Oftel Office of Telecommunications

A Direction relating to a dispute over BT's Transit Risk Review Supplemental Agreement

16 January 2003

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DIRECTION UNDER REGULATION 6(6) OF THE TELECOMMUNICATIONS INTERCONNECTION REGULATIONS 1997 RELATING TO A DISPUTE BETWEEN BRITISH TELECOMMUNICATIONS PLC ("BT") AND THE OPERATORS LISTED IN THE SCHEDULE OVER BT'S TRANSIT RISK REVIEW SUPPLEMENTAL AGREEMENT

Whereas:

(A) The Secretary of State 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 that licence;

(B) By virtue of section 109 of, and paragraph 20 to, 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 each of the operators listed in the Schedule a licence under section 7 of the Act for the running of telecommunications systems specified in that licence;

(D) The operators listed in the Schedule entered into a Standard Interconnect Agreement ("SIA") with BT on the dates set out in the Schedule;

(E) The SIA allows either party to seek to amend the SIA by serving on the other a review notice in certain circumstances. On service of a review notice, the SIA requires that the parties negotiate in good faith the matters to be resolved with a view to agreeing relevant amendments to the SIA. Where the parties fail to reach agreement on the subject matter of a review notice within a period set out in the SIA, either party may, within a period set out in the SIA, request the Director General of Telecommunications to determine the matters upon which the parties have failed to agree;

(F) On 18 December 2001, BT served a review notice ("the Review Notice") on the operators listed in the Schedule. The Review Notice sought amendments to the SIA to introduce reciprocal provisions covering certain bad debt risks in a transit situation;

(G) For the purposes of the Review Notice, the SIA allows for a three month period of negotiation, followed by a three month period within which either party may make a request to the Director to determine any matters upon which the parties have failed to agree;

(H) On 15 April 2002, and following negotiation between the parties which did not result in agreement on the Review Notice, BT sent a proposed supplemental agreement to the SIA signed by BT ("the Supplemental Agreement") to the operators listed in the Schedule. The Supplemental Agreement incorporated BT's proposals as set out in the Review Notice. BT sought the return of a copy of the Supplemental Agreement, signed and dated by the operators listed in the Schedule, by 7 May 2002;

(I) On 13 May 2002, BT wrote to the operators listed in the Schedule seeking the return of a copy of the Supplemental Agreement, signed and dated by those operators, by 20 May 2002. In that letter, BT stated that any operator which had either

(i) indicated their intention not to sign the Supplemental Agreement, or

(ii) not returned a signed and dated copy of the Supplemental Agreement to BT by 20 May 2002,

would be assumed to be in dispute with BT in relation to the Supplemental Agreement;

(J) As at 20 May 2002, the operators listed in the Schedule had either:

(i) indicated their intention not to sign the Supplemental Agreement, or

(ii) not returned a signed and dated copy of the Supplemental Agreement to BT,

and therefore a dispute has arisen;

(K) On 24 May 2002, in accordance with the provisions of Regulation 6(6) of the Telecommunications (Interconnection) Regulations 1997 ("the Regulations"), BT referred the dispute to the Director for determination;

(L) Regulation 6(6) of the Regulations provides that where there is a dispute concerning interconnection between organisations, the Director 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 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;

(M) The Director 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 which accompanies, and is published with, this direction;

(N) The Regulations place upon the Director the general responsibility to encourage and secure adequate interconnection in the interests of all users;

(O) The Director issued a draft of this direction and the explanatory memorandum which contained the Director’s reasons on 31 October 2002 and responses were invited by 28 November 2002;

(P) Non-confidential comments were received as detailed and discussed in Chapter 4 of the explanatory memorandum which accompanies and is published with this direction. The Director in making this direction has taken these comments into account;

THEREFORE:

Pursuant to Regulation 6(6) of the Regulations, and having considered, inter alia, the views of the parties and those matters set out in Regulation 6(8) of the Regulations, the Director makes the following direction to resolve the dispute between BT and the operators listed in the Schedule:

1. The operators listed in the Schedule shall not be required to sign the Supplemental Agreement nor agree to BT's proposals for amendment to the SIA set out in the Review Notice.

2. Except as otherwise defined in this direction, words or expressions used shall have the same meaning as in the Act, the BT licence or the SIA as appropriate.

3. This direction shall take effect on the day it is published.

Heather Julie Clayton

Director of Investigations

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

………. 2002

Schedule – Operators in dispute with BT

	Operator	Agreement Date
1	186K Ltd	June 27, 2001
2	4D Telecom Limited	July 20, 1998
3	Allied Communications (UK) Ltd	August 18, 2000
4	Alpha Telecom (UK) Ltd	August 11, 1999
5	America First Ltd	October 19, 1998
6	AUCS Communications Services (UK) Ltd	November 25, 1999
7	Band-X Managed Services plc	September 12, 2001
8	Bis Ltd	October 6, 2001
9	Broadsystem Ventures Ltd	May 24, 1999
10	BT Cellnet Ltd	May 24, 1996
11	Cable & Wireless Communications (Mercury)	September 23, 1997
12	Call Sciences Ltd	June 13, 1997
13	Cellcom Ltd	December 4, 1997
14	Cheers International Telecom Ltd	October 3, 2001
15	Colloquium Ltd	February 7, 2002
16	COLT Telecommunications	July 24, 1996
17	Communications 2000 Group plc	August 14, 2000
18	Communications Networking Services (UK)	January 5, 2000
19	Core Telecommunications Ltd	February 11, 1998
20	Darose Ltd	December 21, 1999
21	Dolphin Telecommunications Ltd	May 11, 1998
22	Easynet Group PLC	December 18, 1997
23	Ecosse Telecommunications Ltd	November 11, 1998
24	Edinburgh Network Technologies Ltd	December 20, 1999
25	Eircom NI Limited	July 12, 1999
26	Energis Carrier Services UK Ltd	December 4, 1997
27	Energis Communications Ltd	June 20, 1997
28	E-Tel Ventures plc	January 21, 2002
29	First Telecom PLC	April 22, 1998
30	GKC Communications Ltd	April 23, 2001
31	Global Crossing (UK) Telecommunications Ltd	August 31, 1995
32	Global Crossing Communications International Ltd	June 27, 1997
33	Global Electroteks Ltd	April 30, 2001
34	Hutchison 3G UK Ltd	August 13, 2001
35	IDT Global Limited	April 21, 1999
36	INMS UK LTD	December 23, 1999
37	Intelnet Communications Limited	February 16, 1999
38	International Telecom plc	July 31, 2000
39	Interoute Telecommunications (UK) Ltd	July 10, 1997
40	Interweb Design Limited	April 6, 2000
41	Iomart Limited	March 29, 1999
42	Ipsaris Ltd	May 8, 2001

43	iXnet UK Ltd	December 20, 1996
44	Keycom plc	September 9, 2000
45	Kingston Communications (Hull) PLC	December 17, 1998
46	Level 3 Communications Limited	March 24, 2000
47	Manet Telecom Ltd	April 26, 2001
48	MCI WorldCom Ltd	February 20, 1997
49	MediaWays.UK Ltd	January 9, 2001
50	NetKonect Communications Ltd	March 8, 1999
51	Nevada Tele.Com Limited	January 24, 2000
52	OMNE Communications Ltd	June 26, 2001
53	One 2 One Personal Communications Limited	June 17, 1996
54	Opal Telecommunications PLC	December 17, 1996
55	Opera Telecom Ltd	February 16, 2000
56	Orange Personal Communications Services Ltd	December 13, 1996
57	PageOne Communications Ltd	January 26, 2000
58	Patientline UK Limited	April 18, 2000
59	PNC TELECOM plc	August 3, 2000
60	Premier Communications International Ltd	April 26, 2001
61	Primus Telecommunications Ltd	January 7, 1997
62	Prodigy Internet Ltd	September 12, 2001
63	Rateflame Limited	June 25, 1999
64	Reach Europe Ltd	March 27, 1997
65	Redstone Communications Ltd	May 22, 1996
66	Skymaker Limited	December 9, 1998
67	Starcomm Limited	November 2, 1999
68	Startec Global Communications UK Limited	September 15, 1999
69	Stratos Global Ltd	January 5, 2001
70	Swiftnet Ltd	August 8, 2000
71	Syntec UK Limited	February 5, 1999
72	T3 Telecommunications Limited	June 25, 1999
73	Telco Network Services Ltd	March 13, 1997
74	Tele 2 Communications Services Limited	March 30, 1999
75	Telecentric Solutions Ltd	February 29, 1996
76	Telecom Art Limited	April 20, 1999
77	Telecom GB Ltd	September 19, 2000
78	Telecom One Ltd	May 12, 1998
79	Telegroup UK Ltd	December 4, 1997
80	TGC UK Ltd.	July 18, 2000
81	The Phone Company Ltd	June 30, 1997
82	Thus plc	August 16, 1996
83	Tiscali UK Ltd	January 13, 1997
84	Torc Europe Ltd	May 17, 2000
85	Torch Communications Ltd	February 26, 1997
86	Totem Communications Ltd	October 5, 1998
87	UKBELL plc	December 10, 2001
88	Unica Communications Ltd	February 1, 2001

89	Unitel Communications Limited	February 1, 1999
90	Vartec Telecom (U.K.) Limited	October 21, 1998
91	VBCnet (GB) Ltd	August 15, 1999
92	Ventelo UK Ltd	April 28, 1995
93	Via-Fon Limited	April 23, 1999
94	Vodafone Ltd	May 10, 1996
95	World-Link, Inc	May 4, 2000
96	Your Communications Ltd	February 28, 1997
97	Zipcom Telecommunications Limited	October 10, 2000
98	Barnsley Cable Communications Ltd	September 11, 1996
99	Birmingham Cable Ltd	October 24, 1996
100	Cable Camden Ltd	September 30, 1996
101	Cable Enfield Ltd	September 30, 1996
102	Cable Hackney & Islington Ltd	September 30, 1996
103	Cable Haringey Ltd	September 30, 1996
104	Doncaster Cable Communications Ltd	September 11, 1996
105	Eurobell (South West) Ltd	June 28, 1996
106	Eurobell (Sussex) Ltd	June 28, 1996
107	Eurobell West Kent	July 21, 1997
108	Halifax Cable Communications Ltd	September 11, 1996
109	Imminus Ltd	October 2, 1996
110	Middlesex Cable Ltd	September 11, 1996
111	Sheffield Cable Communications Ltd	September 11, 1996
112	Telewest Communications (Central Lancashire) Ltd	September 26, 1996
113	Telewest Communications (Cotswolds) Ltd	September 26, 1996
114	Telewest Communications (Cumbernauld) Ltd	September 26, 1996
115	Telewest Communications (Dumbarton) Ltd	September 26, 1996
116	Telewest Communications (Dundee and Perth) Ltd	September 26, 1996
117	Telewest Communications (Dundee and Perth) Ltd	September 26, 1996
118	Telewest Communications (Falkirk) Ltd	September 26, 1996
119	Telewest Communications (Glenrothes) Ltd	September 26, 1996
120	Telewest Communications (Liverpool) Ltd	September 26, 1996
121	Telewest Communications (Liverpool) Ltd	September 26, 1996
122	Telewest Communications (London South) Ltd	September 26, 1996
123	Telewest Communications (London South) Ltd	September 26, 1996
124	Telewest Communications (London South) Ltd	September 26, 1996
125	Telewest Communications (Midlands) Ltd	September 26, 1996
126	Telewest Communications (Motherwell) Ltd	September 26, 1996
127	Telewest Communications (North East) Ltd	September 26, 1996
128	Telewest Communications (Scotland) Ltd	September 26, 1996
129	Telewest Communications (South East) Ltd	September 26, 1996
130	Telewest Communications (South Thames Estuary) Ltd	September 26, 1996
131	Telewest Communications (South West) Ltd	September 26, 1996
132	Telewest Communications (St Helens and Knowsley) Ltd	September 26, 1996
133	Telewest Communications (Telford) Ltd	September 26, 1996

134	Telewest Communications (Wigan) Ltd	September 26, 1996
135	Telewest Communications PLC	January 15, 1998
136	Wakefield Cable Communications Ltd	September 11, 1996
137	Windsor Television Ltd	September 11, 1996
138	Windsor Television Ltd	September 11, 1996
139	Yorkshire Cable Communications Ltd	September 11, 1996
140	Andover Cablevision Ltd	May 30, 1996
141	Anglia Cable Ltd	March 26, 1997
142	Cable Television Ltd	August 19, 1996
143	Cable Thames Valley Ltd	August 19, 1996
144	CableTel Cardiff Ltd	December 13, 1996
145	CableTel Central Hertfordshire Ltd	December 13, 1996
146	CableTel Hertfordshire Ltd	December 13, 1996
147	CableTel Herts and Beds Ltd	December 13, 1996
148	CableTel Newport	December 13, 1996
149	CableTel North Bedfordshire Ltd	December 13, 1996
150	CableTel Northern Ireland Ltd	April 15, 1996
151	CableTel Surrey and Hampshire Ltd	December 13, 1996
152	CableTel West Glamorgan Ltd	December 13, 1996
153	Comtel Coventry Ltd	September 29, 1997
154	Diamond Cable (GrimClee) Ltd	July 12, 1996
155	Diamond Cable (Leicester) Ltd	July 12, 1996
156	Diamond Cable (Lincoln) Ltd	July 12, 1996
157	Diamond Cable (Mansfield) Ltd	July 12, 1996
158	East Coast Cable Ltd	March 26, 1997
159	Heartland Cablevision UK Ltd	August 19, 1996
160	Herts Cable Ltd	August 19, 1996
161	Lichfield Cable Communications Ltd	March 25, 1997
162	National Transcommunications Ltd	December 22, 1997
163	NTL Cambridge Ltd	March 26, 1997
164	NTL Darlington Ltd	October 30, 1996
165	NTL Glasgow	December 13, 1996
166	NTL Glasgow	December 13, 1996
167	NTL Glasgow	December 13, 1996
168	NTL Glasgow	December 13, 1996
169	NTL Glasgow	December 13, 1996
170	NTL Group Ltd	November 21, 2000
171	NTL Kirklees	December 13, 1996
172	NTL Midlands Ltd	July 12, 1996
173	NTL Teesside Ltd	October 30, 1996
174	NTL Telecom Services Ltd	September 10, 1997
175	Oxford Cable Ltd	May 8, 1996
176	Stafford Communications Ltd	May 8, 1996
177	Swindon Cable Ltd	May 26, 1998
178	Wessex Cable Ltd	May 30, 1996

Explanatory memorandum

Chapter 1

Summary

1.1 The Director General of Telecommunications (the “Director”) has issued a 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 British Telecommunications plc (“BT”) and 178 operators as set out in the Schedule to the direction.

1.2 BT referred this dispute to the Director on 24 May 2002. The Director considered the submissions made by BT and the Operators and issued a draft direction on 31 October 2002 to the industry as a whole for consultation. Comments were received from five operators and these have been taken into account in making this final direction.

1.3 The Director has decided that BT should not be permitted to implement its Transit Risk Review proposals as set out in its Supplemental Agreement of 15 April 2002.

1.4 BT’s proposal’s to implement a claw-back arrangement forms the subject of this dispute and relates to who should bear the financial consequence of bad debt. On the basis of the evidence currently presented, the Director is not convinced that BT’s proposals are necessary, represent a fair balance between BT and other operators or contribute to the maintenance of adequate interconnection arrangements in the UK.

1.5 The background to the dispute is described in Chapter 2. Chapter 3 sets out the history of the dispute, the arguments of the parties and the draft direction issued on 31 October 2002. Chapter 4 outlines the responses to the draft direction and Chapter 5 explains the Director’s considerations and the basis of his final decision.

Chapter 2

Background

2.1 As the UK's largest operator, BT carries large amounts of both interconnection and transit traffic. Transit traffic is that which BT neither originates nor terminates but carries between other operators. Generally, the caller pays the Originating Number Operator ("ONO") for the cost of the call, and the ONO then pays BT a transit and termination payment. BT separately pays the Terminating Number Operator ("TNO") the termination charge. Currently BT pays the termination payment to the TNO whether or not it receives payment from the ONO and, in doing so, is the only party involved in the transaction that is exposed to the risk of non-payment by the ONO.

2.2 A certain level of bad debt is to be expected in any industry and is regarded as a normal cost of doing business. BT has recently sought to introduce two key measures to address bad debt:

Credit Vetting proposal

- to introduce credit vetting procedures designed to limit BT's exposure to bad debt arising from interconnecting operators during their first year of operation and to introduce protective measures where existing operators incur poor payment records; and

Transit Risk proposal

- to eliminate the risk incurred where BT provides transit services only, by enabling it to claw back any termination payments already made to TNOs, or to cancel payments not yet made, where ONOs default on their payments to BT. Parallel measures would apply whereby another operator, as the transit operator, would be able to claw back payments made, or due, to BT as the terminating operator.

2.3 BT has introduced each of these measures in separate proposals for Supplemental Agreements to the Standard Interconnect Agreement ("SIA"). This direction deals only with BT's request for determination on the Transit Risk Review Supplemental Agreement ("the Supplemental Agreement") although, in making the direction, Oftel has considered the extent to which the two proposals interact with each other.

Chapter 3

History of the dispute

3.1 On 18 December 2001 BT issued a contractual Review Notice to Operators. The Review Notice sought amendments to the SIA to transfer bad debt risks to the Transit Principals (those responsible for the origination or termination of the calls) in certain listed situations where BT acts only as the transit operator.

3.2 Discussions took place between BT and interested representatives of the industry during February and March 2002 but no agreement was reached. A number of operators were sympathetic to BT's position but preferred a solution based on a pence per minute ("ppm") surcharge, calculated using forecasts of traffic.

3.3 On 15 April 2002 BT issued the Supplemental Agreement embodying the proposed changes to 226 operators (including franchisees). Twenty-five operators signed and accepted the Supplemental Agreement. 45 operators formally rejected the Supplemental Agreement. The remainder were deemed to have rejected the Supplemental Agreement by failure to sign within the agreed contractual timescales. Since BT referred the dispute to the Director, further operators have signed and returned the Supplemental Agreement to BT leaving, as of the date of the direction, 178 operators ("the Operators") in dispute with BT.

3.4 BT referred this dispute to the Director in a letter of 24 May 2002. In the letter, BT stated that the dispute concerned BT's proposal that for a number of transit products, it should have the right to "clawback" termination payments paid to TNOs in circumstances where it had not been able to recover those payments from an ONO by reason of the ONO's insolvency. Under the terms of the Supplemental Agreement, payments due by BT to another operator would cease to be due, and payments already made would have to be refunded.

3.5 BT has sought a determination from the Director on whether or not it should be able to claw back payments it had made in these circumstances, or to cancel payments not yet made.

Information sought by the Director

3.6 On 30 May 2002, the Director wrote to the operators which had not signed the Supplemental Agreement, advising that he would be making a determination of this dispute in due course and requested comments. A number of operators responded, and these are listed in the Annex to the Explanatory Memorandum. Only four operators other than BT responded formally to the draft direction issued on 31 October 2002. These operators' comments are summarised in Chapter 4.

3.7 A meeting with BT was held at Oftel on 17 July 2002, to discuss the relationship between this dispute and the dispute over credit vetting, the background to the proposals, and possible solutions.

3.8 A meeting with interested operators was held at Oftel on 19 July 2002 to discuss operators' concerns about the both the Transit Risk and Credit Vetting proposals, and this included discussion of alternative solutions to address BT's concerns.

3.9 On 9 August 2002 the Director wrote to BT requesting further information on the extent of transit risk to BT, BT's reasons for not choosing alternative solutions and any supporting information for BT's proposals. BT made an initial response to this letter on 28 August 2002, providing some, but not all, of the information requested. BT provided further information on 13 and 19 September 2002, and fulfilled the remainder of the information request on 4 October 2002. BT requested that these responses be kept confidential to Oftel.

Submissions of the parties

BT

3.10 BT argued that it carried a unique burden of transit risk. It said that it was obliged to provide interconnection, and act as a middle man in transiting calls and collecting termination charges from ONOs on behalf of TNOs. BT said that, as the financial state of the telecomms sector had deteriorated, the burden placed upon it had become increasingly unreasonable. In BT's financial year 2000/01 three operators went into some form of insolvency resulting in losses to BT of around £200,000; in 2001/02, however, this number rose to 22, resulting in the loss of several tens of millions of pounds.

3.11 BT does make some provision for bad debt in its Product Management, Policy and Planning ("PPP") charge, which aims to recover the administration costs of providing an interconnection service. BT claimed, however, that these provisions were negligible, because when the PPP charge was calculated they were based on lower expectations of bad debt than those currently experienced.

3.12 BT claimed that its conveyance charges have a profit margin of only 3 per cent, and that this was insufficient for it to cover the increasing costs of bad debt. BT argued that the increasing exposure meant that it must take protective measures, and it considered that it should have the right to 'clawback' termination payments made to TNOs where it had not been able to recover the money from ONOs by reason of the ONOs' insolvency. The bad debt would therefore, in BT's view, justifiably be the TNOs' risk and cost.

3.13 BT did not believe that a ppm surcharge on charges for transit services payable by ONOs to BT (the solution preferred by other operators) would be workable or equitable since it would rely on predictions of how much transit bad debt BT would suffer in a particular year, along with the volume of transit calls to be carried during that year. Furthermore, operators not terminating calls would have to pay the same charges as those which did.

3.14 BT had considered whether it could insure against transit risk but its enquiries showed that too much information was required from potential insurers. Although BT had not obtained any formal quotes, it believed that insurance would be very costly and cover only a proportion of the bad debt.

3.15 BT acknowledged the view (see paragraph 3.19 below) that an inadequate credit vetting provision could exacerbate the level of transit risk, and said that its proposals for changes to its credit vetting procedures should have a significant impact on the level of transit risk to which it was exposed.

The Operators

3.16 The Director received comments on this proposal from a number of operators listed in Annex to this Explanatory Memorandum. The following arguments were raised by a number of these operators.

3.17 BT has contracts with each of the ONOs and hence is the only operator in a position to control transit risk. Most operators said that it would be unreasonable for BT to pass on bad debts to operators who had no way to control or predict these costs. They considered that if BT could simply pass on losses to TNOs, BT would lose a considerable amount of the incentive it currently had to attempt to control transit and credit risk. Some operators found it conceivable that BT would continue passing on calls knowing that the ONO was in financial difficulty. The TNO would be unaware of the problem until BT attempted to recover monies paid, leaving TNOs unable to estimate how much of the payments already received from BT, acting as the transit operator, they would actually be able to retain. To exacerbate this problem, many TNOs would already have passed on the payments to their customers (i.e. Service Providers) and would not be able to recover the payments themselves. Operators also felt that BT might make less effort to recover monies from ONOs if it knew that it could pass on any losses to the TNOs.

3.18 Condition 45 of BT’s licence sets out BT’s obligations to interconnect on reasonable terms, including that BT will be paid for the services it provides. Some operators considered that where an originating operator had a poor credit or payment history this would allow BT to terminate interconnection with that operator for failing to make payments and that this provided it with ample protection. Since the OLOs do not, for the most part, interconnect directly with each other they do not have this protection available to them. The view of the operators was that there are too many operators for each of them to contract directly with all of the others.

3.19 Some operators felt that the transit risk problem was caused partly by the inadequacy of BT’s credit vetting procedures. Many operators felt that BT’s credit vetting proposals (see paragraph 2.2) could resolve the issue of transit risk.

3.20 Several operators felt that BT had already made adequate provision for bad debt within the PPP charges. While it was accepted that bad debt had been higher in the last year than it had in previous years, the operators said that as BT had been collecting PPP charges since 1995-96, when bad debt was negligible, and should have accumulated sufficient sums to cover the current levels of bad debt.

3.21 Some operators said that if they knew that they were liable for the bad debt of ONOs, they would ask BT not to pass on calls to them from any company in financial difficulty.

3.22 Operators felt that, if there was a need for BT to pass on costs within the industry (and not all operators accepted that this was reasonable) there were other, more preferable solutions. It was suggested by several operators that BT could insure itself against transit risk. Cable & Wireless considered that the solution of passing transit risk to TNOs by requiring them to interconnect directly with each of the ONOs merited further examination. Generally, however, the industry indicated that if the principle that transit risk could be spread across the industry were accepted, they would prefer a ppm surcharge on payments made by ONOs, though approval of this solution would be dependent on BT providing estimates of the level of the surcharge.

The Director's draft decision

3.23 On 31 October 2002 the Director issued a draft direction setting out his proposed decision in resolving the dispute. In summary, Oftel was provisionally of the view that BT's proposal to transfer the burden of bad debt directly to the TNOs was unacceptable for the following reasons:

(i) it transferred the bad debt risk to TNOs which had no contractual relationship with ONOs and thus had no way of minimising the risks of ONOs' bad debt. To transfer all the risk to the TNOs would artificially increase this risk (as the TNOs had no means to reduce it) and move the burden into the termination markets, thereby increasing the riskiness of these markets. This risk would be artificial in the sense that in the normal course of business it would be unreasonable to expect a company in a supply chain to accept terms and conditions where it bears, but does not control, the risk of bad debt; and

(ii) it reduced, but did not remove, BT's incentive to minimise the costs of bad debt from ONOs by implementing credit vetting policies and appropriate credit management policies. BT still bore, and could be expected to take steps to minimise, bad debt on transit charges and where it terminated calls itself. BT was in the best position to minimise transit risk, however, as it knew which operators it was dealing with, had the contractual means to screen them and the technical means to withdraw or suspend services where there was a sufficiently high risk of insolvency.

3.24 Accordingly, the Director was minded to direct that the operators listed in the schedule to the draft direction should not be required to sign the supplemental agreement.

BT’s accounting for bad debt

3.25 Oftel has carried out a partial review of how BT accounts for bad debts, including those that arise out of the provision of transit services. Oftel is of the view however that this review is not vital in resolving the dispute at hand. Oftel notes that going forward, BT is seeking to introduce credit vetting provisions into the SIA. As previously stated, Oftel is considering a dispute in respect of this matter and will be issuing a direction shortly. However, given that Oftel's draft direction stated that it is reasonable in principle for BT to have a credit vetting policy, any policy adopted by BT should enable it to control its exposure to bad debt better and this in time should impact on the level of its bad debt costs.

Chapter 4

Responses to the draft direction

BT

4.1 BT repeated that it is obliged to provide a transit service and that in the current economic climate this posed a significant risk to BT. It noted Oftel’s view that TNOs would be disadvantaged by its proposal as they do not have a direct relationship with ONOs, but maintained that since BT transited calls to TNOs which enjoyed economic benefits from such calls, it was reasonable to expect TNOs to share a proportion of the risk. It also repeated that its profit margin on providing transit services was very small and was quickly eliminated by the failure of even a few ONOs to pay.

4.2 BT said that although its transit risk and credit vetting initiatives were inter-related to a degree, they were separate, and both were needed in some form because one on its own could not achieve reasonable protection. Given what BT perceived to be Oftel’s support in principle for the introduction of reasonable transit risk measures, BT intended to develop a new set of proposals on transit risk for industry discussion in the new year.

The Director’s comments

4.3 The Director’s view is that BT is best placed to manage debtors associated with the provision of transit services. However, in principle this does not imply that BT should automatically bear the full financial burden of this risk. BT reflects the cost of bad debts it incurs within its Network Business regulatory cost base which it recovers by way of charges for network services to other operators and its Retail Systems Business. If the Director felt that charges were not set at a sufficient level to cover the increased levels of risk, additional bad debt provision might be warranted. This would essentially reopen the network charge controls, which the Director would be extremely reluctant to do unless the circumstances were exceptional (eg a significant risk exists that BT would fail to recover its cost of capital). It would be for BT to provide compelling evidence that this was warranted, including evidence on the level of additional risk, the nature of the risk (temporary or permanent), and the effect of proposed changes to BT's credit vetting policies. Additionally, any cost recovery mechanism should be structured in such a way that BT did not simply transfer the risk to other parties.

COLT Telecommunications

4.4 COLT supported the conclusions in the draft direction.

Thus plc

4.5 Thus supported the conclusions in Oftel’s draft direction. It remained of the opinion that it was unreasonable to expect TNOs to shoulder the burden of bad debt recovery from ONOs with whom they were unlikely to enjoy any direct commercial relationship. Thus was also encouraged that Oftel had not been persuaded to consider transit risk proposals in isolation from the various other methods of bad debt recovery available to BT.

ntl

4.6 ntl supported the conclusions in the draft direction. It also believed that given the current economic climate within the telecommunications market, competition in future interconnect arrangements could become constrained and compromised, which would benefit the dominant players. ntl believed BT’s credit vetting proposal (considered separately) would exacerbate this problem.

Energis Communications Ltd

4. 7 Energis supported Oftel’s draft decision. It said that since TNOs had no commercial relationship with the ONOs where BT had provided transit facilities, it seemed anomalous that BT was attempting to pass its own debt risk on to other parties. TNOs were not in a position to control the volume of transit traffic delivered to them by BT and hence were unable to limit their liability for the proposed recovery by BT.

Chapter 5

The Director's final decision

5.1 Having duly considered all of the comments made in response to the draft direction and the matters in Regulation 6(8) of the Telecommunications (Interconnection) Regulations 1997, in particular bearing in mind the relevant market positions of the parties, and the need to ensure that there are adequate interconnection arrangements in the UK, the Director sees no reason to depart from his proposed decision concerning BT's transit risk proposals as set out in the draft Direction. The Director's reasoning is set out in Chapter 5 of the Explanatory Memorandum to the draft Direction. He concludes that BT should not be allowed to implement its transit risk proposals as set out in its transit risk review supplemental agreement.

5.2 BT claims to have lost several million pounds as a result of ONO insolvency and its position as a transit operator. Given current market conditions, this appears to be a legitimate continuing concern for BT. However, BT's proposal provides a one-sided solution which would free BT from the risk but does not ensure that the risk is minimised. Oftel believes that BT is best placed to minimise this risk because:

(i) BT has a direct contractual relationship with the ONOs and can thus screen them (any credit vetting policy implemented by BT will assist this process);
(ii) BT has the technical means to stop calls from insolvent ONOs; and
(iii) BT has direct contractual relationship with the ONOs that allows it to claim money directly from insolvent ONOs.

The Director is not convinced that BT's proposals are necessary, represent a fair balance between BT and other operators or contribute to the maintenance adequate interconnection arrangements in the UK.

Annex

Operators which made submissions to the Director

- 186k Ltd
- Cable and Wireless Communications
- COLT Telecommunications
- Easynet Group plc
- Energis Telecommunications Ltd
- Global Crossing UK Telecommunications Ltd
- Hutchison 3G UK Ltd
- Interoute Telecommunications plc
- Ipsaris Ltd
- Isle of Wight Cable and Telephone Company Ltd
- Kingston Communications (Hull) plc
- ntl: Group of Companies
- Omne Communications Ltd
- Orange plc
- Prodigy Networks Ltd
- Rateflame ltd
- Redstone Communications Ltd
- Stratos Global Ltd
- Telecom One Ltd
- Telewest Group of Companies
- Thus plc
- Viafon Ltd
- Vodafone Ltd
- Worldcom UK Ltd
- Your Communications Ltd