of this direction and the explanatory memorandum that contains the Director General's reasons on 15 February 2002 and responses were invited by 15 March 2002;

(L) Comments were received from [...] as detailed and discussed in sections [...] and [...] of the explanatory memorandum which accompanies and is published with this direction. These comments have been taken into consideration by the Director General in making this direction;

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

(1) For the purposes of calculating the charge BT pays C&W for Premium Rate Services, the Deemed Retail Price shall be the retail price charged by BT for such calls (exclusive of VAT) minus BT's average discounts for such calls of 0.3% based on BT's relevant revenue figures, minus a further 4.4% to compensate for bad debts;

(2) The charges in this Direction shall have effect from 15 October 2001;

(3) If the net amount payable by BT is higher than that previously payable, BT shall pay to C&W 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, C&W 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;

(5) C&W shall modify the OCCN issued on 20 August 2001 to give effect to this direction;

(6) The parties shall modify their interconnect agreement to give effect to this direction; and

(7) Except as otherwise defined in this direction, words or expressions used shall have the same meaning as in the Act, the BT licence or BT's Standard Interconnect Agreement as appropriate.

CHRIS KENNY

DIRECTOR OF COMPLIANCE

**A person authorised under Paragraph 8 of Schedule 1 to the
Telecommunications Act 1984**

[.....] 2002

Explanatory Memorandum

Chapter 1

Summary

1.1 The Director General of Telecommunications ('the Director General') has issued a draft Direction in accordance with the provisions of Regulation 6(6) of the Telecommunications (Interconnection) Regulations 1997 ('the Regulations') for the resolution of a dispute between Cable and Wireless (C&W) and BT under the terms of their Standard Interconnect Agreement (SIA). This draft Direction sets out the level of BT's discounts which the Director General is minded to set to apply to C&W's interconnect charges for calls to Premium Rate Services (PRS), with effect from 15 October 2001. The draft direction also sets out the decision the Director General is minded to make regarding C&W's request that the Director General should retrospectively determine BT's out-payments to C&W in respect of PRS calls since October 1997 on the basis of recalculated discounts.

1.2 C&W referred this dispute to the Director General on 28 September 2001. The Director General has considered the submissions made by C&W and BT and has issued a draft Direction in respect of this dispute and this Explanatory Memorandum on 15 February 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 C&W and BT, together with the reasons why the Director General is minded to make this draft Direction, are set out in Sections 4 and 5. In summary, the Director General is minded to direct that:

- a) from 15 October 2001, BT's average discount applicable on calls to PRS shall be 0.3%; and
- b) there shall be no recalculation of BT's average PRS discounts before this date and previous out-payments to C&W shall not be retrospectively determined.

1.4 Having considered the facts specific to this dispute and the matters set out in Regulation 6(8) of the Regulations, 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's wider duties to promote the development of the telecommunications industry in the UK and to encourage and secure adequate interconnection in the interests of all users in a way that provides maximum economic efficiency and gives the maximum benefit to end users.

Chapter 2

Background

2.1 The term Number Translation Services (NTS) describes a range of specially tariffed services such as those operating within the number ranges 080x (Freefone), 0845 (local call fee access or LCFA), 0870 (national call fee access or NCFA) and 0900/0901 (Premium Rate Services or PRS). These services are offered at specific price points in order that customers calling from any fixed network will be able to associate the number range with a particular pricing arrangement. For example, 080X calls are free to the caller.

2.2 In previous determinations of NTS charges Oftel has given a detailed description of the NTS revenue sharing arrangements and how they were arrived at. Most operators are now familiar with this narrative and it is not, therefore, repeated in this document. Anyone wishing to read the detailed description can refer to Oftel's earlier NTS directions (also known as determinations) which can be found on Oftel's website. Two such documents can be found at:

www.oftel.gov.uk/publications/1999/pricing/btfc499.htm
www.oftel.gov.uk/publications/pricing/ntsd0901.htm

Changes to the NTS regime from 1 January 2000

2.3 In December 1999, Oftel published its *Statement on the Relationship between Interconnection Charges and Retail Prices for Number Translation Services*, now known as 'the NTS Statement'. This can be found on Oftel's website at:

www.oftel.gov.uk/publications/1999/pricing/nts1299.htm

This followed a lengthy discussion and consultation exercise in response to a general industry view that the NTS formula constrained the ability of terminating operators to exercise sufficient control over their NTS revenues. The new regime was intended to allow terminating operators to establish the price at which they would be remunerated for NTS calls. This price would then be added to BT's regulated call origination charge plus any transit charges, where appropriate, to establish the retail price for their service. The new regime de-coupled the retail prices of NTS calls from the originating operators', hitherto, fixed local and national rates and created price ranges from within which terminating operators could choose to position their services.

2.4 In practice operators select a retail price for calls to their services which will, as near as possible, deliver their required revenue after call origination and transit costs have been removed. However, this revenue is also subject to the discounts BT offers to its retail customers. These discounts form part of BT's means of

meeting its retail price control requirements. The combination of headline price reductions and discounts enable BT to achieve its overall 'RPI-X' target.

2.5 Discounts take the form of 'Inclusive Call Allowances' and price reductions and are also used by BT as an incentive to help retain its customer base in the face of price competition from other operators. Over the years BT has continually extended the range and type of discounts it offers and has increased the proportion of its customer base who benefit from them.

Chapter 3

History of the dispute

Prior history

3.1 On 30 January 1996 the Director General published a determination of *Interim Charges for BT's Initial Standard Services for the year ending 31 March 1996*. This determination described the original NTS formula at Annex 6 of the determination.

3.2 Addendum 8 to the determination prescribed that, for PRS, the Deemed Retail Price should be BT's retail price minus 5% for the effect of average discounts and 6% to compensate for bad debts.

3.3 On 12 November 1996, the Director General published a determination of *Interim Charges for BT's Standard Services for the year ending 31 March 1997* in which, at Addendum 6, the determined discount for PRS was set at 3.5%.

3.4 On 28 July 1997, the Director General published a determination of *Interim Charges for BT's Standard Services for the year ending 31 March 1998* in which, at Addendum 5, the determined discount for PRS was confirmed at 3.5%. On 1 October 1997 the Network Charge Control regime came into effect with the result that the July 1997 statement was effective only for the period until 30 September 1997.

3.5 Although the determinations applied to access to BT's services, the principles set out were agreed and adopted by other operators for their charges to BT for access to their NTS services.

Previous disputes (non-PRS) NTS discounts

3.6 On 13 November 1998 and 3 February 1999 BT issued Operator Charge Change Notices ("OCCNs") proposing changes in payments to terminating operators for local and national NTS calls resulting from a recalculation of BT's contemporaneous average NTS discounts of 11.45% with effect from 9 January 1999 and 11.75% with effect from 1 April 1999 respectively. A number of operators rejected BT's proposals and both disputes were referred to the Director General for determination. The Director General concluded, in determinations issued on 13 September 1999, that BT's NTS discounts should be increased by the amounts and on the dates proposed by BT.

3.7 On 7 July 2000 BT issued an OCCN proposing a further increase in its local and national NTS discounts from 11.75% to 16.8% with effect from 1 September 2000 (this was the first increase in the discount since the introduction of the 'new' NTS arrangements earlier that year). A number of operators rejected BT's proposals and the dispute was referred to the Director General for determination.

The Director General concluded, in a Direction issued on 5 September 2001, that BT's local call (LCFA) and national call (NCFA) NTS discounts should be disaggregated and set at 14.8% for LCFA and 2.4% for NCFA calls respectively.

The present dispute

3.8 On 20 August 2001 C&W issued an OCCN to BT proposing to change the termination charges payable by BT to C&W for PRS calls by removing the effect of BT's average discounts. The new charges were proposed to be effective from 3 September 2001. C&W's OCCN effectively proposed to set BT's average PRS discounts at 0% (notwithstanding C&W's concurrent dispute with BT to 'opt-out' of all BT's NTS discounts, as discussed in paragraph 3.9). BT rejected C&W's OCCN on 4 September 2001, stating that it would adhere to Of tel's previously determined figure of 3.5% for PRS discounts. The resulting dispute was referred to the Director General for resolution on 28 September 2001.

Other matters relevant to the dispute

C&W opt-out of BT's discount schemes

3.9 The Director General is currently resolving a concurrent dispute between C&W and BT in respect of a proposal by C&W for it to opt-out of all of BT's NTS discounts (including PRS). The charges payable for termination by BT to C&W for NTS would then remove the effect of all BT's NTS discounts. The Director General has determined to treat these two matters distinctly and will issue a separate Direction resolving this issue. In practice, however, the dispute concerning opt-out of NTS discounts may directly impact upon this dispute relating to the level of PRS discounts. If C&W were to opt-out of all BT's NTS discounts (including PRS), then the effective figure impacting on the charges payable by BT would be 0%, irrespective of the Director General's decision in resolving this dispute. However, this concurrent dispute remains and the Director General is under a duty to resolve the matter.

Regular review of all NTS discounts

3.10 Both C&W and BT have put forward an argument for establishing a regular review process of all BT's NTS discounts. The Director General is aware that other operators have expressed similar views in previous consultations on NTS disputes. The Director General believes that these suggestions should be explored further and proposes to conduct a separate consultation exercise in this respect in the near future.

Chapter 4

Representations of the parties

Submissions by C&W

Current PRS discounts

4.1 C&W stated that in calculating the out-payment paid to it in respect of PRS calls originating on BT's network and terminating on C&W's network, BT currently reduced the headline retail rate of calls by 3.5% to reflect average discounts. This figure of 3.5% was based on Oftel's calculation of the appropriate average discount last made in July 1997 and applicable to the end of September 1997. Since October 1997, C&W said that BT had not sought to vary its PRS discounts figure and, consequently, Oftel had not made any further determination to revise the figure. C&W argued that this figure of 3.5% was out of date and significantly overestimated the effect of retail discounts on BT's PRS call revenues. C&W believed that BT, as a consequence, was retaining more of the average retail price paid by callers than the NTS regime allowed, where BT can retain the regulated amount 'C' plus an amount to cover bad debt.

4.2 C&W stated that the procedure for calculating average discounts as set out in Oftel's recent Direction on BT's (non-PRS) NTS discounts was to calculate the difference between BT's gross and net revenue figures for calls to PRS numbers. C&W said it had no visibility of such figures but that an analysis of BT's retail discount schemes supported its view that the current figure of 3.5% significantly overestimated the effects of BT's PRS discounts.

4.3 C&W argued that in section 3 of the BT Price List, in which BT's discount schemes are set out, the only residential scheme that offered a discount on PRS calls was PremierLine with a discount of 5% (PremierLine customers also face an option fee of £6 per quarter which would reduce the effective discount below 5%). C&W stated that PremierLine was no longer available to new customers, however, and it believed that BT had been migrating existing customers onto its Together packages since November 2000. C&W stated that, as a result, it was likely that the discount available on PremierLine to residential customers would have little impact on the calculation of average PRS discounts.

4.4 C&W also said that BT's Together schemes did not offer discounted rates for PRS numbers, nor do PRS calls contribute to the inclusive call allowance provided for in such schemes or in the standard line rental. Furthermore, PRS numbers cannot be selected for Friends & Family discounts. C&W argued it was reasonable to presume therefore that average PRS discounts for residential customers were close to zero and would continue to fall to zero as any remaining PremierLine customers migrated on to other packages.

4.5 In terms of business users, C&W accepted that some business discount schemes offer a 5% discount on PRS calls. However, C&W stated that a clear majority of businesses actively block calls from their staff to PRS number ranges. C&W believed that the volume of PRS traffic generated by business customers was therefore likely to be extremely low. C&W therefore concluded that BT's average PRS discounts for business and residential users combined would be close to zero and would certainly not justify a figure of 3.5% as applied by BT at present.

4.6 Given C&W's estimation of BT's average PRS discounts, it issued an OCCN to BT on 20 August 2001 proposing to change termination charges payable by BT to C&W to remove the effect of the 3.5% discount figure. BT rejected this proposal stating that BT would continue to apply the figure determined by the Director General until future revision. Given the failure to reach commercial settlement of the dispute, C&W referred the dispute to the Director General for resolution. C&W requested that the Director General make a calculation of BT's average PRS discounts and apply that figure from the date proposed in C&W's OCCN, namely 3 September 2001. C&W stated that BT's argument that the effective date of any recalculated charge should be 23 October 2001 (see paragraph 4.17) was inappropriate in this case. BT argued that C&W should have proposed an effective date in its OCCN giving 56 calendar days notice. C&W said that this notice period was based on the BT/ Operator Charge Change Service Level Agreement that was not part of the SIA between BT and C&W. Furthermore, the purpose of C&W's OCCN was seeking a change in BT's NTS outpayments to C&W, not the normal process for which the OCCN process was designed (to propose changes to operator charges). C&W stated that it saw issuing an OCCN, however, as the only way to ensure that BT would revisit its PRS discount calculation.

Retrospective recalculation

4.7 C&W stated that the Director General had not considered the appropriate level of BT's average PRS discounts since a final determination of charges for the period 1 April 1997 to 30 September 1997, made in April 1998. Although C&W had no visibility of how this figure of 3.5% had been calculated, it believed it was clear that BT had changed the way in which discounts apply to PRS number ranges since then and that a figure of 3.5% has overestimated the effect of discounts on BT's net revenues for a considerable period of time.

4.8 C&W pointed out that BT has not sought to recalculate its average discounts for PRS in stark contrast to its approach to non-PRS NTS discounts which it has sought to increase on several occasions (in the latter case where the Director General determined to de-aggregate discounts between LCFA and NCFA). C&W argued that BT's proposed changes and the Director General's analysis and conclusions in resolving the disputes made it clear that the effects of BT's discounts had changed over time. C&W stated it was illogical to assume that discounts on PRS calls had remained static over the same period of time, although

C&W said it did not have access to the data required to make a calculation at any point.

4.9 C&W argued it had demonstrated that BT's average PRS discounts had to be close to zero (see paragraphs 4.1 to 4.6). This suggested that BT's PRS discounts had fallen over time and that BT's failure to adjust its average PRS discounts figure reflected its expectation that any recalculation would result in a lower applicable figure and lead to an increase in BT's out-payment to terminating operators. There was no incentive on BT under the Network Charge Control regime, therefore, to recalculate this figure and it has remained content to continue to apply a figure of 3.5%.

4.10 C&W stated that evidence that BT had been applying PRS discounts that were too high since October 1997 could be derived from the Director General's recent Direction on non-PRS NTS discounts (September 2001) in which the Director General calculated an average discount figure for NCFA calls to be 2.4%. This figure was calculated from gross and net revenue figures for the final quarter of 1999. C&W argued that NCFA calls offer more applicable discounts than PRS calls and it was therefore reasonable to assume that average PRS discounts would in fact be below the NCFA determined figure of 2.4% in the final quarter of 1999. C&W said that BT had nevertheless continued to apply a figure of 3.5% in calculating its out-payments.

4.11 C&W further argued that if BT had been overestimating its level of PRS discounts since October 1997 it would have been retaining an amount in excess of its regulated retention 'C'. C&W requested, therefore, that the Director General make an assessment of BT's average PRS discounts at intervals between October 1997 and September 2001 and apply the recalculated figures retrospectively to out-payments BT has made to C&W.

4.12 C&W believed that without such retrospective application of recalculated discounts to charges, and facing no obligation to make recalculation of the level of its discounts, BT would face no incentive to act in making such recalculation where this did not act to its advantage. C&W stated that terminating operators such as C&W did not have access to the information necessary in order to calculate a more accurate average discount figure at any point in time. C&W argued that to allow BT to retain the amounts kept by its failure to adjust its level of PRS discounts would be to condone BT's exploitation of its dominance in call origination, and of the asymmetry of information which exists between BT and terminating operators. C&W believed that to oblige BT to repay its excess retention would provide the correct incentive on BT to ensure it applied the NTS regime appropriately in the future.

4.13 C&W further argued that BT was dominant in the service of call origination and competed with C&W in the provision of NTS termination services. By withholding amounts from C&W in excess of its actual level of PRS discounts,

C&W argued BT had given itself a financial advantage in the call termination market.

4.14 C&W was aware that the Director General has previously considered retrospective application of charges to be inappropriate in respect of NTS out-payments. However, C&W believed this was in relation to payments from terminating operators to originating operators, where circumstances provided that, if terminating operators were required to repay monies to reflect past overpayment from originating operators, they might struggle to recover this from service providers to whom they have already made their own out-payments. As such, terminating operators could face inappropriate losses. In the case in hand, however, C&W argued that the issue related to underpayment from the originating operator to the terminating operator. As such, no other party was relevant to the chain of payment and the originating operator would merely be repaying amounts owed in excess of that provided for by the regulatory regime. Moving forward, C&W argued that BT should be required to re-examine its PRS discounts at regular intervals. Looking back, however, C&W stated that the Director General should recalculate BT's PRS discounts at the same points in time at which BT had sought to increase its non-PRS NTS discounts.

Submissions by BT

Current PRS discounts

4.15 BT stated it was unable to agree to C&W's proposals in its OCCN of 20 August 2001 due to the fact that the proposed charges did not fit with the existing determined PRS discount rate of 3.5%. C&W also proposed a discount rate of 0%, which BT regarded as inaccurate. BT also stressed that it was inappropriate for C&W, in proposing a rate of 0% in its OCCN, to attempt to extend the debate beyond the boundaries of the PRS discount rate dispute to include, in effect, opt-out of BT's PRS discounts.

4.16 BT argued that its PRS discounts figure had not been revisited since October 1997 due to the fact that the industry's activities in terms of NTS were focussed on non-PRS number ranges. BT said that the Director General's December 1999 NTS statement had focused on non-PRS NTS and that terminating operators had sought to exploit the NTS formula for their own benefit by the introduction of subscription-free internet access behind 0845 number ranges, for example. BT stated that its own proposals had naturally fallen into the non-PRS sector because it was aware that it had made significant increases in its average discount levels which meant that it was failing to recover its legitimate costs of call origination. BT said it was happy to provide the relevant information to the Director General if he considered it appropriate to redetermine the applicable figure in light of the dispute referred by C&W.

4.17 BT argued that the applicable date of any redetermined figure, however, should not be that proposed in C&W's OCCN, ie 3 September 2001. BT argued

that the relevant date should be the earliest which should have been proposed by C&W in its OCCN of 20 August 2001, namely 23 October 2001, in keeping with OCCN notice periods as set out in the BT/ Operator Charge Change Service Level Agreement. BT's calculation of 56 calendar days was based on BT's equivalent practice of giving operators the same notice period in issuing its OCCNs. BT said that, alternatively, the Charge Change Service Level Agreement could be read at Annex G to require 51 working days notice, extending the relevant date beyond 23 October 2001.

Retrospective recalculation

4.18 BT stated that the OCCN process is consistent with the Network Charge Control regime in that it is forward-looking. The Director General's previous Directions in respect of NTS discounts have supported these principles by making any recalculation effective from BT's forward-looking dates. BT said it saw no valid reason for adopting a different approach in this case.

4.19 BT rejected C&W's statement that it had been "overestimating its discount figure" or "retaining an amount in excess of its regulated retention". BT said it had been applying the discount rate for PRS that forms part of its regulated retention as determined by the Director General. It could not, therefore, by definition be recovering anything in excess of it.

4.20 BT pointed out the time lag involved in identifying relevant levels of discounts and then making proposals via the OCCN process. As a result, BT argued, in respect of non-PRS NTS discounts, its retention for such services is considerably lower than contemporaneous figures and BT has therefore under-recovered its costs to a significant extent since December 1997, and continued to do so.

4.21 BT rejected C&W's claim that BT had given itself a financial advantage in the termination market for NTS by withholding amounts from C&W in excess of that required under the regulatory regime. BT said it had paid C&W and all other terminating operators in accordance with the regulatory regime.

Chapter 5

The Director General's decision and reasons

5.1 Having duly considered the representations of C&W and BT in response to this request for a Direction and the matters set out in Regulation 6(8) of the Telecommunications (Interconnection) Regulations 1997, the Director is minded to conclude that:

- a) From 15 October 2001, BT's average discount applicable to charges payable to C&W for calls to PRS shall be 0.3%; and
- b) There shall be no retrospective recalculation of BT's average PRS discounts figure before this date and out-payments to C&W shall not be retrospectively determined.

a) BT's average PRS discounts from 15 October 2001

5.2 C&W has requested recalculation of BT's average PRS discounts applied to out-payments made by BT to C&W for the termination of such calls. BT has not provided argument that such recalculation would be inappropriate or otherwise undesirable. The Director General believes it is appropriate to carry out such a recalculation on the basis of the evidence provided by C&W that the level of BT's average PRS discounts is lower than the applicable figure of 3.5% still in effect. Accordingly, the Director General has reviewed BT's calculation as described below. The Director General considers that the effective date of any new charges should be 15 October 2001 ie 56 days from the date of C&W's OCCN of 20 August 2001. This is on the basis that C&W issued an OCCN, and the Director General considers that C&W should therefore comply with the agreed practice of giving 56 days' notice in respect of OCCNs, as BT states it provides in practice. The Director General calculates that 56 days from 20 August 2001 is 15 October 2001. The Director General therefore believes it is a fair balance between the parties in this case to apply the recalculated level of BT's PRS discounts from 15 October 2001.

How BT's PRS discounts were calculated

5.3 BT calculates the level of discounts for any telephony package by measuring the total retail revenue collected by BT, net of discounts, made in the period concerned. It then compares this to the gross revenue that would be associated with the 'headline' retail price of the calls. This determination takes account of discounts applied during the 3-month period 1 July to 30 September 2001. Oftel chose this as the most up to date time period in respect of which BT could prepare information for the purposes of this direction.

5.4 For PRS discounts BT identifies gross revenues, gross discounts and option fees on an accruals basis in order to pass on the appropriate revenue to PRS

terminating operators after deduction of its conveyance and retail costs. This is consistent with NTS principles that require that the originating operator (in this case BT) must recover its costs associated with originating NTS calls from call revenues. Once these have been deducted the remaining revenue is passed to the terminating operator as an outpayment.

5.5 Oftel requested that BT provide revenue, option fee and discount data required to calculate the percentage discount rate for each of the 6 quarters up to September 2001. BT has provided this to Oftel. Data for the four quarters to 31 March 2001 was requested as it was the latest information available that had the potential to be reconciled to revenue figures appearing in the 2001 Financial Statements (for which the basis of preparation should be detailed in the publicly available supporting accounting documentation). This documentation should include a detailed description of the attribution methodologies used by BT to identify and allocate revenues, options fees and discounts, which, if complete, would be an important aid to Oftel's understanding. The 2000/01 data would in turn help inform Oftel's review of the second quarter 2001/02 data used to calculate the figure applied in this draft direction by, for example, examining trends in discounts calculated over a period of time.

5.6 A detailed explanation of revenue and discount attribution methodologies is not however available from the accounting documentation supporting the 2000/01 Financial Statements and Oftel therefore asked BT to provide the full methods of attribution necessary to derive the appropriate revenues, option fees and discounts. BT has provided an overview document on the preparation of the revenue, option fee and discount data, although this falls short of a complete and detailed description necessary for Oftel to fully understand BT's calculations.

5.7 BT has also provided, at Oftel's request, a schedule of the applicability of discounts to PRS under its various customer options as at 31 March 2001. This data is drawn from BT's Price List. The applicability of discounts is shown both in terms of their impact at the individual call level and, where relevant, whether any related inclusive call allowances can be applied to such calls. This information is attached at Annex A. This schedule appears to omit some charging schemes and Oftel has requested BT to provide a complete version of the discount applicability schedule. Oftel has requested BT to provide a reconciliation of the 2000/01 quarterly data in the 2001 Financial Statements. Neither the revised discount applicability schedule nor the reconciliation statements have been provided to Oftel by the date of this draft Direction.

5.8 Oftel has reviewed the data provided by BT. In reviewing this data relating to discounts for LCFA and NCFAs services in September 2001, Oftel considered the impact of inclusive call allowances (ICA). PRS calls, however, cannot be offset against ICAs and therefore ICAs will have no impact on the average level of PRS discounts.

5.9 Over six quarters from April 2000 to September 2001 the discount rate as calculated by BT fell from 1.2% of gross revenue to 0.3%. The principal reason for the fall was that over this period the PremierLine residential customer option was being withdrawn from BT's portfolio and, in the main, being replaced by BT's Together options, none of which provided discounts on PRS calls. For business customers, the only options as at 31 March 2001 which provided discounts were Business Choices, Corporate Choices, Tier 2000 and Embark, all at 5% of gross revenue, and ISDN reduced minimum fee.

5.10 Oftel has also considered ascertaining separate discount rates for different categories of calls within PRS number ranges, for example, between pay for product calls, calls capped at £5 maximum for each call or fixed fee up to £1 per call. BT could not provide this level of detail, however, as it only analyses PRS discounts as a single total. In view of the low overall incidence of PRS discounts, further disaggregation may be considered disproportionate in this case. This picture might change, however, if BT were to further restrict discounts in relation to certain subsets of PRS calls, for example, if BT were to exclude pay for product PRS calls from all discounts.

The determined discount figure and interest charges

5.11 Further to the above, the Director General is minded to direct that, from 15 October 2001, the discounts that apply to BT's terminating out-payments to C&W in respect of PRS calls shall be 0.3%.

5.12 In accordance with Clause 13.13 of the SIA, this Direction provides that BT, which since 15 October 2001 has been making payments to C&W for terminating PRS calls based on average discounts of 3.5%, will pay to C&W the amount of the difference plus interest from that date. The applicable annual rate set out in Clause 13.13 as the 'Oftel Interest Rate' is the London Inter-Bank Offered Rate (LIBOR) plus 3/8 per cent.

b) Retrospective recalculation of PRS discounts from October 1997

5.13 In considering whether retrospection would be appropriate in this case, the Director has taken into account the balance of the interests of the parties and the criteria set out in Regulation 6(8) of the Telecommunications (Interconnection) Regulations 1997, in particular the relevant market position of the parties and the promotion of competition, including the potentially negative effect on the market of a decision to allow retrospection. He has also considered whether the parties have a legitimate expectation that retrospection will apply in this case. The Director notes that there has been no agreement between the parties that retrospection will apply (other than to the dates proposed in the relevant OCCN) and therefore there can be no such legitimate expectation.

5.14 In deciding whether retrospection ought to apply in this case, the Director has also taken into account the availability of information to the parties since 1997,

and notes particularly that C&W has had access to a certain level of information such that it has now been able to refer this dispute to Of tel with initial evidence that the figure of 3.5% for the level of discounts may have overestimated the level of BT's PRS discounts during the period since October 1997.

5.15 It is clearly not possible for C&W to be able to make detailed calculation of BT's average PRS discounts. To do so requires access to BT's gross and net revenue information that is of a commercially confidential nature. However, it appears to the Director General that it is reasonable to assume that C&W could have made reasonable estimate of BT's PRS discounts by reference to BT's published price information, and certainly to make consideration of whether BT's discounts may have fallen over time.

5.16 In issuing its OCCN to BT of 20 August 2001 and then subsequently referring this dispute to the Director General, C&W has made such an analysis. By referring to BT's published price list and assessing which of BT's discount packages apply to calls to PRS, C&W has, through a relatively simple process, been able to make estimate of the level of BT's average PRS discounts.

5.17 In view of the above, the Director General is minded to conclude that retrospection is not justified in these circumstances.

5.18 The Director General's decision in this case, both in deciding to recalculate the level of PRS discount applicable to C&W's interconnect charges for calls to PRS, and in deciding to reject C&W's request to recalculate charges retrospectively to 1997, has been based on legal advice, an analysis of the facts and a review of the accounting information supplied by BT, and on the balance of the interests of the parties. It has also been based on consideration of the criteria set out in Article 9(5) of the Interconnection Directive 97/33/EC (as implemented in Regulation 6(8) of the Telecommunications (Interconnection) Regulations 1997, in particular the relevant market position of the parties and the promotion of competition. In the view of the Director General this direction represents a fair balance between the interests of the parties.

Chapter 6

Consultation and timetable for responses

6.1 The Director General's proposed draft Direction is being made available to interested parties, together with the Director General's reasons, so that they may have a reasonable opportunity to make representations. Having considered any such representations, the Director General will, if appropriate, make the Direction and will notify BT and interested parties of that determination and his reasons for making it. The closing date for submitting representations is **15 March 2002**.

6.2 Where possible, comments should be made in writing and sent by e-mail to richard.thompson@oftel.gov.uk. However, copies may also be posted or faxed to the address below. If any stakeholders are unable to respond in one of these ways, they should discuss alternatives with the Oftel manager named below:

Richard Thompson
Oftel
50 Ludgate Hill
London
EC4M 7JJ

Telephone: (020) 7634 8983
Fax: (020) 7634 8943
E-mail: richard.thompson@oftel.gov.uk

Further copies of this document

6.3 This document can be viewed in the *Publications* section of Oftel's website (www.oftel.gov.uk), under classification *Pricing and price control*. Paper copies and more accessible formats such as large print, Braille, disc and audio cassette can be made available on request. Please contact Oftel's Research and Information Unit by phoning 020 7634 8761 or by sending an e-mail to infocent@oftel.gov.uk.

Publication of representations made by stakeholders

6.4 On this occasion, Oftel is not programming a formal period during which interested parties may comment on the representations made by others. However, in the interests of transparency, all representations will be published, except where respondents indicate that a response, or part of it, is confidential. Respondents are therefore asked to separate out any confidential material into a **confidential annex which is clearly identified** as containing confidential material. Oftel will take steps to protect the confidentiality of all such material from the moment that it is received at Oftel's offices.

6.5 Non confidential representations can be viewed on Oftel's website in the *Publications* section under classification *Responses to Oftel consultations*. They can also be viewed at Oftel's Research and Information Unit. Appointments must be made in advance by phoning 020 7634 8761 or sending an e-mail to infocent@oftel.gov.uk.

Annex A

Schedule of BT's applicable discounts to PRS

Discounts applicable at 31 March 2001 (source: BT)

Option	Discount
Option 15	N
PremierLine	Y (5%)
Call & Save	N
Daytime Caller	N
Advantage	N
Business Choices	Y (5%)
Corporate Choices	Y (5%)
Tier2000	Y (5%)
Embark	Y (5%)
Commitment	N
ISDN reduced Minimum Fee	Y
Key City/Region	N
Together	N
Friends & Family /Best Friend	N
Key numbers/contact	N
Standard Residential ICA	N
Together ICA	N
Advantage ICA	N
Highway ICA	N
Surftime Eve & Weekend/ Anytime	N
Schools Internet	N

Glossary

Local Call Fee Access (LCFA): Calls to non-geographic NTS services for which calling customers are charged at the local call rate

National Call Fee Access (NCFA): Calls to non-geographic NTS services for which calling customers are charged at the national call rate

Number Translation Services (NTS): the process associated with the routing of a non-geographic number to a network termination point, e.g., the number is translated from its non-geographic format into a geographic or mobile number to enable it to be routed to a geographic location or to a mobile phone

Operator Charge Change Notice (OCCN): the process used by operators, including BT, for offering and amending charges in payment for access to another operator's services

Originating operator: operator on whose network the call originates, ie the operator with the line to the customer.

Premium Rate Service (PRS): services, including recorded information and live conversation, run by independent service providers. All calls to these companies are charged at a higher rate than ordinary calls to cover the companies' costs in providing the content of the call and the operator's cost for the special network facilities needed.

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