



Provisional conclusions concerning re-determination of disputes relating to BT's charges for Ethernet services (remitted by the CAT)

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About this document

In December 2012 Ofcom resolved five disputes between BT and each of Cable & Wireless Worldwide (now Vodafone), Sky, TalkTalk, Verizon and Virgin concerning BT's charges for Ethernet services. We found that BT had overcharged these parties approximately £95 million for Ethernet services during the period 2006/07 to 2010/11. Ofcom's determinations of these disputes were appealed to the CAT.

In August 2014, the CAT issued its judgment on the appeals. Following this, the CAT remitted a number of issues to Ofcom for resolution, including the rate of interest payable in respect of BT's overcharge for Ethernet services.

This document sets out Ofcom's provisional conclusions for determining the remitted matters.

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Glossary of terms

2003 Act: The Communications Act 2003.

The Altnets: CWW, Verizon and Virgin.

BT: British Telecommunications PLC company whose registered company number is 01800000, and any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 1159 of the Companies Act 2006.

CAT: The Competition Appeal Tribunal.

CC: The Competition Commission.

CDS: Credit default swap. A CDS is a form of insurance against possible default on a debt.

CP: Communications provider.

CWW: Cable & Wireless Worldwide plc (whose registered company number is 7029206) group, including the following CWW companies: Cable & Wireless UK (registered company number 1541957), Cable & Wireless Access Limited (registered company number 4005262), Energis Communications Limited (registered company number 2630471), Thus Group Holdings Limited (registered company number SC192666) and Your Communications Group Limited (registered company number 4171876).

The Disputing Parties: CWW, Sky, TalkTalk, Verizon and Virgin.

ECCs: Excess construction charges. A charge that BT levies where the installation of an Ethernet circuit requires extra work.

The Ethernet Disputes: Five disputes between BT and each of CWW, Sky, TalkTalk, Verizon and Virgin concerning BT's charges for Ethernet services.

The Ethernet Determinations: The five determinations issued on 20 December 2012 to resolve disputes between BT and each of CWW, Sky, TalkTalk, Verizon and Virgin concerning BT's charges for Ethernet services.

Ethernet services: Services that provide dedicated transmission capacity at a range of bandwidths between sites.

The Gamma Determination: A determination to resolve a dispute between BT and Gamma Telecom Holdings Limited relating to the "Ofcom Interest Rate" contained within BT's Standard Interconnect Agreement.

The Interest Guidance: Guidance setting out Ofcom's approach to interest in the context of resolving disputes involving charges payable under the SIA, which provides an indication of the interest rate that we are generally likely to adopt in such cases.

The Judgment: The CAT's judgment on the appeals of the Ethernet Disputes, handed down on 1 August 2014.

The Orders: Three Orders issued by the CAT to give effect to the Judgment and Supplementary Judgment, issued on 10 December 2014.

The Parties: BT, CWW, Sky, TalkTalk, Verizon and Virgin.

The Provisional Conclusions: This document.

The Remitted Matters: The matters that the CAT remitted to Ofcom in the Orders.

SIA: BT's Network Charge Change Control Standard Interconnect Agreement, which provides the terms and conditions on which calls are connected between BT and other CPs.

Sky: Sky UK Limited whose registered company number is 02906991, and any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 1159 of the Companies Act 2006.

SMP: Significant Market Power.

The Supplementary Judgment: The CAT's supplementary judgment, handed down on 4 December 2014.

TalkTalk: TalkTalk Telecom Group PLC whose registered company number is 07105891, and any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 1159 of the Companies Act 2006.

Vanilla WACC: A way of calculating weighted average cost of capital that uses the pre-tax cost of debt and the post-tax cost of equity.

Verizon: Verizon UK Limited whose registered company number is 02776038, and any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 1159 of the Companies Act 2006.

Virgin: Virgin Media Limited whose registered company number is 02591237, and any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 1159 of the Companies Act 2006.

Vodafone: Vodafone Limited whose registered company number is 01471587, and any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 1159 of the Companies Act 2006.

WACC: Weight average cost of capital.

Section 1

Summary

- 1.1 On 20 December 2012, Ofcom issued five determinations (the “Ethernet Determinations”)¹ resolving disputes between British Telecommunications plc (“BT”) and each of Sky UK Limited (“Sky”),² TalkTalk Telecom Group plc (“TalkTalk”), Virgin Media Limited (“Virgin”),³ Cable & Wireless Worldwide plc⁴ (“CWW”),⁵ and Verizon UK Limited (“Verizon”)⁶ (together the “Parties”). The Ethernet Determinations found that BT had overcharged each of CWW, Sky, TalkTalk, Virgin, and Verizon (together the “Disputing Parties”) for certain Ethernet services from 2006/07 to 2010/11. The Ethernet Determinations ordered BT to repay to the Disputing Parties a total of £94.8 million.⁷
- 1.2 Three appeals (the “Appeals”) of the Determinations were lodged with the CAT: by BT;⁸ by Sky and TalkTalk (jointly);⁹ and by CWW, Virgin and Verizon (jointly).¹⁰
- 1.3 On 1 August 2014, the CAT handed down its judgment (the “Judgment”) on the Appeals.¹¹ The CAT upheld our decision that BT had overcharged the Disputing Parties but found that:
- Ofcom should have made an adjustment to BT’s rental costs in 2009/10 in respect of the exclusion of excess construction charges (ECCs); and
 - Ofcom should have ordered BT to pay interest on the repayments.
- 1.4 On 10 December, the CAT issued three Orders (the “Orders”),¹² which remitted the following matters to Ofcom (the “Remitted Matters”):
- a) the rate of interest payable in respect of BT’s overcharge for Ethernet services;
 - b) the repayments to which BT is entitled in respect of the exclusion of ECCs from its rental costs;

¹ http://stakeholders.ofcom.org.uk/binaries/consultations/ethernet-services/annexes/Ethernet_FD.pdf

² At the time of the Ethernet Determinations, Sky was known as British Sky Broadcasting Limited.

³ http://stakeholders.ofcom.org.uk/enforcement/competition-bulletins/closed-cases/all-closed-cases/cw_01052/

⁴ CWW was acquired by Vodafone on 30 July 2012.

⁵ http://stakeholders.ofcom.org.uk/enforcement/competition-bulletins/closed-cases/all-closed-cases/cw_01078/

⁶ http://stakeholders.ofcom.org.uk/enforcement/competition-bulletins/closed-cases/all-closed-cases/cw_01087/

⁷ The Ethernet Determinations, paragraph 15.153.2.

⁸ <http://www.catribunal.org.uk/239-7889/1205-3-3-13-British-Telecommunications-PLC.html>

⁹ <http://www.catribunal.org.uk/239-7925/1207-3-3-13-1-British-Sky-Broadcasting-Limited-and-2-TalkTalk-Telecommunications-Group-plc-.html>

¹⁰ <http://www.catribunal.org.uk/239-7924/1206-3-3-13--1-Cable--Wireless-Worldwide-plc-2-Virgin-Media-Limited-and-3-Verizon-UK-Limited-.html>

¹¹ <http://www.catribunal.org.uk/238-8608/Judgment.html>

¹² http://www.catribunal.org.uk/files/1206_Cable_Order_101214.pdf; http://www.catribunal.org.uk/files/1205_BT_Order_101214.pdf; and http://www.catribunal.org.uk/files/1207_BSkyB_Order_101214.pdf

- c) BT's claim for interest in respect of the repayment referred to at (b); and
 - d) the total amount payable as between BT and Sky, TalkTalk, CWW, Virgin and Verizon.
- 1.5 We opened a case on 3 February 2015 to determine the Remitted Matters.
- 1.6 This document (the "Provisional Conclusions") sets out for comment our provisional reasoning and assessment of the Remitted Matters.

Ofcom's provisional conclusions on the Remitted Matters

- 1.7 Our provisional conclusions are that:
- 1.7.1 Adjusting for the ECC overpayment, the correct amount of principal overcharge by BT is £94,620,000.
 - 1.7.2 The corrected figure above takes account of the repayment that BT is entitled to in respect of the exclusion of ECCs of £203,000.
 - 1.7.3 The interest on the corrected principal overcharge payable by BT is £22,422,000.
 - 1.7.4 The net amount which BT should repay to the Disputing Parties (i.e. the interest less the ECCs adjustment) is £22,219,000; and
 - 1.7.5 From 29 December 2012, BT should pay interest on the net amount due to the Disputing Parties at a rate of BoE+1%.
- 1.8 From 29 December 2012, BT is entitled to interest on the ECC overpayment. By calculating a net amount due to the Disputing Parties, and allowing for interest on that net amount only, BT's entitlement has been given effect to in these Provisional Conclusions.

Structure of the remainder of this document

- 1.9 This document sets out for comment the main elements of our provisional reasoning and assessment in relation to the Remitted Matters.
- 1.10 The introduction and background are set out in **section 2** and the analysis underpinning our provisional reasoning and assessment is set out in **section 3**.

Next steps

- 1.11 We consider it appropriate to set a consultation period of 10 working days. Accordingly, the Parties and other interested parties have until **5pm on 6 July 2015** to comment on these Provisional Conclusions.
- 1.12 After considering any comments received, we will make our final determinations. Details of how to respond to these Provisional Conclusions are set out in **Annexes 1 and 2**.

Section 2

Background

2.1 In this section, we set out the relevant background to this case, including a summary of the Ethernet Disputes, the Appeals and guidance published by Ofcom on its approach to the award of interest in the context of a previous dispute determination.

The Ethernet Disputes

2.2 On 27 July 2010, Sky and TalkTalk made a joint submission to Ofcom asking us to resolve disputes with BT concerning BT's charges for Ethernet services. Virgin submitted a dispute on 10 August 2010, CWW submitted a dispute on 17 November 2011 and Verizon submitted a dispute on 22 February 2012. We accepted the Sky, TalkTalk and Virgin disputes for resolution on 13 September 2010 (the "Initial Disputes"),¹³ the CWW dispute on 9 December 2011,¹⁴ and the Verizon dispute on 15 March 2012.¹⁵

2.3 The services in dispute in the Ethernet Disputes were Wholesale Extension Services (WES) and Backhaul Extension Services (BES). WES and BES are types of wholesale Ethernet services. They provide dedicated transmission capacity at a range of bandwidths between sites. WES are used by CPs to provide a dedicated fibre optic data circuit between a retail customer's premises and the CP's network. BES are fibre optic data circuits that run between a CP's network and its equipment within an unbundled BT local exchange. They are used by Local Loop Unbundling operators.

2.4 In market reviews in 2004 and 2008, Ofcom found that BT had significant market power (SMP) in the alternative interface symmetric broadband origination (AISBO) market, which included the provision of wholesale Ethernet services. Based on this finding, Ofcom imposed an SMP condition on BT (Condition HH3.1) which required BT to ensure that its charges for services (including Ethernet services) were cost orientated, and to be able to demonstrate this to Ofcom's satisfaction.¹⁶

2.5 In the Ethernet Disputes, the Disputing Parties contended that BT had overcharged for Ethernet services in breach of Condition HH3.1 and that BT should be ordered by Ofcom to repay to them the amount of the overcharge.

¹³ Disputes between each of Sky, TalkTalk and Virgin Media and BT regarding BT's charges for Ethernet services (CW/01055/08/10).

¹⁴ Dispute between Cable and Wireless and BT about BT's charges for Ethernet services (CW/01078/11/11).

¹⁵ Dispute between Verizon and BT relating to BT's charges for WES (CW/01087/02/12).

¹⁶ Condition HH3.1 required that BT: "*shall secure, and shall be able to demonstrate to the satisfaction of Ofcom, that each and every charge offered, payable or proposed for Network Access covered by Condition HH1 is reasonably derived from the costs of provision based on a forward looking long run incremental cost approach and allowing an appropriate mark up for the recovery of common costs including an appropriate return on capital employed.*"

http://stakeholders.ofcom.org.uk/binaries/consultations/llmr/statement/state_note.pdf and <http://stakeholders.ofcom.org.uk/binaries/consultations/bcmr08/summary/bcmr08.pdf>

- 2.6 The Disputing Parties argued that Ofcom should require BT to repay interest on any repayment.¹⁷
- 2.7 Each of the Ethernet Disputes concerned different services and periods:
- 2.7.1 TalkTalk and Sky's dispute concerned certain BES services from 24 June 2004 to 31 July 2009.
 - 2.7.2 Virgin's dispute concerned certain BES and WES services from 1 April 2006 to 31 March 2009.
 - 2.7.3 CWW's dispute concerned certain BES and WES services from 1 April 2006 to 31 March 2011.
 - 2.7.4 Verizon's dispute concerned certain WES services from 1 January 2007 to 31 March 2011.
- 2.8 We therefore considered whether BT had overcharged the Disputing Parties for Ethernet services during the period between 24 June 2004 and 31 March 2011.
- 2.9 As part of our analysis we made a number of adjustments to the financial data included in BT's published regulatory financial statements (RFS), which we used as the basis of our analysis of whether BT had overcharged. One of these was to remove the costs associated with Excess Construction Charges (ECCs), a charge that BT levies where the installation of an Ethernet circuit requires extra work. BT submitted that Ofcom should reduce the adjustment it had made for ECCs in 2009/10, as the costs associated with ECCs had already been removed from the financial data supplied by BT for that year.¹⁸
- 2.10 On 20 December 2012, Ofcom issued the Ethernet Determinations to resolve all of the disputes. The Ethernet Determinations found that BT had overcharged each of the Disputing CPs in breach of Condition HH3.1 and required BT to make repayments for the total amount of the overcharge.
- 2.11 We considered that we did not have sufficient evidence to decide whether we should also award interest, which would involve setting aside the contractual provision, in order to meet our regulatory objectives. Therefore, no order was made for interest to be paid.¹⁹
- 2.12 Following the Ethernet Determinations, BT issued credit notes to each of the Disputing Parties on 28 December 2012 for the amounts that Ofcom had ordered BT to repay.²⁰

The Interest Guidance

- 2.13 On 25 October 2013, Ofcom issued a determination (the "Gamma Determination") to resolve a dispute between Gamma Telecom Holdings Limited and BT (the "Gamma Dispute") concerning the interest rate set out in BT's Standard Interconnect

¹⁷ The Ethernet Determinations, paragraph 15.74.

¹⁸ The Ethernet Determinations, paragraphs 13.194 and 13.199-13.200.

¹⁹ The Ethernet Determinations, paragraphs 15.74 -15.144.

²⁰ BT's 19 February 2015 response to Ofcom's 1st Section 191 Notice.

Agreement (SIA), known as the “OfTel Interest Rate”, which applied, among other things, to any repayments required as a result of a direction by Ofcom.²¹

- 2.14 As part of the Gamma Determination, Ofcom issued guidance (the “Interest Guidance”) in which it indicated its general approach to interest in the context of resolving disputes involving charges payable under the SIA,²² and “*sought to identify the interest rate that we are generally likely to adopt*” in such cases.²³
- 2.15 The Interest Guidance states that it is likely to be appropriate to award interest in the majority of cases in which we order repayment, our main objective being to avoid creating an incentive for CPs to set charges that are unduly high. The Interest Guidance also says that the starting point is that the interest rate should generally reflect the time value of the principal to the overcharging firm, i.e. the benefit the overcharging firm enjoys by virtue of the delay between its overcharging and the date on which it makes a repayment.²⁴
- 2.16 The Interest Guidance states that it would be reasonable to expect that the opportunity cost to the overcharging firm reflects the cost of debt as it could repay outstanding debt or avoid taking out debt with an additional increase in cash as a result of the overcharge. This implies that a cost of debt rate would be appropriate.²⁵ We explained that the interest rate which would represent the cost of debt to the overcharging firm is determined by two factors: (a) the term of the debt; and (b) the premium over and above the risk-free rate which reflects the risk of default by the overcharging firm.²⁶
- 2.17 We also explained in the Interest Guidance that although we could seek to assess on a case-by-case basis the *actual* benefit to the overcharging firm as a result of the overcharge in that case, such an in-depth assessment would be complex and is unlikely to be practical. We also noted that it is important to adopt an approach which would foster commercial and regulatory certainty and that an appropriate interest rate should be readily calculable using available data.²⁷
- 2.18 We stated that:

“We therefore do not consider that it would be appropriate to seek to assess the actual benefit to the overcharging firm in the context of resolving a dispute. Instead, in view of the difficulties which may be involved in seeking to determine a ‘theoretically accurate’ rate which approximates the actual benefit to an overcharging CP in a particular case, we consider that it is reasonable and proportionate to adopt a more pragmatic approach, provided that the applicable rate would be within the range of the cost of debt to the overcharging CP that may reasonably be expected.”²⁸

²¹ See http://stakeholders.ofcom.org.uk/binaries/enforcement/competition-bulletins/closed-cases/all-closed-cases/cw_01108/CW_011080613.pdf

²² The charges for the relevant services in the Ethernet Disputes were not payable under the SIA. However, as noted at paragraph 4.14 of the Gamma Determination, we consider that the Interest Guidance is also relevant more generally to repayments directed by Ofcom.

²³ Gamma Determination, paragraph A2.2.

²⁴ Gamma Determination, paragraphs A2.3-A2.4.

²⁵ Gamma Determination, paragraph A2.8.

²⁶ Gamma Determination, paragraph A2.8.

²⁷ Gamma Determination, paragraph A2.9-10.

²⁸ Gamma Determination, paragraphs A2.11.

2.19 We explained that we considered that the Bank of England base rate plus 1% (BoE+1%)²⁹ is likely to be an appropriate rate to reflect the benefit derived by the overcharging firm from the overcharge in most cases.³⁰ However, we recognised that, depending on the facts of the case and taking into account any evidence provided by the Parties, it may be appropriate to adopt a different rate in order to ensure that our objectives are met.³¹

The Appeals

2.20 In February 2013, BT,³² Sky and TalkTalk (jointly),³³ and CWW, Virgin and Verizon (jointly)³⁴ lodged appeals against the Ethernet Determinations.

2.21 On 1 August 2014, the CAT handed down its judgment on the Appeals (the “Judgment”).³⁵ The CAT substantially upheld Ofcom’s decision that BT had overcharged the Disputing Parties and dismissed most of BT’s and Sky and TalkTalk’s grounds of appeal, but found that:

- Ofcom should have made an adjustment to BT’s rental costs in 2009/10 in respect of the exclusion of ECCs;³⁶ and
- Ofcom had jurisdiction to require a payment of interest and should have ordered BT to pay interest on the repayments.³⁷

2.22 On 10 December 2014, the CAT issued three orders (the “Orders”) giving directions. The CAT remitted to Ofcom in accordance with section 195(4) of the 2003 Act the following matters for Ofcom to determine, as soon as reasonably practicable,³⁸ in accordance with the Judgment and the Supplementary Judgment:

- a) the rate of interest payable in respect of BT’s overcharge for Ethernet services;
- b) the repayments to which BT is entitled in respect of the exclusion of ECCs from its rental costs;
- c) BT’s claim for interest in respect of the repayment referred to at (b); and
- d) the total amount payable as between BT and Sky, TalkTalk, CWW, Virgin and Verizon.

²⁹ We noted that this is the rate which has conventionally been adopted by the High Court in commercial cases and by the CAT when awarding interest on penalties on appeal.

³⁰ Gamma Determination, paragraph A2.12.

³¹ Gamma Determination, paragraph A2.13.

³² Case number , see <http://www.catribunal.org.uk/239-7889/1205-3-3-13-British-Telecommunications-PLC.html>

³³ Case number , see <http://www.catribunal.org.uk/239-7924/1206-3-3-13--1-Cable--Wireless-Worldwide-plc-2-Virgin-Media-Limited-and-3-Verizon-UK-Limited-.html>

³⁴ Case number , see <http://www.catribunal.org.uk/239-7924/1206-3-3-13--1-Cable--Wireless-Worldwide-plc-2-Virgin-Media-Limited-and-3-Verizon-UK-Limited-.html>

³⁵ See http://www.catribunal.org.uk/files/1205-7_Ethernets_Judgment_CAT_14_010814.pdf

³⁶ The Judgment, paragraphs 214-220 and 316(a).

³⁷ The Judgment, paragraphs 286-315 and 316(b).

³⁸ Order of the CAT, case no. 1206/3/3/13 and Order of the CAT, case no 1207/3/3/13.

- 2.23 Section 195(6) of the 2003 Act requires Ofcom to comply with every direction given by the CAT under section 195(4) of the Act. We therefore opened this case in order to determine the matters remitted to us by the CAT.

The current case and the Remitted Matters

- 2.24 On 29 December 2014, we wrote to the Parties inviting them to provide submissions on the Remitted Matters, as well as the relevance of the Interest Guidance in this case. The Parties provided submissions on 2 February 2015. On 3 February 2015, we published details of the case, including the scope, on the Competition and Consumer Enforcement Bulletin part of our website.³⁹
- 2.25 Ofcom will issue its determinations in accordance with the terms of the Orders.

Interested parties

- 2.26 One stakeholder, KCOM, has expressed an interest in the outcome of this dispute.

Information relied upon in determining the Remitted Matters

- 2.27 These Provisional Conclusions draw on information provided by the Parties. This includes:
- 2.27.1 BT submission, 2 February 2015;
 - 2.27.2 Report prepared for Vodafone, Virgin, Verizon, Sky and TalkTalk by Alix Partners concerning the rate of interest repayable on overcharge by BT relating to Ethernet Services (the “Alix Report”), 2 February 2015;
 - 2.27.3 Herbert Smith Freehills submission on behalf of Sky and TalkTalk, 2 February 2015;
 - 2.27.4 Towerhouse submission on behalf of Vodafone, Virgin and Verizon, 2 February 2015;
 - 2.27.5 BT’s 19 February 2015 response to Ofcom’s Section 191 Notice;
 - 2.27.6 BT submission, 18 March 2015;
 - 2.27.7 Report prepared for BT by Ernst & Young LLP on the rate of interest repayable on the overcharges by BT relating to Ethernet services (the “Ernst & Young Report”), 18 March 2015;
 - 2.27.8 Herbert Smith Freehills submission on behalf of Sky and TalkTalk, 16 March 2015;
 - 2.27.9 Report prepared for Vodafone, Virgin, Verizon, Sky and TalkTalk by Alix Partners concerning the rate of interest repayable on overcharge by BT relating to Ethernet Services (the “second Alix Report”), 16 March 2015; and

³⁹ http://stakeholders.ofcom.org.uk/enforcement/competition-bulletins/open-cases/all-open-cases/cw_01149/

2.27.10 Towerhouse submission on behalf of Vodafone, Virgin and Verizon, 18 March 2015.

Section 3

Analysis and provisional conclusions

Introduction

3.1 This section sets out our provisional reasoning and analysis.

The correct level of principal overcharge

Introduction

3.2 The CAT ordered us to determine the repayments that BT is entitled to with respect of the exclusion of ECCs (see paragraph 2.22 above). We propose to do this by adjusting our original calculation of BT's overcharge to account for ECC costs in 2009/10.

Parties' views

3.3 In an email from BT dated 5 September 2014, BT supplied its calculations of the correct amount of overcharge by BT to Ofcom, taking account of the adjustment for ECC costs. BT's calculations are set out in Table 3.1.

Table 3.1 Corrected total overcharge by CP (£)

	2006/07	2007/08	2008/09	2009/10	2010/11	Total
Sky	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
TalkTalk	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Virgin	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
CWW	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Verizon	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Total CPs	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	94,620,000

Source: Email from BT to Ofcom, Towerhouse and Herbert Smith Freehills, 5 September 2014⁴⁰

3.4 BT says that it appears that all of the Parties⁴¹ have agreed with the corrected figures that have been supplied to Ofcom and the parties, and that Ofcom should therefore make an adjustment accordingly.⁴²

⁴⁰ Email from BT to Ofcom, Towerhouse and Herbert Smith Freehills, 5 September 2014

⁴¹ BT refers to an email from Towerhouse to BT dated 12 September and a letter from Herbert Smith Freehills to BT dated 11 September 2014 as evidence of the agreement of the Disputing Parties to BT's recalculations.

⁴² BT submission, 2 February 2015, paragraph 55 and footnote 60.

3.5 The Disputing Parties have confirmed that they have agreed with BT the repayments to which BT is entitled in respect of ECCs.⁴³

Our analysis

3.6 On 9 September 2014, we wrote to BT and confirmed that the figures provided on 5 September 2014 were consistent with our own calculations of the adjustments and that we would be content to agree a direction for Ofcom to re-determine the Ethernet Disputes by amending the amount of the repayments due by BT to take account of the CAT's approach to ECCs in the Judgment.⁴⁴

3.7 We therefore consider that the repayments should be amended in line with BT's 5 September 2014 adjustments.

3.8 Table 3.2 sets out the repayments due to BT from the Disputing Parties reflecting the adjustment to the principal overcharge relating to ECCs.

Table 3.2: Amounts due to BT for ECCs adjustment (£)

	2006/07	2007/08	2008/09	2009/10	2010/11	Total
Sky	[X]	[X]	[X]	[X]	[X]	[X]
TalkTalk	[X]	[X]	[X]	[X]	[X]	[X]
Virgin	[X]	[X]	[X]	[X]	[X]	[X]
CWW	[X]	[X]	[X]	[X]	[X]	[X]
Verizon	[X]	[X]	[X]	[X]	[X]	[X]
Total CPs	[X]	[X]	[X]	[X]	[X]	203,000

Source: Ofcom. Calculated as the difference between Table 3.1 and Table 15.1 from the Ethernet Determinations.

Provisional conclusion on the correct level of overcharge

3.9 We have provisionally concluded that, taking into account the adjustment in respect of ECCs, the correct amount by which BT overcharged the Disputing Parties is £94,620,000.

3.10 We therefore provisionally conclude that, taking account of the adjustment in respect of ECCs, the amounts which BT should have repaid to the Disputing Parties are as set out in Table 3.1

⁴³ Herbert Smith Freehills submission on behalf of Sky and TalkTalk, 2 February 2015, paragraph 3; Email from Towerhouse to Ofcom, 8 June 2015.

⁴⁴ Email from Ofcom to BT, 9 September 2014.

The appropriate rate of interest on the principal

Introduction

- 3.11 The Ethernet Determinations did not order BT to pay interest on the overcharge. The Judgment found that Ofcom should have ordered BT to pay interest on the overcharge and ordered Ofcom to determine the rate of interest payable in respect of BT's overcharge for Ethernet services.
- 3.12 We will therefore consider the appropriate level of interest to be applied in respect of the overcharge which BT was required to repay in the Ethernet Determinations. In doing so, we will have regard to the Interest Guidance, as appropriate.
- 3.13 We will also consider:
- whether interest should be simple or compound; and
 - if compound, at what intervals interest should be awarded.

BT's view

- 3.14 BT believes that it would be a "*fundamental error*" to depart from the "*clearly settled*" principle set out in the Interest Guidance, that the interest rate should reflect the time value of the principal to the overcharging firm.⁴⁵
- 3.15 BT believes that having conducted a detailed and extensive review in the Gamma Determination and having laid out clear guidance in the form of the Interest Guidance, "*it would now be contrary to regulatory practice and commercial certainty for Ofcom to depart from applying the Gamma Determination appropriate rate (i.e. Base Rate plus 1%) as the interest rate in this specific case, unless there were truly exceptional circumstances (which there are not).*"⁴⁶
- 3.16 BT also argues that the period of time for which it held the overcharge in this case (from 2006/07 until December 2012) is not a reason to depart from the Gamma Determination. Noting that the original dispute was submitted in July 2010 and accepted by Ofcom in September 2010, BT argues that it could reasonably have expected to have had to repay the overcharge within the next four months. BT considers that the fact that it took Ofcom a further two years to reach its final determination should not be seen as a reason to assume that BT would have used the money for longer term deposits or to reduce longer term debt, since it could reasonably have expected that it would need to repay the money in a much shorter period.⁴⁷
- 3.17 Although BT believes that Ofcom should award interest at BoE+1%, it argues that the actual benefit of the overcharge to BT is likely to be less than BoE+1%.⁴⁸
- 3.18 BT observes that between 2006 to 2013, it had a substantial cash surplus in excess of one billion pounds in all but two years.⁴⁹ It argues that even accounting for the total

⁴⁵ BT submission, 2 February 2015, paragraph 7.

⁴⁶ BT submission, 2 February 2015, paragraph 10.

⁴⁷ BT submission, 2 February, paragraphs 21 and 22.

⁴⁸ BT submission, 2 February 2015, paragraph 28.

overcharge in the market (which did not arise in a single year) the “overcharge would not have so reduced BT’s cash liquidity that it would have induced further borrowing.”⁵⁰

- 3.19 Ernst & Young, in their report on behalf of BT, assess the counterfactual situation, specifically whether there would have been any differences in BT’s cost of financing its operations and/or its capex programme. They consider that “we need to assess which part of BT’s funding was “subsidised” during the period of overcharging, by virtue of BT not incurring financing costs in respect of the overpayments when it would, absent the overpayments, be expected to do so.”⁵¹
- 3.20 With respect to BT’s WACC, Ernst & Young argue that BT had a significant amount of cash and cash equivalents during the period of the overcharge, and that “these amounts were sufficiently large that it is reasonable to conclude that its overall financing requirements could have been funded in full without recourse to the equity or debt markets in the event that it had not received overpayments in respect of its ethernet services.”⁵²
- 3.21 With respect to BT’s capex, Ernst & Young state that they “would expect that the amount that BT invested in capital projects from year to year would be determined not by the amount of funds to which it has access (since this can be increased or decreased to meet demands) but, rather, by the number and size of financially viable projects available to the company.”⁵³
- 3.22 Considering which elements of BT’s financing would be different in the counterfactual, given the context of BT’s financial position, Ernst & Young consider three alternatives for the benefit received by BT from the overcharges.
- 3.22.1 **Overall cost of capital:** Ernst and Young say that “BT’s WACC reflects the respective financing costs of both debt and equity funding. The debt consists of a variety of instruments but, in general, a common characteristic of debt financing instruments is a finite term to maturity, i.e., the point at which the principal is required to be repaid. In contrast, equity funding represents an investment which is usually considered longer term in nature and is typically subject to more uncertain returns. What is clear is that BT’s benefit was limited to a period of approximately five years or less and, as such, was not a substitute for long term finance”.⁵⁴
- 3.22.2 **Cost of debt:** Ernst and Young say that in the context of the overcharge, “BT enjoyed the benefits of the overpayments for a finite term, which meant that in theory it could have required less debt to be raised as a consequence of the overpayments. The interest rate on debt of a relevant maturity would seem to be the most appropriate approach to approximate the benefit to BT”.⁵⁵

⁴⁹ In 2011 and 2012, BT’s balance sheet showed respectively £370 million and £844 million of cash liquidity. BT submission, 2 February 2015, paragraph 29.

⁵⁰ BT submission, 2 February 2015, paragraph 29.

⁵¹ Ernst & Young Report, 18 March 2015, paragraph 3.4.

⁵² Ernst & Young Report, 18 March 2015, paragraph 3.6.

⁵³ Ernst & Young Report, 18 March 2015, paragraph 3.7.

⁵⁴ Ernst & Young Report, 18 March 2015, paragraph 3.11 (a).

⁵⁵ Ernst & Young Report, 18 March 2015, paragraph 3.11 (b).

- 3.22.3 **Cash and equivalents:** Ernst and Young say that another option to consider is that “*BT benefited from the overpayments by having additional cash deposits, rather than reducing its funding requirements.*”⁵⁶ They suggest that “*given this scale of available cash and the relatively short-term nature (relative to BT’s other forms of funding) of the period from the beginning of the overpayments to the date of the repayments, it may be reasonable to consider the cash deposit rates as a proxy for the benefit to BT.*”⁵⁷
- 3.23 Ernst & Young set out that:
- “...it seems clear that the overcharge is (i) finite in term and (ii) immaterial to BT’s financial operations and associated decision-making. This suggests, given the size of BT’s cash holdings, that an interest rate based on the cash deposit rate would represent a reasonable proxy for the benefit that BT could reasonably have expected to receive from the overpayments. We consider that an interest rate based on BT’s WACC can be rejected as inappropriate as it weights the benefit of the overcharge towards longer term financing, which is not consistent with the benefits which BT actually enjoyed as a result of the repayments.”⁵⁸
- 3.24 Ernst & Young believe that if Ofcom is to consider what an overcharging CP would have had a reasonable opportunity to do with the overcharge, “*then it is necessary to take into account at what point BT had a reasonable expectation of repayment.*”⁵⁹ They say that “*when considering the likely term of the debt, it is not obvious that it is appropriate to consider the period during which the dispute resolution process was extended for ‘exceptional reasons’.*”⁶⁰
- 3.25 Ernst & Young consider an appropriate estimate of BT’s short term debt is the sum of the relevant swap rate and a credit risk premium obtained by interpolating from a Credit Default Swap (CDS)⁶¹ curve.⁶²
- 3.26 Although they consider that an interest rate based on the cash deposit rate and estimated using swap rates and CDS curve is the best approximation for the benefit to BT, Ernst & Young consider that the Gamma rate of BoE+1% “*is close to the actual benefit BT obtained from overpayments*” and “*is consistent with some of the overpayments being used by BT to increase its cash position and some of it being used to avoid debt financing.*”⁶³ They conclude that, given the aim of ensuring commercial and regulatory certainty, the Gamma rate is a reasonable rate of interest to apply in this case, “*especially in view of the complexity of accurately estimating the actual benefit in cases such as these.*”⁶⁴

⁵⁶ Ernst & Young Report, 18 March 2015, paragraph 3.11 (c).

⁵⁷ Ernst & Young Report, 18 March 2015, paragraph 3.11 (c).

⁵⁸ Ernst & Young Report, 18 March 2015, paragraph 3.13.

⁵⁹ Ernst & Young Report, 18 March 2015, paragraph 3.18.

⁶⁰ Ernst & Young Report, 18 March 2015, paragraph 3.18.

⁶¹ A CDS is a form of insurance against possible default on a debt and can therefore provide an estimate of the credit spread. A CDS curve shows the interest rate, or spread, of a CDS of varying maturities.

⁶² Ernst & Young Report, 18 March 2015, paragraph 3.21.

⁶³ Ernst & Young Report, 18 March 2015, paragraph 3.24.

⁶⁴ Ernst & Young Report, 18 March 2015, paragraph 3.25.

- 3.27 BT accepts that interest should be compounded at yearly intervals. BT also states that “*it would be illogical to compound interest at any point other than when any new principal overcharge has accrued.*”⁶⁵
- 3.28 BT says that “*the only sensible legal analysis is that the overcharge must crystallise at the end of the year when the RFS period... comes to an end.*”⁶⁶ If Ofcom rejects this approach, BT contends that no assumptions can be made as to how each overcharge is spread throughout the year, and therefore “*the only sensible solution would be to take the mid-point in the year (i.e. 1 October).*”⁶⁷

The Disputing Parties’ views

- 3.29 The Disputing Parties note that in the Gamma Determination, Ofcom concluded that its primary objective in setting an interest rate is to avoid CPs having an incentive to set charges that are unduly high.⁶⁸ They agree that Ofcom’s focus on an interest rate which avoids CPs having incentives to set unduly high charges is appropriate, and therefore that the appropriate interest rate should reflect the benefit to BT from the overcharge and put BT back in the position that it would have been in but for the overcharging.⁶⁹
- 3.30 The Disputing Parties believe, however, that if Ofcom wishes to achieve the main objective set out in the Interest Guidance, we should base the interest rate on BT’s cost of capital rather than cost of debt as that reflects the benefit of the overcharge to BT.⁷⁰
- 3.31 Sky and TalkTalk believe that the approach set out in paragraphs A2.8 to A2.14 of the Interest Guidance “*should not in fact be Ofcom’s general approach*” and, in any event, the approach of using the Bank of England base rate plus 1% as a proxy of BT’s cost of debt should not be adopted in this case.⁷¹
- 3.32 The Altnets argue that “*Ofcom should approach the question of the rate entirely afresh and without any preference for the Gamma rate.*”⁷²
- 3.33 The Disputing Parties believe that the appropriate interpretation of the overcharges in the Ethernet Disputes is that they led to an overall reduction in BT’s net financing requirement during the years in question.⁷³ Specifically, Alix Partners, in its report on

⁶⁵ BT submission, 2 February 2015, paragraph 47.

⁶⁶ BT submission, 2 February 2015, paragraph 23.

⁶⁷ BT submission, 2 February 2015, paragraph 23.

⁶⁸ Herbert Smith Freehills submission on behalf of Sky and TalkTalk, 2 February 2015, paragraph 8-10, Towerhouse submission on behalf of Vodafone, Virgin and Verizon, 2 February 2015, paragraph 4.4, Alix Report, 2 February 2015, paragraph 3.2.2.

⁶⁹ Herbert Smith Freehills submission on behalf of Sky and TalkTalk, 2 February 2015, paragraphs 11-12, Towerhouse submission on behalf of Vodafone, Virgin and Verizon, 2 February 2015, paragraph 5, Alix Report, 2 February 2015, paragraph 3.2.3.

⁷⁰ Herbert Smith Freehills submission on behalf of Sky and TalkTalk, 2 February 2015, paragraph 19, Towerhouse submission on behalf of Vodafone, Virgin and Verizon, 2 February 2015, paragraph 4.4, Alix Report, 2 February 2015, paragraph 3.3.13.

⁷¹ Herbert Smith Freehills submission on behalf of Sky and TalkTalk, 2 February 2015, paragraph 13

⁷² Towerhouse submission on behalf of Vodafone, Virgin and Verizon, 2 February 2015, paragraph 4.1.

⁷³ Herbert Smith Freehills submission on behalf of Sky and TalkTalk, 2 February 2015, paragraphs 18 to 20, Towerhouse submission on behalf of Vodafone, Virgin and Verizon, 2 February 2015, paragraph 4.4, Alix Report, 2 February 2015, paragraph 3.3.8.

behalf of the Disputing Parties, argues that, due to the overcharges, BT would have earned more revenue than it would have otherwise, meaning that BT had a “*reduced net financing requirement given the level of capital expenditure planned by BT.*”⁷⁴

- 3.34 Alix Partners argue that the principles of corporate finance demonstrate that there are both direct and indirect effects on the costs associated with a net financing requirement, and that the costs associated would not vary at the margin irrespective of the precise financing instrument that BT would avoid as a result of the overcharge. They argue that the Modigliani-Miller irrelevance theorem⁷⁵ “*explains that when the linkages between the cost of debt, the cost of equity and the level of gearing are all taken into account, the overall cost of financing is the same whether the firm issues debt, equity or a combination of both at the margin.*”⁷⁶ They argue that “*the overall cost associated with a change in the net financing requirement is equal to the cost of capital irrespective of the specific instrument used to fund it.*”⁷⁷
- 3.35 Alix Partners therefore believe that the appropriate interest rate is BT’s WACC. The Alix Report says that the relevant WACC is the BT Group nominal vanilla WACC (which uses the pre-tax cost of debt and the post-tax cost of equity) estimated using the WACC parameters published by Ofcom in various reports from 2005 to 2013.⁷⁸ This is because:
- 3.35.1 BT’s treasury policy is carried out at a group level and any overcharge would lead to a change in the debt and equity mix at the BT Group level;⁷⁹
- 3.35.2 since the repayment of the principal does not take account of inflation, a nominal WACC compensates the overcharged parties for the effects of inflation;⁸⁰ and
- 3.35.3 a vanilla WACC reflects the risk-adjusted discount rate applied by investors to cash flows earned by the firm.⁸¹
- 3.36 The Disputing Parties believe that the facts of this case suggest that the overcharge was not akin to debt, but rather that the more appropriate interpretation is that the overcharge led to an overall reduction in the next financing requirement of BT.⁸² Alix Partners (in their report on behalf of the Disputing Parties) cite their understanding of the relevant facts as:
- i) “*Some of the overcharges started as early as 2006/7 and continued to 2010/11 (a period of five years);*

⁷⁴ Alix Report, 2 February 2015, paragraph 3.3.12.

⁷⁵ Modigliani and Miller hypothesised that in perfect markets a firm’s WACC is not affected by the choice of financing (therefore the choice of capital structure is irrelevant). This is summarised in Annex 2 of the Alix Report.

⁷⁶ Alix Report, 2 February 2015, paragraph 3.3.16.

⁷⁷ Alix Report, 2 February 2015, paragraph 3.3.17.

⁷⁸ Alix Report, 2 February 2015, paragraphs 3.5.1 and 3.4.7.

⁷⁹ Alix Report, 2 February 2015, paragraph 3.4.14.

⁸⁰ Alix Report, 2 February 2015, paragraph 3.4.16.

⁸¹ Alix Report, 2 February 2015, paragraph 3.4.18.

⁸² Herbert Smith Freehills submission on behalf of Sky and TalkTalk, 2 February 2015, paragraph 15.2, Towerhouse submission on behalf of Vodafone, Virgin and Verizon, 2 February 2015, paragraph 4.3, Alix Report, 2 February 2015, paragraph 3.3.2.

- ii) *Following Ofcom's investigation into disputes submitted by various CPs, Ofcom published Provisional Determinations in February 2012 and the Determinations in December 2012;*
- iii) *BT made repayments to CPs following Ofcom's Determinations. These repayments included only the principal overcharge, not interest on any basis;*
- iv) *Ofcom's decision was appealed to the CAT by BT, and a Judgment was reached in August 2014. The CAT Judgment confirmed that overcharges had taken place on BES and WES services from 2006/07 to 2010/11 and that interest should be awarded on the overcharges;*
- v) *BT first recognised the Ethernet disputes outcome as a Specific Item in its financial statement for the year ending 31 March 2013.*⁸³⁸⁴

3.37 Alix Partners also state that "even if BT had realised that an overcharge had occurred, at that time it would only be expected to be repaid if a series of events also occurred:

- i) *"A party (most likely the regulator or the affected CPs) identifies that an overcharge has (likely) taken place. The CPs, however, may not have been aware that an overcharge has occurred;*
- ii) *Sufficient evidence arises for the CPs of the regulator to pursue the dispute; and*
- iii) *Ofcom accepts the dispute for resolution and reaches a finding that an overcharge has occurred which is either i) not appealed or ii) not overturned on appeal.*⁸⁵

3.38 Alix Partners believe that given the facts of this case, "it is difficult to see how the overcharge can be treated as substituting one debt (to CPs) for another, certainly at least until a liability was recognised in BT's accounts."⁸⁶ In order for the overcharge to be treated as a debt obligation from BT to the Disputing Parties, Alix Partners believe that there would have to be recognition of the overcharge when it occurred by each party and an explicit agreement for the repayment of the overcharge on agreed terms. They also say that other characteristics of debt do not apply, for example that

⁸³ Alix Report. 2 February 2015, paragraphs 3.3.3 (i) - (v)

⁸⁴ BT says the issue of when a CP first recognised the potential liability was considered in the Gamma Determination, at paragraphs 4.57-4.60. In any event, BT say that the Alix Report is factually incorrect, as "when the 2013 accounts were published in May 2013, BT had **already** [BT's emphasis] made payment for the overcharges determined by Ofcom on 20 December 2012, The statement in the accounts therefore relied upon in the Alix Report did not reflect BT recognising that for the first time it had a **contingent liability** [BT's emphasis] to repay money, but BT's acknowledgment that the sums **had already** [BT's emphasis] been paid." See BT submission, 18 March 2015, paragraph 38. BT also says that "it is quite clear that by May 2012 (when BT's Financial Statements for the year end 31 March 2012 accounts were published with BT's Annual Report), no express provision for the contingent liability of the overcharges was published. This reflects the fact that the sums in question (i.e. amounts approximately equivalent to the overcharge finally determined by Ofcom in December 2012) were deemed to be not sufficiently material that they required express provision in BT's published accounts." See BT submission, 18 March 2015, paragraph 39.

⁸⁵ Alix Report. 2 February 2015, paragraphs 3.3.4 (i)-(iii).

⁸⁶ Alix Report. 2 February 2015, paragraph 3.3.5.

it is reported as a liability on the balance sheet and that it would have seniority in the event of bankruptcy proceedings.⁸⁷

- 3.39 Sky and TalkTalk and the Altnets also argue that it is relevant that BT has contended that it should not have to make repayments, as this suggests that at the time of the overcharge BT would not have expected to make repayments, and that therefore this is a further reason that the nature of the overcharge is not akin to debt.⁸⁸
- 3.40 In the event that Ofcom considers it appropriate to use a cost of debt approach, Alix Partners believe that BT's cost of debt should be estimated by reference to BT's outstanding debt during the relevant period, taking account of the market conditions that BT faces.⁸⁹
- 3.41 Alix Partners propose that the average yield to maturity over each of BT's relevant financial years is a reasonable estimate of BT's cost of debt.⁹⁰ Given that BT held multiple bonds of differing values and volumes, *"the annual average should be weighted by the contribution of each bond to the total outstanding stock of bonds in that year."*⁹¹
- 3.42 In the event that Ofcom decides that a cost of debt rate is appropriate and should be derived by reference to a risk-free rate plus a credit-spread,⁹² Alix Partners propose that *"the most appropriate approach would be to apply a spread for UK BBB+ and BBB bonds to 5 year Government gilts."*⁹³
- 3.43 Alix Partners believe that interest should be compounded at yearly intervals.⁹⁴ They further argue that we should consider that the overcharges occurred at the mid-point of the financial year (i.e. 30 September), as this is consistent with the fact that Ethernet services were purchased throughout each of the overcharge years.⁹⁵
- 3.44 In the Second Alix Report, Alix Partners argue that the *"mid-point for each financial year is a reasonable assumption to take for the purpose of this calculation, since this assumes that Ethernet services are purchased and paid for throughout each financial year. BT's argument that the end-of-year should be assumed because an overcharge is only crystallised at the end of each financial year is not consistent with the evidence presented by Ofcom in the Ethernet Final Determination which suggests that Ethernet services are in fact paid for over the course of the year."*⁹⁶

⁸⁷ Alix Report, 2 February 2015, paragraph 3.3.6.

⁸⁸ Herbert Smith Freehills submission on behalf of Sky and TalkTalk, 2 February 2015, paragraph 15.2(d), Towerhouse submission on behalf of Vodafone, Virgin and Verizon, 2 February 2015, paragraphs 4.5 and 4.6.

⁸⁹ Alix Report, 2 February 2015, paragraph 4.2.22.

⁹⁰ Alix Report, 2 February 2015, paragraph 4.2.19.

⁹¹ Alix Report, 2 February 2015, paragraph 4.2.20

⁹² In the Gamma Determination, we said that *"in addition to a risk-free rate for an appropriate term of debt, a spread which estimates the additional risk of investing in BT should be added to the interest rate."* See the Gamma Determination, paragraph 3.93.

⁹³ Alix Report, 2 February 2015, paragraph A4.28.

⁹⁴ Alix Report, 2 February 2015, paragraph 5.3.2.

⁹⁵ Alix Report, 2 February 2015, paragraph 6.2.1.

⁹⁶ Second Alix Report, 16 March 2015, paragraph 2.210.

Our analysis

Ofcom's objectives in awarding interest

- 3.45 We explained in the Interest Guidance that:
- 3.45.1 when exercising our powers under section 190(2)(d) of the 2003 Act to make a direction requiring a repayment to be made in the context of resolving a dispute, Ofcom will decide whether interest should be payable, and, if so at what rate, taking account of all relevant considerations, with a view to setting an amount of principal plus interest which would best meet our statutory duties and regulatory objectives, in particular, with a main objective of avoiding CPs having incentives to set unduly high charges;⁹⁷
 - 3.45.2 it is likely to be appropriate to award interest in the majority of cases in which a direction for repayment is considered appropriate in order to avoid creating an incentive for CPs to set charges that are unduly high;⁹⁸ and
 - 3.45.3 our starting point was that the interest rate should generally reflect the time value of the principal to the overcharging firm, i.e. the benefit the overcharging firm enjoys by virtue of the delay between its overcharging and the date on which it makes a repayment.⁹⁹
- 3.46 We also said that when awarding interest in disputes, we are likely to consider whether any contractual rate in place would meet our regulatory objectives.¹⁰⁰
- 3.47 We note that, in the Judgment, the CAT considered that our starting point to approaching the award of interest as set out in the Interest Guidance, with reference to our main objective of avoiding an incentive for CPs to set charges that are unduly high, was “*relevant and amply justified on the facts of the present case*”.¹⁰¹
- 3.48 The CAT also found that, insofar as the contractual clause precluding interest¹⁰² is inconsistent with the achievement of our objectives in the circumstances of this case, our decision on interest is not constrained by the contractual provision.¹⁰³ The CAT concluded that “*the incentives on BT [to comply with its cost orientation obligation]... were inadequate in this case*” and “*the additional incentive to avoid overcharging that an award of interest provides is entirely appropriate*”.¹⁰⁴ It therefore found that the Ethernet Determinations should have included a direction to pay interest.¹⁰⁵
- 3.49 In line with the Interest Guidance and the views of the Parties in this case, and consistent with the Judgment, we consider that the main objective set out in the Interest Guidance is the appropriate starting point for determining an appropriate rate of interest in this case. We will therefore seek to determine a rate of interest in this

⁹⁷ Gamma Determination, paragraph A2.1.

⁹⁸ Gamma Determination, paragraph A2.3.

⁹⁹ Gamma Determination, paragraph A2.4.

¹⁰⁰ Gamma Determination, paragraphs A2.5; our regulatory objectives in awarding interest are set out Gamma Determination, paragraph 3.15.

¹⁰¹ The Judgment, paragraph 314.

¹⁰² I.e. clause 12.3 of the relevant Ethernet services contracts which provided that interest would not be payable on charges that were recalculated or adjusted under a direction by Ofcom.

¹⁰³ The Judgment, paragraph 302.

¹⁰⁴ The Judgment, paragraph 304.

¹⁰⁵ The Judgment, paragraph 315.

case which would meet our main objective of avoiding an incentive for CPs to set unduly high charges. We will do so by seeking to determine a rate which would generally reflect the time value of the principal (i.e. the overcharge) to the overcharging firm – in this case BT.

The contractual rate

- 3.50 As the relevant contractual clause relating to the payment of interest in this case does not allow for the payment of interest, awarding interest in line with the contractual rate would not meet our regulatory objectives, as set out in the Judgment. We therefore consider that it would not be appropriate to award the contractual interest rate in this case.

The approach towards setting an interest rate that reflects the time value of the overcharge

- 3.51 Taking the main objective of the Interest Guidance as our starting point, we will consider what rate of interest would best reflect the opportunity cost to the overcharging firm in this case.
- 3.52 In considering the rate of interest that would best reflect the opportunity cost to the overcharging firm, it is relevant to consider whether we are concerned with incentives on the firm, i.e. BT as a corporate entity, or incentives on the owners of the firm, i.e. BT's shareholders.
- 3.53 In charge controls we are typically concerned with BT as a corporate entity. This is because it is the firm that needs to raise funds from debt and equity holders for the purposes of investing in the business. We therefore allow the firm a return on its WACC in charge controls.
- 3.54 In setting the interest rate as part of this dispute, we are concerned with avoiding giving BT an incentive to overcharge. If BT overcharges then any benefit from avoiding interest payments when repaying that overcharge accrues to its shareholders, via lower interest payments and higher profits. Assuming the firm does not default, debt holders have a passive position and receive the same returns regardless of whether BT overcharges or not. Therefore, since the benefits of overcharging accrue to shareholders we have considered the incentives on BT's shareholders.
- 3.55 We do not agree with the Disputing Parties that the overcharge should be characterised as reducing BT's net financing requirement. For example, if BT requires £1000 to finance a project, and overcharges CPs by £200, the £200 overcharge does not change the fact that BT's financing requirement for the project is £1000.
- 3.56 We consider that the overcharge should instead be characterised as an additional source of funding to BT. Given this, the relevant consideration when determining what rate reflects the time value of the overcharge to BT is what sort of funding the overcharge represents. This can be informed by considering the relationship between BT and the Disputing Parties.
- 3.57 Regardless of what any of the parties thought at the time of the overcharge, the overcharge is akin to debt because it represents a sum of money that, consequent on Ofcom's determination that it is an overcharge in breach of BT's regulatory

obligations and should be repaid, must be repaid in full. The amount that BT has to repay the Disputing Parties is the same regardless of BT's performance.

- 3.58 We do not consider that the overcharge is akin to equity, because the overcharge has not led to the creation of an additional shareholder who is bearing any equity risk.
- 3.59 With respect to the overcharge, the Disputing Parties did not take on any of the equity risk associated with BT. All equity risk remained with BT's shareholders, as the overcharge has to be repaid in full regardless of BT's performance.
- 3.60 Given that the Disputing Parties did not take on any of the equity risk associated with BT, we disagree that it would be appropriate to base the interest rate on BT's WACC (which represents the weighted average of BT's cost of debt and its cost of equity).
- 3.61 We therefore consider that it would be reasonable to expect the opportunity cost to BT of having the benefit of the overcharge over a period of time would reflect its cost of debt. This is because where a debt carries zero interest, as was the case with the overcharge, the benefit to BT's shareholders is the interest rate that would have otherwise been paid on debt.
- 3.62 In line with our reasoning in the Gamma Determination and the Interest Guidance, we therefore consider that it is reasonable to expect that an interest rate based on cost of debt best reflects the time value of the overcharge to the overcharging party.

Whether BoE+1% is an appropriate proxy for BT's cost of debt in this case for the period 2006 to 2012

- 3.63 In the Gamma Determination, we said that we did not consider that it would be appropriate to work out the actual benefit obtained from an overcharge on a case-by-case basis. This is because seeking to assess the actual benefit derived from the overcharge is complex, involving a range of factors and considerations. These factors included:
- 3.63.1 what the overcharging CP actually did or had the reasonable opportunity to do with the overcharge;
 - 3.63.2 the period over which the overcharge occurred;
 - 3.63.3 the date on which the dispute was raised;
 - 3.63.4 the investment/funding conditions available to the overcharging CP over the period; and
 - 3.63.5 the extent of the overcharge.¹⁰⁶
- 3.64 Instead, we said that the principle should be to consider what an overcharging CP would have had a reasonable opportunity to do with those funds and to adopt an interest rate which provides a fair and reasonable proxy for the benefit that the overcharging CP could reasonably have been expected to receive from the funds on

¹⁰⁶ Some factors that could be relevant in seeking to assess the actual benefit to the overcharging firm are set out at paragraph 3.76 of the Gamma Determination.

that basis.¹⁰⁷ We remain of the view that it is reasonable and proportionate to adopt a more pragmatic approach, provided that the applicable rate would be within the range of the cost of debt to the overcharging CP that may reasonably be expected.

- 3.65 In the Interest Guidance we said that BoE+1% is likely to provide a reasonable approximation of the cost of debt for an overcharging CP such as BT. We recognised, however, that it may be appropriate to depart from that rate where supported by evidence, i.e. where the parties to a dispute put forward reasoned and evidence-based submissions as to why they considered that the BoE+1% would not be appropriate in the circumstances of a given dispute, for example, because it would not meet our regulatory objectives or would be unfair to one of the parties. We explained that this pragmatic approach should help promote regulatory and commercial certainty, whilst providing sufficiently flexibility to ensure that the level of interest award in a given case achieves our regulatory objectives and is fair as between the parties.¹⁰⁸
- 3.66 The Disputing Parties contend that the Gamma Determination can be distinguished because, in that case, we were concerned with developing a ‘broad-brush’ approach to awarding interest on a forward-looking basis when resolving disputes relating to BT’s Standard Interconnect Agreement, whereas here we are considering the appropriate rate of interest to apply in a specific case of historic overcharging by BT in breach of an SMP condition.¹⁰⁹ The Disputing Parties argue that given the overcharging in this case took place over many years and BT did not recognise that it was overcharging at the time, this is a reason to distinguish the Gamma Determination. The Disputing Parties consider that adopting a more “*tailored approach with proper regard to the particular circumstances of BT*” is appropriate, as this would best give effect to Ofcom’s main objective and it would not be unduly burdensome to do so in this particular case.¹¹⁰
- 3.67 We noted in the Gamma Determination that “*in principle, the guidance we have outlined as to the appropriate approach to interest in the context of this Dispute may also be relevant more generally to repayments directed by Ofcom relating to other products and services*”.¹¹¹ We consider that the approach we adopted in the Interest Guidance is an appropriate starting point for our analysis in this case. In the Gamma Determination, we considered the approach to determining an appropriate level of interest when directing the repayment of an overcharge under section 190(2)(d) of the 2003 Act in resolving a dispute. That is also the question which we are considering in this case. In both cases, our main objective is the same— i.e. to seek to determine a rate of interest which will reflect the time value of the overcharge to the overcharging CP, in order to avoid creating an incentive to overcharge. Therefore, we do not consider that it is necessary to adopt a more “bespoke” approach because this case concerns a specific incident of historic overcharging, in particular since the approach we outlined in the Interest Guidance already builds in sufficient flexibility to take account of the circumstances of a particular case.

¹⁰⁷ Gamma Determination, paragraph 3.79.

¹⁰⁸ Gamma Determination, paragraphs A2.12 to A2.14.

¹⁰⁹ Herbert Smith Freehills submission on behalf of Sky and TalkTalk, 2 February 2015, paragraph 15.1, Towerhouse submission on behalf of Vodafone, Virgin and Verizon, 2 February 2015, paragraph 4.3

¹¹⁰ Herbert Smith Freehills submission on behalf of Sky and TalkTalk, 2 February 2015, paragraphs 15.1 (d) and 22.4 (ii), Towerhouse submission on behalf of Vodafone, Virgin and Verizon, 2 February 2015, paragraph 6-7

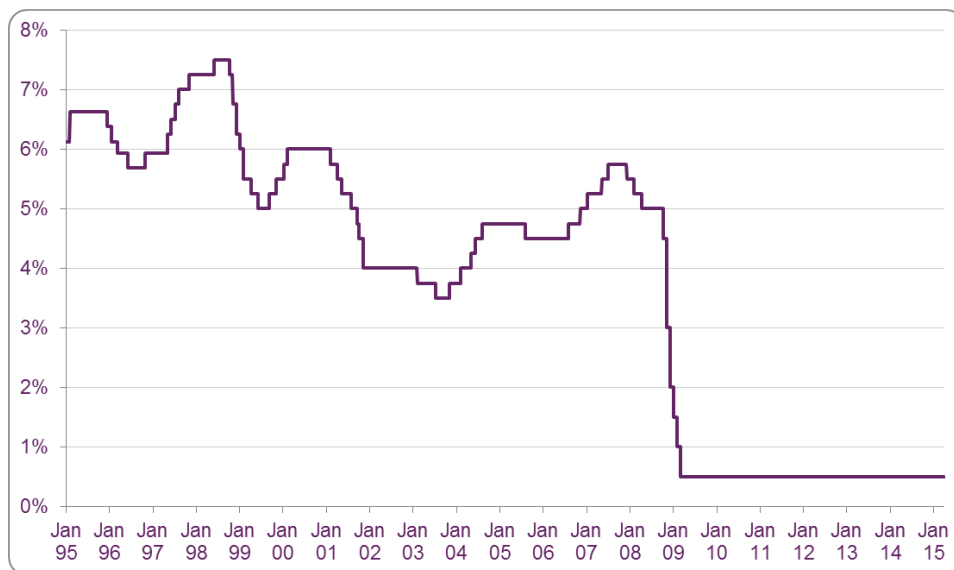
¹¹¹ Gamma Determination, paragraph 4.14.

- 3.68 We remain of the view that BoE+1%, which has conventionally been adopted by the High Court in commercial cases and by the CAT when awarding interest on penalties on appeal, is likely to be an appropriate rate to reflect the benefit derived by the overcharging firm from the overcharge in most cases.
- 3.69 However, as set out in the Gamma Determination and in the Interest Guidance, we recognise that it may be appropriate to depart from this rate in order to ensure that our objectives are met, depending on the facts of a particular case. In the circumstances of this case, the Disputing Parties have put forward arguments and evidence which they consider supports the view that the BoE+1% would not be an appropriate rate of interest to meet our regulatory objectives on the facts of this case. We will therefore consider, in the light of the facts of this case, whether there are grounds to depart from BoE+1% because it would not meet our regulatory objectives in the circumstances and an alternative interest rate would be more appropriate in order to meet our regulatory objectives. We consider that it is appropriate to do this by cross-checking whether BoE+1% lies outside the range of the cost of debt to BT that may reasonably be expected in the circumstances of this dispute, having regard to the range of periods over which BT could reasonably be expected to retain the overcharge.
- 3.70 In order to carry out this cross check we have considered the range of the cost of debt to BT by taking into account:
- The term of the debt, informed by the period over which BT could have reasonably expected to retain the overcharge.
 - the yield on BBB bonds with the same term in the relevant period for the rate of interest on the principal of 2006 to 2012.
- 3.71 In the Gamma Determination we said that the overcharging party could generally reasonably expect to retain an overcharge for between one year and at least three years.¹¹² To reflect the fact that in this dispute the period between the start of overcharging and repayment (i.e. 2006 to 2012) was longer than three years, we have considered periods of up to five years in our cross check.
- 3.72 We have considered the yield on Bloomberg indices of BBB bonds maturing in one to five years compared to the BoE rate during the period 2006 to 2012, which is the period during which BT held the overcharge. We consider that yields on BBB bonds provide a reasonable estimate of BT's cost of debt because BT was BBB rated throughout this period.¹¹³
- 3.73 We note in this regard that much of the period from 2006 to 2012 coincides with the financial crisis that resulted in significant movements in interest rates, including a number of sharp reductions in the BoE rate in late 2008, as illustrated in Figure 3.1.

¹¹² Gamma Determination, paragraph 3.126.

¹¹³ S&P and Fitch have given BT a BBB +/- rating since mid-2006. Moody's have given BT a Baa1/2 rating since 2001. The Bloomberg Composite rating of these three credit rating agencies is currently BBB.

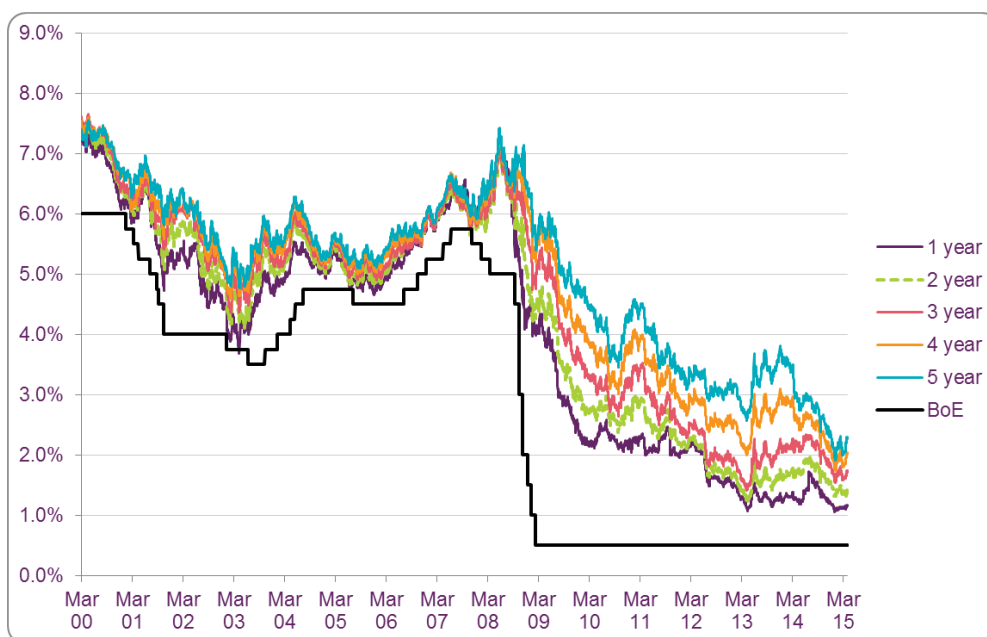
Figure 3.1: Bank of England rate



Source: Ofcom, Bank of England

3.74 Figure 3.2 shows the yield on Bloomberg indices of BBB bonds maturing in one to five years compared to the BoE rate.

Figure 3.2: Yields on BBB bonds compared to BoE rate

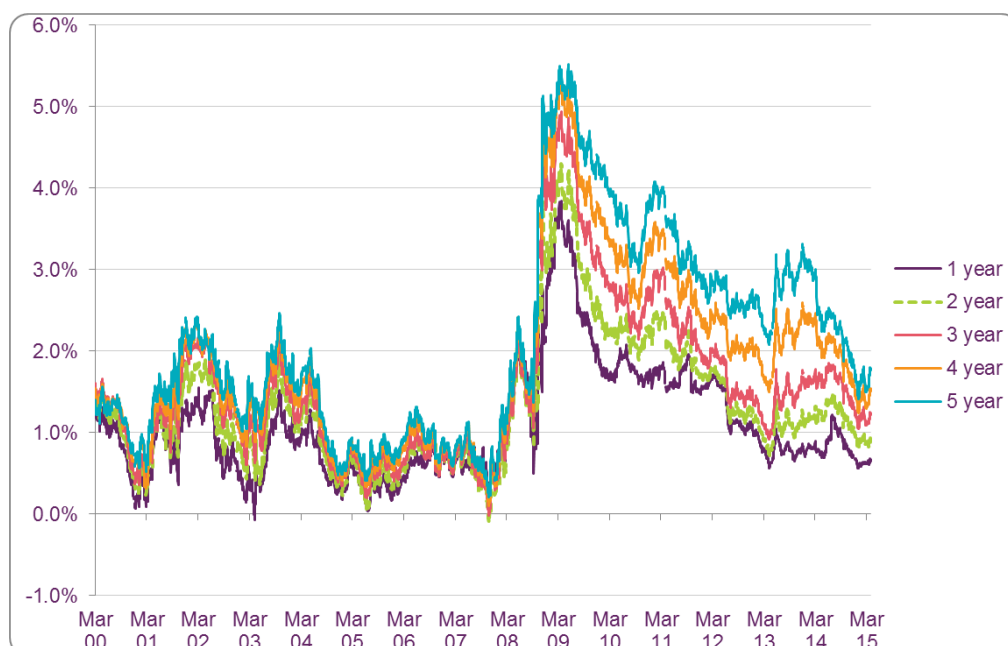


Source: Bank of England, Bloomberg. BBB bonds from Bloomberg using following indices: C4051Y, C4052Y, C4053Y, C4054Y, C4055Y.

3.75 Figure 3.2 indicates that prior to mid-2008 there was a reasonably stable relationship between the BoE rate and yields on BBB bonds maturing in one to five years. Since mid-2008, that relationship has been less stable. The premium of BBB bonds over the BoE rate was particularly volatile during the 2006 to 2012 period, with the premium ranging from 0% to 5.5% above the BoE rate for bonds maturing in one to

five years. This is illustrated in Figure 3.3 which plots the difference between the yields on BBB bonds and the BoE rate.

Figure 3.3: Difference between yields on BBB bonds and the BoE rate



Source: Ofcom, Bank of England, Bloomberg. BBB bonds from Bloomberg using following indices: C4051Y, C4052Y, C4053Y, C4054Y, C4055Y.

3.76 This evidence demonstrates that during the 2006 to 2012 period, there was not a stable relationship between the BoE rate and yields on BBB bonds for one to five year terms (as a proxy for BT’s cost of debt). Therefore our provisional view is that adopting a rate of BoE+1% would not, in the particular circumstances of this case, provide a reasonable and appropriate estimate of the cost of BT’s debt during the period 2006 to 2012, regardless of the assumptions made as to the appropriate ‘term’ of the debt (i.e. the period for which BT may reasonably have been expected to hold the benefit of the overcharge).

The appropriate approach to calculating a proxy for BT’s cost of debt in this case

3.77 In light of our provisional conclusion that BoE+1% is not likely to provide a reasonable estimate of the benefit to BT of retaining the overcharge in the circumstances of this case, we must consider an alternative approach to calculating an interest rate which would be appropriate to reflect the benefit to BT of holding the overcharge during this period. For the reasons explained at paragraphs 3.51-3.62, we consider that this would be a rate reflecting BT’s cost of debt.

Initial considerations

3.78 In order to calculate an interest rate which would represent BT’s cost of debt we need to make assumptions about the following factors, which we discuss further below:

3.78.1 **Point of overcharging and compounding.** In order to estimate an interest rate we need to establish at what point during the relevant financial year the overcharge is assumed to have occurred. We also need to decide at what intervals interest should be compounded.

3.78.2 **Term of the debt on the principal overcharge.**

3.78.3 **Yield on debt associated with the relevant term.**

Point of overcharging and compounding

- 3.79 We do not agree with BT that it would be reasonable to assume that the overcharge occurs on the final day of each financial year. Although information on BT's revenue and costs for the year is reported as at 31 March, BT generates revenue and incurs costs throughout the financial year. This means that the benefit of any overcharge would also accrue over the course of the financial year.
- 3.80 We agree with BT that it is difficult to make assumptions about exactly how the overcharge is spread throughout the year.¹¹⁴ Given this, we also agree with Alix Partners that it is reasonable to assume that the overcharge occurred at the mid-point of the financial year.
- 3.81 As to compounding, we noted in the Gamma Determination that conceptually the interest rate should be applied on a compound basis in order to reflect the time value of the extra funds from overcharging to the overcharging firm, as opposed to awarding simple interest.¹¹⁵ We agree with BT and the Disputing Parties that interest should be compounded annually.
- 3.82 We therefore provisionally conclude that:
- 3.82.1 we should assume that the overcharge occurs on 1 October each year, e.g. the overcharge relating to the 2006/07 financial year occurred on 1 October 2006 and on 30 September 2007 it attracted a year's worth of interest; and
- 3.82.2 interest should be compounded annually.

'Term of debt' on the principal overcharge

- 3.83 We now consider what would be an appropriate 'term of debt' in respect of the principal overcharge in this case. Following the approach in the Interest Guidance, in the following section we consider the range of periods over which BT could reasonably have been expected to retain the overcharge in this case.
- 3.84 In line with our views in the Gamma Determination,¹¹⁶ we consider that there are a number of factors which could be relevant in determining BT's reasonable expectation of the period it would retain the principal in this case:
- An overcharging firm may reasonably have expected to repay before the actual date of repayment (in this case 28 December 2012).
 - An overcharging firm is likely to reasonably have expected to hold on to the overcharge for at least 12 months from the date of overcharge, given (i) the lag between an overcharge occurring and the RFS being published, (ii) a period of negotiation between the overcharging firm and the overcharged firm and (iii) a period of at least four months to resolve the dispute.

¹¹⁵ Gamma Determination, paragraph 4.74.

¹¹⁶ Gamma Determination, paragraphs 3.124 to 3.126.

- Once a dispute has been accepted by Ofcom, an overcharging firm could generally expect to have to repay within four months. Although disputes have taken longer than this where exceptional circumstances have arisen, it would not be reasonable to assume in general that exceptional circumstances would apply.
- The interest rate should reflect the average rate in effect over the period that the overcharge was retained.

3.85 Our starting point is to consider the actual period that BT retained the principal and what this implies about the average duration. We then consider whether BT could have reasonably expected to retain the principal for a shorter period than this.

3.86 In the Ethernet Disputes, we determined that the first year in which BT overcharged the Disputing Parties was 2006/07. The final year of overcharge was 2010/11. Following the Ethernet Determinations, BT repaid the Disputing Parties on 28 December 2012.¹¹⁷

3.87 Assuming, as set out at paragraph 3.80, that each overcharge occurred at the mid-point of each financial year and given that BT repaid the principal sum to the Disputing Parties on 28 December 2012, Table 3.3 sets out the period that BT retained the principal overcharge arising in each financial year. For example BT retained the overcharge occurring on 1 October 2006 (relating to the 2006/07 financial year) for 6.25 years; that is, the period between 1 October 2006 and 28 December 2012.

Table 3.3: Actual period BT retained the overcharge

Year overcharge occurred	Corrected repayment to Disputing Parties £m	Period retained (years)
2006/07	[REDACTED]	6.25
2007/08	[REDACTED]	5.25
2008/09	[REDACTED]	4.24
2009/10	[REDACTED]	3.24
2010/11	[REDACTED]	2.24
Total	94.6	
Weighted average		5.02

Source: Ofcom

3.88 In this case, the weighted average period that BT retained the principal was about five years (weighted by the total repayment due to the Disputing Parties in each year).

¹¹⁷ BT's 19 February 2015 response to Ofcom's Section 191 Notice.

- 3.89 We consider that there are a number of reasons why it may have been reasonable to expect that BT would have retained the overcharge for a shorter time than the actual period of five years (on average).
- 3.90 Typically, a dispute will be resolved within four months of being accepted, except where exceptional circumstances apply. The Initial Disputes were accepted by Ofcom on 13 September 2010, therefore, in practice, the earliest that BT would have been ordered to make repayment would be four months later, i.e. around 13 January 2011. Assuming an anticipated repayment date of 13 January 2011, Table 3.4 shows a weighted average period of around three years.

Table 3.4: Period BT retained overcharge if repayment expected on 13 January 2011

Year overcharge occurred	Corrected repayment to Disputing Parties £m	Period retained (years)
2006/07	[REDACTED]	4.29
2007/08	[REDACTED]	3.29
2008/09	[REDACTED]	2.28
2009/10	[REDACTED]	1.28
2010/11	[REDACTED]	0.20
Total	94.6	
Weighted average		3.06

Source: Ofcom

- 3.91 BT argues that, in considering how long BT may reasonably have expected to have held on to the overcharge for the purposes of determining an interest rate, it is not relevant that exceptional circumstances applied in the Ethernet Disputes, resulting in the disputes taking more than four months to resolve.¹¹⁸
- 3.92 In practice, the Ethernet Disputes were not resolved within four months as a result of exceptional circumstances. At the time when Ofcom accepted the Initial Disputes for resolution, the CAT was in the process of hearing appeals¹¹⁹ against Ofcom's determination of disputes concerning BT's compliance with a similarly-worded cost-orientation obligation relating to Partial Private Circuits (the "PPC disputes")¹²⁰. On 5 October 2010, Ofcom announced that it considered that there were exceptional circumstances in the Ethernet Disputes, as there was a significant overlap between the issues raised in the PPC and Ethernet disputes and the judgment in the PPC

¹¹⁸ BT submission, 18 March 2015, paragraph 45.

¹¹⁹ See <http://www.catribunal.org.uk/237-5136/1146-3-3-09-British-Telecommunications-Plc-.html>

¹²⁰ See http://stakeholders.ofcom.org.uk/enforcement/competition-bulletins/closed-cases/all-closed-cases/cw_992/ and http://stakeholders.ofcom.org.uk/enforcement/competition-bulletins/closed-cases/all-closed-cases/cw_01002/

appeals was likely to have a bearing on the Ethernet Disputes.¹²¹ Judgment in the PPC appeals was handed down on 22 March 2011, and there was then a further appeal to the Court of Appeal, in which judgment was handed down on 27 July 2012.

- 3.93 We note that BT itself appeared to consider that the overlap between the PPC disputes and the Ethernet Disputes meant that there were exceptional circumstances as to why the Ethernet Disputes could not be resolved within the four month statutory period.
- 3.93.1 After Ofcom opened an enquiry into the Sky & TalkTalk Dispute, BT wrote to Ofcom on 10 August 2010 to say that “*Ofcom should, pending the publication of the PPC Appeal Judgment, find that the PPC Appeal cross-over issues are such that it is appropriate for Ofcom to find that there are exceptional reasons for not proceeding to investigate the dispute at this stage, even though this would result in Ofcom not being able to resolve the dispute within 4 months*”.¹²²
- 3.93.2 Ofcom wrote to the parties on 13 September 2010, informing them of our decision to accept the Initial Disputes for resolution. We sought the Parties’ views as to whether exceptional circumstances applied in this case. In its response, dated 20 September 2010, BT said that “*There are clearly good reasons in this case to delay the resolution of these Ethernet disputes as the issues clearly overlap with issues in the PPC appeal*.”¹²³
- 3.94 We also note that on 15 November 2010, BT appealed Ofcom’s decision to accept the Initial Disputes to the CAT. The CAT issued its judgment on 3 May 2011, unanimously dismissing BT’s appeal. It is reasonable to assume that BT could have expected that this appeal would have resulted in a delay in the resolution of the Ethernet Disputes.
- 3.95 While in the Interest Guidance we said that “*it would not be reasonable to assume that in general an overcharging firm could expect that exceptional circumstances would apply*”,¹²⁴ we consider that in the circumstances of this case it may have been reasonable for BT to expect that it may take longer to resolve the Ethernet Disputes than the statutory four month period, as a result of the exceptional circumstances which applied in this case. We think that it is relevant to take this into account when deciding how long BT could reasonably have been expected to retain the overcharge. However, it is difficult to estimate the length of delay that could have reasonably have been expected.
- 3.96 On this basis, we consider that it would be appropriate to consider a range of between three and five years on average to represent the period for which BT may reasonably have expected to retain the overcharge in this case. Three years would be the lower bound, which would end four months after Ofcom accepted the Initial Disputes for resolution, and five years would be the upper bound, representing the actual period that BT retained the principal. Within this range we propose to use a central estimate of four years.

¹²¹ See http://stakeholders.ofcom.org.uk/enforcement/competition-bulletins/closed-cases/all-closed-cases/cw_01052/

¹²² Letter from BT to Ofcom, 10 August 2010.

¹²³ Letter from BT to Ofcom, 20 September 2010.

¹²⁴ Gamma Determination, paragraph 3.126(b).

Yield on debt associated with the relevant term

- 3.97 We discuss below our estimate of BT's cost of debt for three, four and five year terms in each year starting 1 October between 2006 and 2012.
- 3.98 In the Interest Guidance, we said that the cost of debt to the overcharging firm could be determined by the premium over and above the risk free rate which reflects the risk of default by the overcharging firm.¹²⁵ However, where it is possible to estimate yields on BT's debt with an appropriate term (or yields on debt similar to BT's) during this period, we consider that it is reasonable to estimate the cost of debt by reference to these yields rather than separately identify a risk free rate and a debt premium.¹²⁶
- 3.99 Our starting point in estimating BT's cost of debt in this case therefore is to look at the yields on bonds issued by BT. However, BT's bonds during this period are denominated in a number of currencies (pound sterling, US dollars, euros¹²⁷) and do not mature in exactly three, four or five years as at the midpoint of each financial year. In order to estimate BT's cost of debt for three, four and five year maturities during the period of the overcharge using BT's existing bonds, we would need to:
- a) estimate the average yield of BT's existing bonds for each year starting 1 October;
 - b) translate the yields into sterling using spot and forward currency rates; and
 - c) identify bonds in each year that mature in approximately three, four and five years and estimate by interpolation a sterling yield for the relevant term.
- 3.100 We consider that a range of assumptions would have to be made in order to achieve steps b) and c). Those assumptions would involve first, deciding over what period to estimate spot and forward exchange rates to translate yields to sterling; and second, which BT bonds to use as proxies for the term of the debt and how best to interpolate between two or more bonds where the maturity of BT's bonds does not equate to a three, four or five year term. There may be a range of different reasonable assumptions that could be made in respect of each of these aspects, all of which could lead to a different overall interest rate. We therefore consider that this approach risks introducing an undesirable level of complexity into the relevant calculation.
- 3.101 We consider that it would be simpler and more practicable to estimate BT's cost of debt using yields on an index of BBB bonds from Bloomberg.¹²⁸
- 3.102 During the period 2006-2012, BT was BBB rated.¹²⁹ We would expect the yields on an index of BBB bonds to be a reasonable proxy of BT's cost of debt during this

¹²⁵ Gamma Determination, paragraph A2.8(b).

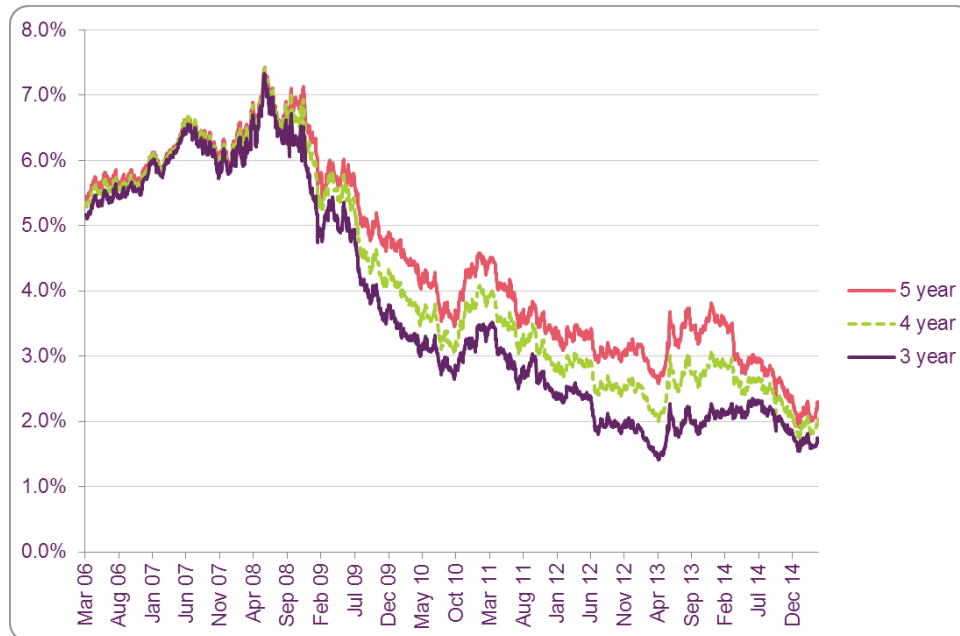
¹²⁶ For example, where the debt premium is based on the spread between the yield on BBB bonds of an appropriate maturity and the yield on index linked gilts (as a proxy for the risk free rate) of the same maturity, adding this spread to the yield on index-linked gilts will give the yield on BBB bonds that we started with.

¹²⁷ Table A3.1 of the Alix Report lists the 23 BT bonds that were in issue during the period. Six of these were denominated in euros, seven in sterling and ten in US dollars.

¹²⁸ The use of BBB bonds is consistent with the Gamma Determination. In Table 1 of the Gamma Determination we estimated the debt premium associated with debt maturing in one to four years by reference to the spread of BBB bonds over gilts using data from Bloomberg.

period. Bloomberg has a series of BBB indices covering the 2006-2012 period that are available in a range of maturities, including three, four and five year terms. Figure 3.4 illustrates the yields on these Bloomberg BBB indices.

Figure 3.4: Yields on Bloomberg BBB indices



Source: Bloomberg. C4053Y, C4054Y and C4055Y indices.

3.103 Table 3.5 shows the annual average yields we have estimated using the yields on Bloomberg's BBB indices during the period 2006 to 2012. For each term, the interest rate represents the simple average yield in the period between 1 October and 30 September.

¹²⁹ S&P and Fitch have given BT a BBB +/- rating since mid-2006. Moody's have given BT a Baa1/2 rating since 2001. The Bloomberg Composite rating of these three credit rating agencies is currently BBB.

Table 3.5: Annual yields on Bloomberg BBB indices

Financial year	Year from	3 years	4 years	5 years
2006/07	01 Oct 06	6.0%	6.1%	6.1%
2007/08	01 Oct 07	6.3%	6.4%	6.5%
2008/09	01 Oct 08	5.3%	5.7%	6.0%
2009/10	01 Oct 09	3.4%	3.9%	4.4%
2010/11	01 Oct 10	3.1%	3.6%	4.0%
2011/12	01 Oct 11	2.4%	2.9%	3.3%
2012/13	01 Oct 12	1.8%	2.5%	3.1%

Source: Bloomberg. C4053Y, C4054Y and C4055Y indices. Annual yields are calculated as the simple average of daily yields, where we assume the yield associated with non-trading days is the same as the yield on the last trading day.

3.104 As set out at paragraph 3.96, we consider that BT may have reasonably expected to retain the principal for a period of between three and five years, with a central assumption of four years. We therefore consider that the annual yields on Bloomberg's four year BBB index are an appropriate proxy for BT's cost of debt in this case.

We do not propose to estimate cost of debt using swap rates and credit default swaps

3.105 The Ernst & Young Report estimates BT's cost of debt by considering a swap rate as a proxy for the risk free rate plus a credit risk premium on BT's debt by reference to a CDS spread.¹³⁰

3.106 As explained above, where it is possible to estimate yields on BT's debt with an appropriate maturity (or yields on debt similar to BT's such as BBB rated debt) we consider it is reasonable to estimate the cost of debt by reference to these yields rather than separately estimating a risk free rate and a debt premium, as would be the case if we adopted Ernst & Young's proposed approach. In this case we can estimate the yields on BBB-rated bonds with appropriate maturities which we consider are likely to provide a reasonable estimate of BT's cost of debt in this period since BT's debt was BBB-rated throughout the period.

We do not propose to estimate the benefit to BT using interest earned on cash deposits

3.107 BT has suggested that the benefit it derived was equal to the interest earned on cash deposits. We disagree that this would be the relevant interest rate in this case because we consider that BT could have reasonably expected to retain the overcharge for between three and five years and because it had outstanding debt that it could have reasonably repaid in full or in part. We consider that the cash deposit rate would only be appropriate where BT expected to have to repay the

¹³⁰ Ernst & Young Report, paragraphs 3.20-3.21.

overcharge within a short period of time such that it would not be practicable to repay debt or where it had no opportunity to repay debt or avoid taking out additional debt (this might be the case, for example, if it had little debt in issue). We do not consider that these factors apply to this case.

Provisional conclusions on the correct rate of interest on the overcharge

3.108 We provisionally conclude that the appropriate rate of interest in the circumstances of this case is equivalent to the average annual yield on Bloomberg’s BBB bonds with a four year term.

Table 3.6: Annual interest rates on the principal overcharge

Period	Interest rate
01 Oct 06 – 30 Sep 07	6.1%
01 Oct 07 – 30 Sep 08	6.4%
01 Oct 08 – 30 Sep 09	5.7%
01 Oct 09 – 30 Sep 10	3.9%
01 Oct 10 – 30 Sep 11	3.6%
01 Oct 11 – 30 Sep 12	2.9%
01 Oct 12 – 28 Dec 12	2.5%

Source: Ofcom

Interest on Interest

Introduction

3.109 The Disputing Parties have argued that BT should also be required to pay interest on the unpaid interest. This would mean that BT would have to pay interest on the principal overcharge up to the date that it repaid the Disputing CPs following the Ethernet Determinations (28 December 2012), and then interest on unpaid interest thereafter.

3.110 We will therefore also consider whether the BT should pay the Disputing CPs interest on the unpaid interest from after the date it repaid the Disputing CPs following the Ethernet Determinations, and, if we decide that this is appropriate, the appropriate rate of interest.

Whether BT should be required to pay ‘interest on interest’

Parties’ views

3.111 As noted above, the Disputing Parties argue that Ofcom needs to reflect the fact that interest was not paid by BT to them at the date of the Ethernet Determinations and still has not been paid, and BT should be required to pay them a sum of money in respect of that unpaid interest.

3.112 The Alix Report states:

“From an economic perspective, there is no question that BT has gained a benefit associated with the delayed repayment of the interest on overcharges. Had the earlier repayment been designed to meet Ofcom’s objective of ensuring BT did not have an incentive to set excessive charges (and hence the benefit of the overcharge to BT been fully paid) it would have paid both the principal and a sum reflecting the interest on the overcharge up to the date of repayment. Since the interest component was not repaid alongside the repayment of principal, BT has gained the advantage of holding this interest for the period.”¹³¹

- 3.113 Sky and TalkTalk believe that BT should have to pay interest on interest because “*full disgorgement is important in giving effect to Ofcom’s statutory objectives.*”¹³² They observe that “*more than two years have passed in which BT has been able to reap the benefit of (wrongly) retaining this money*” and that unless interest on interest is paid “*BT will be better off as a result of having overcharge than if it had complied with its regulatory obligations.*”¹³³
- 3.114 Sky and TalkTalk compare the payment of interest on interest to BT’s position that it should be awarded interest on the ECCs adjustment. They say that “*the basis for BT’s position is that the CPs ‘have had the benefit’ of this amount (BT §56), and BT considers it to be ‘a matter of principle’ that it should be awarded interest on it. By parity of reasoning, BT should have to pay interest to reflect the period over which it held on to funds to which it was not entitled.*”¹³⁴
- 3.115 BT argues that Ofcom has no jurisdiction to order BT to pay interest in respect of the unpaid interest (which we will refer to as ‘interest on interest’). BT argues that:
- 3.115.1 the original dispute submissions “*only requested interest on the principal sum*” and that the scope of the dispute “*did not suggest anything further than a payment in respect of the principal sum overcharged*”;¹³⁵
- 3.115.2 The Altnets did not seek the specific relief of interest on interest in the Notice of Appeal to the CAT and the CAT only has jurisdiction to determine the appeal in accordance with the Notice of Appeal;¹³⁶ and
- 3.115.3 The CAT did not address this issue in the Supplementary Judgment (despite the Altnets having specifically raised the issue before the CAT) and the Orders remit to Ofcom only the question of the rate of interest payable in respect of BT’s overcharge for Ethernet services, therefore no issue permitting Ofcom to make such an order has been remitted by the CAT to Ofcom.¹³⁷
- 3.116 BT believes that even if Ofcom were to have jurisdiction to consider this matter, “*Ofcom itself decided to follow the contractual rate of interest (i.e. no interest) in*

¹³¹ Alix Report, 2 February 2015, paragraph 6.5.2.

¹³² Herbert Smith Freehills submission on behalf of Sky and TalkTalk, 16 March 2015, paragraph 37.

¹³³ Herbert Smith Freehills submission on behalf of Sky and TalkTalk, 16 March 2015, paragraph 37.

¹³⁴ Herbert Smith Freehills submission on behalf of Sky and TalkTalk, 16 March 2015, paragraph 38.

¹³⁵ BT submission, 2 February 2015, paragraph 51; see also BT submission, 18 March 2015, paragraph 73(a).

¹³⁶ BT submission, 2 February 2015, paragraph 52; see also BT submission, 18 March 2015, paragraph 73(b).

¹³⁷ BT submission, 2 February 2015, paragraph 52; see also BT submission, 18 March 2015, paragraph 73(c).

*making its original Determination.*¹³⁸ BT argues that it was entitled to rely on the Determination, and that this has been recognised in previous cases before the CAT, specifically the 08x Numbers case.¹³⁹

3.117 BT also observes that: *“The Tribunal’s whole basis for allowing the appeal on interest was to provide an incentive to BT not to overcharge. However, for the period after 20 December 2012, the alleged interest (i.e. the interest on interest) arose, not as a result of BT’s overcharging, but as a result of BT following Ofcom’s Determination. The very justification for allowing interest, therefore, simply does not arise with the Altnets’ request for ‘interest on interest’.”*¹⁴⁰

3.118 In summary, BT believes that *“to penalise BT now for following Ofcom’s original decision and not paying interest at the end of 2012, not only sends out a perverse regulatory message (namely that regulated parties cannot rely upon rulings of regulators) but completely subverts the principle upon which both Ofcom in the Gamma Determination and the Tribunal accepted as the reason for awarding interest.”*¹⁴¹

3.119 Sky and TalkTalk believe that their Notice of Appeal and the CAT’s Orders *“are worded sufficiently broadly as to cover the payment of interest to reflect the benefits to BT of holding on to funds until the date of Ofcom’s order for repayment”* and that *“there is nothing in either which precludes an order for interest over that period.”*¹⁴²

Our analysis

3.120 The CAT has found that BT should have been ordered to pay interest in respect of the repayment of the overcharge in December 2012. Because BT was not ordered to pay interest on the principal overcharge, there has been a period over which BT has retained this sum representing the interest payment which should have been made.

3.121 While we note BT’s argument that it was entitled to rely upon Ofcom’s original determination not to pay interest, our determination in the Ethernet Disputes of the correct level of interest has since been overturned by the CAT and Ofcom is now bound to give effect to the CAT’s Orders and to determine the rate of interest payable in respect of BT’s overcharge.

3.122 The CAT said that *“the facts clearly demonstrate that the incentives on BT [to comply with its cost orientation obligation]... were inadequate in this case, and the additional incentive to avoid overcharging that an award of interest provides is entirely appropriate.”*¹⁴³ As we have explained above, and consistent with the Interest Guidance, our main objective in awarding interest is to ensure that CPs do not have an incentive to set charges that are unduly high, and the CAT agreed with this objective.

3.123 Our preliminary view is that in all the circumstances of the case it is fair and appropriate for BT to pay an amount representing interest on the unpaid interest

¹³⁸ BT submission, 2 February 2015, paragraph 53.

¹³⁹ BT refers to the 08x Numbers Case [2011] CAT 24, where the CAT held that the Mobile Network Operators should not be penalised for relying on Ofcom’s determination in that case, at paragraph 456(4) of that Judgment.

¹⁴⁰ BT submission, 2 February 2015, paragraph 54.

¹⁴¹ BT submission, 18 March 2015, paragraph 13.

¹⁴² Herbert Smith Freehills submission on behalf of Sky and TalkTalk, 16 March 2015, paragraph 39.

¹⁴³ The Judgment, paragraph 304.

since December 2012 to ensure that our main objective is met. By retaining this sum of money, BT has derived a benefit in much the same way that it would have in the case of an overcharge, for example it could have repaid outstanding debt or avoided taking out debt. Therefore, in order to ensure that the benefit that BT derived from the overcharge is removed, we provisionally conclude that BT should pay interest on interest.

- 3.124 We note that in the Supplementary Judgment, the CAT did not specifically respond on the point of whether or not the Disputing Parties should be awarded interest in respect of the unpaid interest. However, the CAT ordered Ofcom to determine “*the rate of interest payable in respect of BT’s overcharge for Ethernet services*” and “*the total amount payable as between BT and Sky and TalkTalk*” and “*the total amount payable as between BT and the Altnets.*”¹⁴⁴ We consider that the wording of the CAT’s Orders is not limited to consideration of interest on the principal overcharge but instead is sufficiently broad to cover the issue of whether a sum should be paid in respect of interest on unpaid interest.

The appropriate proxy for cost of debt during the period of interest on interest

Parties’ views

- 3.125 As noted at paragraphs 3.115-3.118, BT does not believe that it should be required to pay interest on interest, and makes no comment on the appropriate proxy for cost of debt during this period.
- 3.126 Alix Partners argue that “*the most appropriate rate for the period to August 2014 is the WACC, with the conservative approach of applying the cost of debt rate to the remaining period until the interest is repaid*”, although they suggest that the case for applying a WACC rate to the period from December 2012 is less strong than in the case of the earlier period.¹⁴⁵ This is because before the Judgment of the CAT was handed down in August 2014, there would have been a period of uncertainty during which the market would “*not have had any clear information to suggest that interest would be required for a significant period from December 2012.*”¹⁴⁶
- 3.127 Alix Partners say that the relevant rates for this period are the BT Group nominal vanilla WACC and BT’s weighted average cost of debt based on BT’s actual bonds.¹⁴⁷

Our analysis

- 3.128 In line with the approach in the Interest Guidance and as discussed above in relation to the rate of interest on the principal overcharge, we take as our starting point the assumption that BoE+1% is likely to be an appropriate rate to reflect the benefit to BT for having not had to pay interest on the unpaid interest since the date of the Ethernet Determinations, provided that it would be within a reasonable range for BT’s cost of debt during the relevant period. This is because we consider that the nature of the benefit BT has received from not paying interest at the time of the Ethernet Determinations is comparable to the benefit that BT has derived from the overcharge itself.

¹⁴⁴ Order of the CAT, case no. 1206/3/3/13 and Order of the CAT, case no 1207/3/3/13.

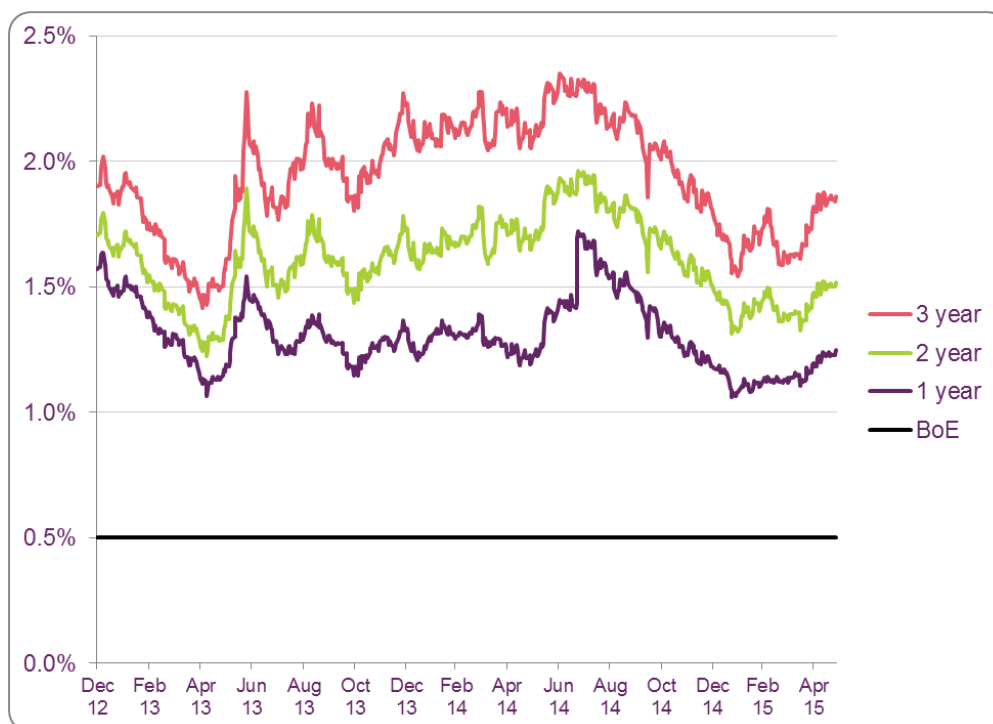
¹⁴⁵ Alix Report, 2 February 2015, paragraph 6.5.9.

¹⁴⁶ Alix Report, 2 February 2015, paragraph 6.5.7.

¹⁴⁷ Alix Report, 2 February 2015, paragraph 6.5.10.

- 3.129 As with the interest rate on the principal overcharge, we will consider whether there are grounds to depart from BoE+1% because it would not meet our regulatory objectives in the circumstances and an alternative interest rate would be more appropriate in order to meet our regulatory objectives. We consider that it is appropriate to do this by cross-checking whether BoE+1% lies outside the range of the cost of debt to BT that may reasonably be expected in the circumstances of this dispute, having regard to the range of periods over which BT could reasonably be expected to retain the relevant sum of money – in this case, the unpaid interest on the principal.
- 3.130 In making an assumption as to what an appropriate ‘term of debt’ would be for the purposes of this cross-check, we have assumed that BT is likely to have retained the interest due on the principal for a total period of around two and a half years (i.e. from 28 December 2012 up until the date of repayment following our final determination of the Remitted Matters).
- 3.131 However, we have also considered that there may be reasons why BT may reasonably have been expected to retain the interest on the principal overcharge for a shorter time than two and a half years. We note, for example, that the oral hearing for the Ethernet appeals concluded at the end of November 2013 and it could have been reasonable to expect that judgment might have been handed down in the case from early 2014 onwards and that a subsequent order to pay interest could have been handed down shortly after that.
- 3.132 We therefore consider that it would be reasonable to look at a range of between one and two and a half years from 28 December 2012 in undertaking a ‘cross-check’ as to whether BoE+1% would represent a reasonable proxy for BT’s costs of debt in this case.
- 3.133 Unlike the 2006-2012 period associated with the principal overcharge, between late 2012 to date, the BoE rate has been unchanged at 0.5% and there has been a less volatile relationship between the BoE rate and BT’s cost of debt. To illustrate this, Figure 3.5 shows the yield on Bloomberg indices of BBB bonds maturing in one, two and three years compared to the BoE rate, during the period 28 December 2012 to the end of May 2015.

Figure 3.5: Yields on BBB bonds compared to BoE rate



Source: Ofcom, Bloomberg, Bank of England.

3.134 During this period, the difference between the yields on one, two and three year BBB bonds and the BoE rate averaged 0.8%, 1.1% and 1.4% respectively.

3.135 Evidence from Figure 3.5 suggests that BoE+1% would be a reasonable proxy for BT's cost of debt for debt with terms of one to 2.5 years during this period. We therefore propose to estimate interest on unpaid interest using BoE+1%.

Provisional conclusions on interest on interest

3.136 We provisionally conclude that in estimating interest on interest the appropriate rate of interest is equivalent to BoE+1%.

Interest on ECCs

Introduction

3.137 The CAT found that Ofcom should have accepted BT's argument that the cost of ECCs was already reflected in the financial data it provided for 2009/10 and reflected this in the adjustment it made for BT's ECC costs.

3.138 Because Ofcom did not do so, the repayments we ordered BT to make were higher than they would otherwise have been. BT argued that it was entitled to interest on the overpayment that it made to the Disputing CPs as a result of Ofcom's ECCs adjustment.

3.139 The CAT ordered us to determine BT's claim for interest in respect of the overpayment resulting from the exclusion of ECCs.

Parties' views

3.140 BT believes that it should be awarded interest on the overpayment of the principal overcharge that it made due to ECCs, which has meant that the Disputing Parties were repaid an excess of what they were entitled to. BT argues that it should be entitled to offset interest on this amount against the sum that BT will itself pay in interest for reasons of equity, fairness and good regulatory practice.¹⁴⁸

3.141 Sky and TalkTalk accept that BT, by analogy to the approach on interest on unpaid interest, is entitled to interest on ECCs on the same terms.¹⁴⁹

3.142 The Altnets did not comment on this point in their submissions.

Our analysis

3.143 In the interests of fairness, we consider that it is appropriate for BT to receive interest on ECCs. For the same reason, we consider that the appropriate rate of interest is BoE+1%.

Provisional conclusion on whether to award interest on the ECCs overpayment

3.144 We provisionally conclude that BT should be entitled to an amount representing interest on the overpayment due to ECCs at a rate of BoE+1%. By calculating a net amount due to the Disputing Parties, and allowing for interest on that net amount only, BT's entitlement to interest on ECCs has been given effect to in this Provisional Determination.

The total amounts payable as between BT and each of Sky, TalkTalk, CWW, Virgin and Verizon

Introduction

3.145 The CAT ordered us to determine the total amount payable between BT and each of Sky, TalkTalk, CWW, Virgin and Verizon.

3.146 We will take the following steps to determine this matter:

- a) we will calculate the interest BT must pay up to the date that BT originally repaid each CP following the Determinations, taking account of any adjustment to the principal overcharge in relation to BT's ECCs; and
- b) set out the steps that BT must take to calculate further payments in respect of interest awarded on interest, less any amount that BT is owed in relation to ECCs.

¹⁴⁸ BT submission, 2 February 2015, paragraph 57.

¹⁴⁹ Herbert Smith Freehills submission on behalf of Sky and TalkTalk, 2 February 2015, paragraph 26.

Our analysis

Correction for ECC overpayment and interest on corrected principal

- 3.147 For the period to 28 December 2012 (i.e. the date on which BT made repayments of the principal overcharge as originally calculated by Ofcom in the Ethernet Determinations), BT is required to pay interest on the adjusted level of principal overcharge (see paragraph 3.108 above) at the rates set out in Table 3.6.
- 3.148 BT is also entitled to a refund as at this date of the overpayments it made in respect of ECCs, as set out in Table 3.2.
- 3.149 Table 3.7 sets out our provisional assessment of the repayments due from BT to the Disputing Parties, showing separately the interest due from BT as at 28 December 2012 on the adjusted level of the principal overcharge and the repayment due to BT in relation to ECCs. Annex 3 shows the interest due to the Disputing Parties in each year.

Table 3.7: Interest on the principal overcharge and ECC repayments

	ECC repayment	Interest on corrected principal overcharge to 28 December 2012	Net amount payable from BT to Disputing CPs
Sky	[X]	[X]	[X]
TalkTalk	[X]	[X]	[X]
Virgin	[X]	[X]	[X]
CWW	[X]	[X]	[X]
Verizon	[X]	[X]	[X]
Total	(203,000)	22,422,000	22,219,000

Source: Interest on principal is calculated by applying the interest rates from Table 3.6 to the principal amount from Table 3.1. The ECC repayment is taken from Table 3.2.

Interest on interest and on ECC overpayment

- 3.150 BT is also required to make interest payments on the net amount due as at 28 December 2012 from Table 3.7 at an annual rate of BoE+1%. The net amount represents the interest due from BT on the principal overcharge less the repayments due to BT relating to ECCs. Making interest payments on this net amount means that the interest rate applicable to both interest on interest and interest on ECCs is BoE+1%.

Provisional conclusion on the total amount payable

- 3.151 We provisionally conclude that:

- BT should repay a total of £22,219,000 to the Disputing CPs representing the interest due on the principal overcharge as at 28 December 2012, net of any repayments relating to ECCs.

- BT should pay interest on the amount of £22,219,000 from 29 December 2012 at an annual rate of BoE+1%.

Assessment of consistency of Ofcom’s provisional conclusion with our statutory duties and Community obligations

3.152 As part of our analysis, we have also considered our general duties in section 3 of the Act and also the six “Community requirements” set out in section 4 of the 2003 Act, which give effect, among other things, to the requirements of Article 8 of the Framework Directive.¹⁵⁰ In particular, we have had regard to:

- a) our duty to further the interests of citizens (i.e. all members of the public in the United Kingdom) in relation to communications matters and to further the interests of consumers in relevant markets, where appropriate by promoting competition (section 3(1));
- b) our duty to have regard to the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed; as well as any other principles appearing to Ofcom to represent the best regulatory practice (section 3(3)); and
- c) our duty to promote competition (section 4(3)) and to encourage, to the extent Ofcom considers it appropriate, the provision of network access and service interoperability for the purposes of securing efficiency and sustainable competition in communications markets, efficient investment and innovation and the maximum benefit for the customers of communications network and services providers (sections 4(7) and 4(8)).

3.153 We consider that our provisional conclusions are consistent with these duties for the reasons set out above which are firmly rooted in the duties contained in the 2003 Act.

3.154 In setting out our provisional assessment, we have kept in mind our duty under subsection 3(3)(a) of the 2003 Act to ensure that our regulatory activities are, among other things, transparent, accountable, proportionate and targeted only at cases where action is needed. In particular, this document sets out the Parties’ arguments and the reasoning that underpins our provisional assessment, and the Parties will have an opportunity to comment on this in advance of our final determination of the Remitted Matters.

Summary of provisional conclusions

3.155 Based on the analysis set out in this section, the outcome of our provisional assessment in respect of the Remitted Matters is that:

- 3.155.1 Adjusting for the ECC overpayment, the correct amount of principal overcharge by BT is £94,620,000.
- 3.155.2 The corrected figure above takes account of the repayment that BT is entitled to in respect of the exclusion of ECCs of £203,000.

¹⁵⁰ Directive 2002/21/EC.

- 3.155.3 The interest on the corrected principal overcharge payable by BT is £22,422,000.
- 3.155.4 The net amount which BT should repay to the Disputing Parties (i.e. the interest on the corrected principal overcharge less the ECCs adjustment) is £22,219,000.
- 3.155.5 From 29 December 2012, BT should pay interest on the net amount due to the Disputing Parties at a rate of BoE+1%.
- 3.156 From 29 December 2012, BT is entitled to interest on the ECC overpayment. By calculating a net amount due to the Disputing Parties, and allowing for interest on that net amount only, BT's entitlement to interest on the ECC overpayment at a rate of BoE+1% has been given effect to in these Provisional Conclusions.
- 3.157 We set out our draft determinations at Annexes 5-9.

Annex 1

Responding to the provisional conclusions

How to respond

- A1.1 Ofcom invites written views and comments on the issues raised in this document, to be made **by 5pm on 6 July 2015**.
- A1.2 We would be grateful if you could assist us by completing a response cover sheet (see Annex 2), to indicate whether or not there are confidentiality issues.
- A1.3 For larger consultation responses - particularly those with supporting charts, tables or other data - please email samuel.hinkley@ofcom.org.uk attaching your response in Microsoft Word format, together with a response coversheet.
- A1.4 Responses may alternatively be posted to the address below:
- Samuel Hinkley
4th Floor
Competition Group
Riverside House
2A Southwark Bridge Road
London SE1 9HA
- A1.5 Note that we do not need a hard copy in addition to an electronic version.
- A1.6 It would be helpful if you can explain why you hold your views and how Ofcom's proposals would impact on you.

Further information

- A1.7 If you want to discuss the issues raised in this document, or need advice on the appropriate form of response, please contact Samuel Hinkley on 020 7981 3752.

Confidentiality

- A1.8 In line with our Dispute Resolution Guidelines,¹⁵¹ as part of publishing a final determination, Ofcom may publish non-confidential versions of responses. If you think your response should be kept confidential, can you please specify what part or whether all of your response should be kept confidential, and specify why. Please also place such parts in a separate annex.
- A1.9 If someone asks us to keep part or all of a response confidential, we will treat this request seriously and will try to respect this. For the avoidance of doubt, Ofcom does not regard submissions on legal or regulatory policy to be confidential and any such submissions will normally be disclosed publicly. Further, Ofcom will sometimes

¹⁵¹ Dispute Resolution Guidelines – Ofcom's guidelines for the handling of regulatory disputes (June 2011) See: <http://stakeholders.ofcom.org.uk/binaries/consultations/dispute-resolution-guidelines/statement/guidelines.pdf>

be required to publish/disclose information marked as confidential in order to meet legal obligations.

- A1.10 Please also note that copyright and all other intellectual property in responses will be assumed to be licensed to Ofcom to use. Ofcom's approach on intellectual property rights is explained further on its website at <http://www.ofcom.org.uk/about/accoun/disclaimer/>.

Next steps

- A1.11 Following this consultation, Ofcom will publish a final determination.
- A1.12 Please note that you can register to receive free mail updates alerting you to the publications of relevant Ofcom documents. For more details please see: http://www.ofcom.org.uk/static/subscribe/select_list.htm.

Annex 2

Response cover sheet

- A2.1 We have produced a coversheet for responses (see below) and would be very grateful if you could send one with your response. This will speed up our processing of responses, and help to maintain confidentiality where appropriate.
- A2.2 Please put any parts of your response you consider should be kept confidential in a separate annex to your response and include your reasons why this part of your response should not be published. This can include information such as your personal background and experience. If you want your name, address, other contact details, or job title to remain confidential, please provide them in your cover sheet only, so that we don't have to edit your response.

Cover sheet for response to an Ofcom consultation

BASIC DETAILS

Consultation title:

To (Ofcom contact):

Name of respondent:

Representing (self or organisation/s):

Address (if not received by email):

CONFIDENTIALITY

Please tick below what part of your response you consider is confidential, giving your reasons why

Nothing	<input type="checkbox"/>	Name/contact details/job title	<input type="checkbox"/>
Whole response	<input type="checkbox"/>	Organisation	<input type="checkbox"/>
Part of the response	<input type="checkbox"/>	If there is no separate annex, which parts?	

If you want part of your response, your name or your organisation not to be published, can Ofcom still publish a reference to the contents of your response (including, for any confidential parts, a general summary that does not disclose the specific information or enable you to be identified)?

DECLARATION

I confirm that the correspondence supplied with this cover sheet is a formal consultation response that Ofcom can publish. However, in supplying this response, I understand that Ofcom may need to publish all responses, including those which are marked as confidential, in order to meet legal obligations. If I have sent my response by email, Ofcom can disregard any standard e-mail text about not disclosing email contents and attachments.

Name

Signed (if hard copy)

Annex 3

Interest payments on the principal overcharge by year

Table A3.1: Interest on the principal overcharge and ECC repayments

Period ending	30-Sep-07	30-Sep-08	30-Sep-09	30-Sep-10	30-Sep-11	30-Sep-12	28-Dec-12	Total	Total (rounded)
Interest rate	6.1%	6.4%	5.7%	3.9%	3.6%	2.9%	0.6%		
Sky	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
TalkTalk	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
Virgin	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
CWW	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
Verizon	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]	[X]
Total CPs	[X]	[X]	[X]	[X]	[X]	[X]	[X]	22,422,231	22,422,000

Source: Ofcom. Total repayments have been rounded to the nearest £000.

Annex 4

Copy of the Interest Guidance

- A4.1 We have included on the following three pages a copy of the Interest Guidance. Paragraph numbering and footnote numbering are the same as Gamma Determination, to which the Interest Guidance was annexed.

Ofcom's guidance on its approach to interest in the context of resolving a dispute involving charges payable under BT's Standard Interconnect Agreement

- A2.1 When exercising our powers under section 190(2)(d) of the Communications Act 2003 ("2003 Act") to make a direction requiring a repayment to be made in the context of resolving a dispute, Ofcom will decide whether interest should be payable, and if so, at what rate, taking account of all relevant considerations with a view to setting an amount of principal plus interest which would best meet our statutory duties and regulatory objectives, in particular, with a main objective of avoiding CPs having incentives to set unduly high charges.
- A2.2 Providing an indication of our approach to interest and the interest rate that we are generally likely to adopt contributes towards providing a stable and predictable regulatory framework. It also has the practical benefit of avoiding substantial time being spent assessing interest during future disputes. This is helpful given that we must determine disputes within four months (except in exceptional circumstances). Accordingly we have sought to identify the interest rate that we are generally likely to adopt when directing a repayment in order to resolve a dispute relating to charges payable under BT's Standard Interconnect Agreement, as well as our reasoning for selecting that rate.

Our starting point

- A2.3 In our view, it is likely to be appropriate to award interest in the majority of cases in which a direction for repayment is considered appropriate in order to avoid creating an incentive for CPs to set charges that are unduly high (in the absence of evidence to the contrary). Doing so is likely to meet our statutory duties in most cases. In particular, our main objective of avoiding CPs having an incentive to set unduly high charges is likely to benefit consumers.¹⁴⁵
- A2.4 Our starting point is that the interest rate should generally reflect the time value of the principal to the overcharging firm, i.e. the benefit the overcharging firm enjoys by virtue of the delay between its overcharging and the date on which it makes a repayment.

Approach to an applicable contractual interest rate

- A2.5 Where an applicable contractual interest rate is in place, we shall have regard to the extent to which that rate would meet our regulatory objectives, in particular, having regard to the need to foster commercial certainty and a stable and predictable regulatory environment, which are important for the promotion of investment, competition and therefore the interests of consumers.

¹⁴⁵ While this will generally be our main objective, depending on the facts of the dispute it may be appropriate to place weight on other objectives as well.

- A2.6 We are also likely to consider whether the contractual rate evidences what the Parties have agreed would represent a fair and reasonable proxy for the benefit to the overcharging firm. It might be expected that, where the parties have agreed a contractual rate, this may reflect their desire to ensure that an overcharging party does not benefit from any overpayment. Whether or not this is the case in any dispute may need to be considered on the relevant facts before Ofcom at the time of its decision.
- A2.7 However, where we have grounds to consider that the contractual rate would not meet our statutory duties and regulatory objectives, we may decide that it is not appropriate to apply the contractual rate and will need to consider what rate to apply to ensure that our statutory duties and regulatory objectives are met.¹⁴⁶ In such cases, we are likely to have regard to the principles outlined in paragraphs A2.8 to A2.14 below.

Overview of our approach

- A2.8 We consider that it would be reasonable to expect that the opportunity cost to the overcharging firm reflects the cost of debt as it could repay outstanding debt or avoid taking out debt with an additional increase in cash as a result of an overcharge. This implies that a cost of debt rate would be appropriate. The interest rate which would represent the cost of debt to the overcharging firm is determined by two factors:
- a) The term of the debt. In determining an appropriate term of debt to act as a proxy for the overcharge, we would consider the length of time for which the overcharging party could reasonably expect to retain the principal; and
 - b) The premium over and above the risk-free rate which reflects the risk of default by the overcharging firm.
- A2.9 In principle, in order to determine what rate of interest would appropriately represent the time value of the overcharge to the overcharging firm in a particular case, we could seek to assess on a case-by-case basis the *actual* benefit to the overcharging firm as a result of the overcharge in that case. However, such an in-depth assessment would be complex and is unlikely to be practical. For example, we would be likely to need significant data which may not always be available on the facts of a given case.¹⁴⁷ Moreover, given the four month statutory deadline by which Ofcom must resolve disputes, there is unlikely to be sufficient time in which to undertake a detailed assessment of the nature of interest once all issues surrounding the merits of the dispute and the award of the principal amount have been considered.
- A2.10 We also consider that it is important to adopt an approach which will foster commercial and regulatory certainty and that an appropriate interest rate should be readily calculable using available data.
- A2.11 We therefore do not consider that it would be appropriate to seek to assess the *actual* benefit to the overcharging firm in the context of any dispute. Instead, in view of the difficulties which may be involved in seeking to determine a 'theoretically

¹⁴⁶ See *Telefónica O2 UK Ltd and others v British Telecommunications plc* [2012] EWCA Civ 1002, paragraph 74.

¹⁴⁷ For example, it is unlikely to be feasible in practice to identify what the overcharging firm actually did with the funds in question, since they will be intermingled with other revenues.

accurate¹ rate which approximates the actual benefit to an overcharging CP in a particular case, we consider that it is reasonable and proportionate to adopt a more pragmatic approach, provided that the applicable rate would be within the range of the cost of debt to the overcharging CP that may reasonably be expected.

- A2.12 We consider that the Bank of England base rate plus 1%, which has conventionally been adopted by the High Court in commercial cases and by the CAT when awarding interest on penalties on appeal¹⁴⁸, is likely to be an appropriate rate to reflect the benefit derived by the overcharging firm from the overcharge in most cases. In the absence of evidence to the contrary, we consider that it is likely to provide a reasonable approximation of the cost of debt for a firm in the position of an overcharging CP.
- A2.13 However, we recognise that, depending on the facts of a particular case, it may be appropriate to depart from that rate in order to ensure that our objectives, in particular our main objective, are met. If parties put forward relevant evidence which suggests that an alternative rate should be applied in a given case, we would consider it.¹⁴⁹ In most cases, we would expect that parties to a dispute should be in a position to put forward reasoned and evidence-based submissions as to why they consider that the Bank of England base rate plus 1% would not be appropriate in the circumstances of a given dispute, for example, because they consider it would not meet our regulatory objectives or would be unfair to one of the parties.
- A2.14 This approach represents a pragmatic solution that parties to futures dispute will be familiar with and should help promote regulatory and commercial certainty, whilst ensuring that our approach to interest is sufficiently flexible to ensure that the level of interest awarded in a given case achieves our regulatory objectives and is fair as between the parties.

¹⁴⁸ See for example, the White Book paragraph 7.017(a) and the Admiralty Commercial Court Guide, paragraph J14.1 in respect of the past practice of the High Court and *Napp Pharmaceutical v DGFT* [2002] CAT 3 at paragraph 13, *Richard W Price v OFT* [2005] CAT 12 at paragraphs 21 to 24 and the CAT Guide to Proceedings at paragraphs 18.4 to 18.5 in respect of the CAT's general practice.

¹⁴⁹ Relevant evidence may include a cross-check suggesting that the Bank of England base rate plus 1% lies outside the range of the cost of debt to the overcharging CP that may reasonably be expected in the circumstances of the dispute (taking account of the factors set out in paragraph A2.8).

Annex 5

Draft determination to resolve the dispute between BT and CWW

Determination under sections 188 and 190 of the Communications Act 2003 (the “2003 Act”) for resolving a dispute between BT and CWW concerning BT’s charges for Ethernet services

WHEREAS—

- (A) on 20 December 2012 Ofcom determined a dispute between BT and CWW relating to BT’s charges for certain Ethernet services (the “2012 Determination”) finding that BT had overcharged CWW for the provision of the Ethernet services specified in the paragraph 1 of the 2012 Determination (the “Relevant Services”) and for the years specified in that explanatory statement to the 2012 Determination, and directed BT to pay CWW, by way of an adjustment of an overpayment for the Relevant Services, the sum of money set out in the 2012 Determination (the “principal overcharge”);
- (B) on 28 December 2012, BT repaid CWW the amount of the principal overcharge as required pursuant to the 2012 Determination;
- (C) on 20 February 2013 BT and CWW lodged appeals with the CAT against the 2012 Determination;
- (D) on 1 August 2014 the CAT gave its Judgment:
 - allowing CWW’s appeal against Ofcom’s decision not to award interest on the amount of the repayment of the overcharge; and
 - allowing BT’s appeal in respect of an adjustment in relation to Excess Construction Charges (ECCs) costs;
- (E) section 195(4) of the 2003 Act requires the CAT to remit the decision under appeal to Ofcom with such directions, if any, it considers appropriate for giving effect to its decision;
- (F) on 4 December 2014 the CAT issued a Supplementary Judgment and on 10 December 2014 the CAT issued Orders setting out directions in respect of the Appeals;
- (G) the Orders remitted to Ofcom pursuant to section 195(4) of the 2003 Act the following matters for it to determine, as soon as reasonably practicable, in accordance with the Judgment and the Supplementary Judgment:
 - the repayments to which BT is entitled in respect of the exclusion of excess construction costs from its rental costs;
 - the rate of interest payable in respect of BT’s overcharge for Ethernet services;
 - BT’s claim for interest in respect of the repayment on excess construction costs; and

- the total amount payable as between BT and CWW.
- (H) in the explanatory statement accompanying this Determination, Ofcom has set out a revised figure for the principal overcharge for the Relevant Services, taking into account the adjustment which needs to be made in relation to ECCs,
- (I) in the explanatory statement accompanying this Determination, Ofcom has also set out that BT should be required to pay interest on the principal overcharge for the period up to 28 December 2012 and has set out the rates applicable and calculated the amounts due from BT to CWW in respect of this interest.

NOW, therefore, pursuant to the CAT's Orders dated 10 December 2014 Ofcom makes, for the reasons set out in the accompanying explanatory statement, this Determination—

I Declaration of rights and obligations, etc.

- 1 Ofcom gives a direction to BT to pay CWW, by way of an adjustment of an overpayment for the Relevant Services, the sum of £[~~£~~].
- 2 From 29 December 2012, interest at a rate of Bank of England base rate plus 1% compounded annually shall be payable by BT to CWW on the amount set out in paragraph 1 above.

II Binding nature and effective date

- 3 This Determination is binding on CWW and BT in accordance with section 190(8) of the 2003 Act.
- 4 This Determination shall take effect on the day it is published.

III Interpretation

- 5 For the purpose of interpreting this Determination —
 - a) headings and titles shall be disregarded; and
 - b) the Interpretation Act 1978 shall apply as if this Determination were an Act of Parliament.
- 6 In this Determination —
 - a) “2003 Act” means the Communications Act 2003 (c.21);
 - b) “2012 Determination” means a determination made in respect of Ofcom case ref: CW/01078/11/11 in respect of a dispute between BT and CWW regarding BT's charges for Ethernet Services and dated 20 December 2012;
 - c) “BT” means British Telecommunications plc, whose registered company number is 1800000, and any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 1159 of the Companies Act 2006;
 - d) “CAT” means the Competition Appeal Tribunal;

- e) “Judgment” means the final judgment given by the CAT in respect of case numbers 1205/3/3/13, 1206/3/3/13 and 1207/3/3/13 and dated 1 August 2014;
- f) “Orders” means the orders given by the CAT in respect of case numbers 1205/3/3/13, 1206/3/3/13 and 1207/3/3/13 and dated 10 December 2014;
- g) “Relevant Services” means the Ethernet services specified in the paragraph 1 of the 2012 Determination;
- h) “CWW” means Cable & Wireless Worldwide plc (whose registered company number is 7029206) group, including the following CWW companies: Cable & Wireless UK (registered company number 1541957), Cable & Wireless Access Limited (registered company number 4005262), Energis Communications Limited (registered company number 2630471), Thus Group Holdings Limited (registered company number SC192666) and Your Communications Group Limited (registered company number 4171876); and
- i) “Supplementary Judgment” means the supplementary judgment given by the CAT in respect of case numbers 1205/3/3/13, 1206/3/3/13 and 1207/3/3/13 and dated 4 December 2014.

Signed by:

Neil Buckley

Director of Investigations

A person duly authorised in accordance with paragraph 18 of the Schedule to the Office of Communications Act 2002

Draft determination to resolve the dispute between BT and Sky

Determination under sections 188 and 190 of the Communications Act 2003 (the “2003 Act”) for resolving a dispute between BT and Sky concerning BT’s charges for Ethernet services

WHEREAS—

- (A) on 20 December 2012 Ofcom determined a dispute between BT and Sky relating to BT’s charges for certain Ethernet services (the “2012 Determination”) finding that BT had overcharged Sky for the provision of the Ethernet services specified in the paragraph 1 of the 2012 Determination (the “Relevant Services”) and for the years specified in that explanatory statement to the 2012 Determination, and directed BT to pay Sky, by way of an adjustment of an overpayment for the Relevant Services, the sum of money set out in the 2012 Determination (the “principal overcharge”);
- (B) on 28 December 2012, BT repaid Sky the amount of the principal overcharge as required pursuant to the 2012 Determination;
- (C) on 20 February 2013 BT and Sky lodged appeals with the CAT against the 2012 Determination;
- (D) on 1 August 2014 the CAT gave its Judgment:
- allowing Sky’s appeal against Ofcom’s decision not to award interest on the amount of the repayment of the overcharge; and
 - allowing BT’s appeal in respect of an adjustment in relation to Excess Construction Charges (ECCs) costs;
- (E) section 195(4) of the 2003 Act requires the CAT to remit the decision under appeal to Ofcom with such directions, if any, it considers appropriate for giving effect to its decision;
- (F) on 4 December 2014 the CAT issued a Supplementary Judgment and on 10 December 2014 the CAT issued Orders setting out directions in respect of the Appeals;
- (G) the Orders remitted to Ofcom pursuant to section 195(4) of the 2003 Act the following matters for it to determine, as soon as reasonably practicable, in accordance with the Judgment and the Supplementary Judgment:
- the repayments to which BT is entitled in respect of the exclusion of excess construction costs from its rental costs;
 - the rate of interest payable in respect of BT’s overcharge for Ethernet services;
 - BT’s claim for interest in respect of the repayment on excess construction costs; and

- the total amount payable as between BT and Sky.
- (H) in the explanatory statement accompanying this Determination, Ofcom has set out a revised figure for the principal overcharge for the Relevant Services, taking into account the adjustment which needs to be made in relation to ECCs,
- (I) in the explanatory statement accompanying this Determination, Ofcom has also set out that BT should be required to pay interest on the principal overcharge for the period up to 28 December 2012 and has set out the rates applicable and calculated the amounts due from BT to Sky in respect of this interest.

NOW, therefore, pursuant to the CAT's Orders dated 10 December 2014 Ofcom makes, for the reasons set out in the accompanying explanatory statement, this Determination—

I Declaration of rights and obligations, etc.

- 1 Ofcom gives a direction to BT to pay Sky, by way of an adjustment of an overpayment for the Relevant Services, the sum of £[~~£~~].
- 2 From 29 December 2012, interest at a rate of Bank of England base rate plus 1% compounded annually shall be payable by BT to Sky on the amount set out in paragraph 1 above.

II Binding nature and effective date

- 3 This Determination is binding on Sky and BT in accordance with section 190(8) of the 2003 Act.
- 4 This Determination shall take effect on the day it is published.

III Interpretation

- 5 For the purpose of interpreting this Determination —
 - a) headings and titles shall be disregarded; and
 - b) the Interpretation Act 1978 shall apply as if this Determination were an Act of Parliament.
- 6 In this Determination —
 - a) “2003 Act” means the Communications Act 2003 (c.21);
 - b) “2012 Determination” means a determination made in respect of Ofcom case ref: CW/01052/08/10 in respect of a dispute between BT and Sky regarding BT's charges for Ethernet Services and dated 20 December 2012;
 - c) “BT” means British Telecommunications plc, whose registered company number is 1800000, and any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 1159 of the Companies Act 2006;
 - d) “CAT” means the Competition Appeal Tribunal;

- e) “Judgment” means the final judgment given by the CAT in respect of case numbers 1205/3/3/13, 1206/3/3/13 and 1207/3/3/13 and dated 1 August 2014;
- f) “Orders” means the orders given by the CAT in respect of case numbers 1205/3/3/13, 1206/3/3/13 and 1207/3/3/13 and dated 10 December 2014;
- g) “Relevant Services” means the Ethernet services specified in the paragraph 1 of the 2012 Determination;
- h) “Sky” means Sky UK Limited¹⁵² whose registered company number is 02906991, and any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 1159 of the Companies Act 2006; and
- i) “Supplementary Judgment” means the supplementary judgment given by the CAT in respect of case numbers 1205/3/3/13, 1206/3/3/13 and 1207/3/3/13 and dated 4 December 2014.

Signed by:

Neil Buckley

Director of Investigations

A person duly authorised in accordance with paragraph 18 of the Schedule to the Office of Communications Act 2002

¹⁵² Previously named British Sky Broadcasting Limited at the time of the 2012 Determination

Draft determination to resolve the dispute between BT and TalkTalk

Determination under sections 188 and 190 of the Communications Act 2003 (the “2003 Act”) for resolving a dispute between BT and TalkTalk concerning BT’s charges for Ethernet services

WHEREAS—

- (A) on 20 December 2012 Ofcom determined a dispute between BT and TalkTalk relating to BT’s charges for certain Ethernet services (the “2012 Determination”) finding that BT had overcharged TalkTalk for the provision of the Ethernet services specified in the paragraph 1 of the 2012 Determination (the “Relevant Services”) and for the years specified in that explanatory statement to the 2012 Determination, and directed BT to pay TalkTalk, by way of an adjustment of an overpayment for the Relevant Services, the sum of money set out in the 2012 Determination (the “principal overcharge”);
- (B) on 28 December 2012, BT repaid TalkTalk the amount of the principal overcharge as required pursuant to the 2012 Determination;
- (C) on 20 February 2013 BT and TalkTalk lodged appeals with the CAT against the 2012 Determination;
- (D) on 1 August 2014 the CAT gave its Judgment:
- allowing TalkTalk’s appeal against Ofcom’s decision not to award interest on the amount of the repayment of the overcharge; and
 - allowing BT’s appeal in respect of an adjustment in relation to Excess Construction Charges (ECCs) costs;
- (E) section 195(4) of the 2003 Act requires the CAT to remit the decision under appeal to Ofcom with such directions, if any, it considers appropriate for giving effect to its decision;
- (F) on 4 December 2014 the CAT issued a Supplementary Judgment and on 10 December 2014 the CAT issued Orders setting out directions in respect of the Appeals;
- (G) the Orders remitted to Ofcom pursuant to section 195(4) of the 2003 Act the following matters for it to determine, as soon as reasonably practicable, in accordance with the Judgment and the Supplementary Judgment:
- the repayments to which BT is entitled in respect of the exclusion of excess construction costs from its rental costs;
 - the rate of interest payable in respect of BT’s overcharge for Ethernet services;

- BT's claim for interest in respect of the repayment on excess construction costs; and
 - the total amount payable as between BT and TalkTalk.
- (H) in the explanatory statement accompanying this Determination, Ofcom has set out a revised figure for the principal overcharge for the Relevant Services, taking into account the adjustment which needs to be made in relation to ECCs,
- (I) in the explanatory statement accompanying this Determination, Ofcom has also set out that BT should be required to pay interest on the principal overcharge for the period up to 28 December 2012 and has set out the rates applicable and calculated the amounts due from BT to TalkTalk in respect of this interest.

NOW, therefore, pursuant to the CAT's Orders dated 10 December 2014 Ofcom makes, for the reasons set out in the accompanying explanatory statement, this Determination—

I Declaration of rights and obligations, etc.

- 1 Ofcom gives a direction to BT to pay TalkTalk, by way of an adjustment of an overpayment for the Relevant Services, the sum of £[~~£~~].
- 2 From 29 December 2012, interest at a rate of Bank of England base rate plus 1% compounded annually shall be payable by BT to TalkTalk on the amount set out in paragraph 1 above.

II Binding nature and effective date

- 3 This Determination is binding on TalkTalk and BT in accordance with section 190(8) of the 2003 Act.
- 4 This Determination shall take effect on the day it is published.

III Interpretation

- 5 For the purpose of interpreting this Determination —
 - a) headings and titles shall be disregarded; and
 - b) the Interpretation Act 1978 shall apply as if this Determination were an Act of Parliament.
- 6 In this Determination —
 - a) "2003 Act" means the Communications Act 2003 (c.21);
 - b) "2012 Determination" means a determination made in respect of Ofcom case ref: CW/01052/08/10 in respect of a dispute between BT and TalkTalk regarding BT's charges for Ethernet Services and dated 20 December 2012;
 - c) "BT" means British Telecommunications plc, whose registered company number is 1800000, and any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 1159 of the Companies Act 2006;

- d) "CAT" means the Competition Appeal Tribunal;
- e) "Judgment" means the final judgment given by the CAT in respect of case numbers 1205/3/3/13, 1206/3/3/13 and 1207/3/3/13 and dated 1 August 2014;
- f) "Orders" means the orders given by the CAT in respect of case numbers 1205/3/3/13, 1206/3/3/13 and 1207/3/3/13 and dated 10 December 2014;
- g) "Relevant Services" means the Ethernet services specified in the paragraph 1 of the 2012 Determination;
- h) "TalkTalk" means TalkTalk Telecom Group PLC whose registered company number is 07105891, and any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 1159 of the Companies Act 2006; and
- i) "Supplementary Judgment" means the supplementary judgment given by the CAT in respect of case numbers 1205/3/3/13, 1206/3/3/13 and 1207/3/3/13 and dated 4 December 2014.

Signed by:

Neil Buckley

Director of Investigations

A person duly authorised in accordance with paragraph 18 of the Schedule to the Office of Communications Act 2002

Annex 8

Draft determination to resolve the dispute between BT and Verizon

Determination under sections 188 and 190 of the Communications Act 2003 (the “2003 Act”) for resolving a dispute between BT and Verizon concerning BT’s charges for Ethernet services

WHEREAS—

- (A) on 20 December 2012 Ofcom determined a dispute between BT and Verizon relating to BT’s charges for certain Ethernet services (the “2012 Determination”) finding that BT had overcharged Verizon for the provision of the Ethernet services specified in the paragraph 1 of the 2012 Determination (the “Relevant Services”) and for the years specified in that explanatory statement to the 2012 Determination, and directed BT to pay Verizon, by way of an adjustment of an overpayment for the Relevant Services, the sum of money set out in the 2012 Determination (the “principal overcharge”);
- (B) on 28 December 2012, BT repaid Verizon the amount of the principal overcharge as required pursuant to the 2012 Determination;
- (C) on 20 February 2013 BT and Verizon lodged appeals with the CAT against the 2012 Determination;
- (D) on 1 August 2014 the CAT gave its Judgment:
- allowing Verizon’s appeal against Ofcom’s decision not to award interest on the amount of the repayment of the overcharge; and
 - allowing BT’s appeal in respect of an adjustment in relation to Excess Construction Charges (ECCs) costs;
- (E) section 195(4) of the 2003 Act requires the CAT to remit the decision under appeal to Ofcom with such directions, if any, it considers appropriate for giving effect to its decision;
- (F) on 4 December 2014 the CAT issued a Supplementary Judgment and on 10 December 2014 the CAT issued Orders setting out directions in respect of the Appeals;
- (G) the Orders remitted to Ofcom pursuant to section 195(4) of the 2003 Act the following matters for it to determine, as soon as reasonably practicable, in accordance with the Judgment and the Supplementary Judgment:
- the repayments to which BT is entitled in respect of the exclusion of excess construction costs from its rental costs;
 - the rate of interest payable in respect of BT’s overcharge for Ethernet services;

- BT's claim for interest in respect of the repayment on excess construction costs; and
 - the total amount payable as between BT and Verizon.
- (H) in the explanatory statement accompanying this Determination, Ofcom has set out a revised figure for the principal overcharge for the Relevant Services, taking into account the adjustment which needs to be made in relation to ECCs,
- (I) in the explanatory statement accompanying this Determination, Ofcom has also set out that BT should be required to pay interest on the principal overcharge for the period up to 28 December 2012 and has set out the rates applicable and calculated the amounts due from BT to Verizon in respect of this interest.

NOW, therefore, pursuant to the CAT's Orders dated 10 December 2014 Ofcom makes, for the reasons set out in the accompanying explanatory statement, this Determination—

I Declaration of rights and obligations, etc.

- 1 Ofcom gives a direction to BT to pay Verizon, by way of an adjustment of an overpayment for the Relevant Services, the sum of £[~~£~~].
- 2 From 29 December 2012, interest at a rate of Bank of England base rate plus 1% compounded annually shall be payable by BT to Verizon on the amount set out in paragraph 1 above.

II Binding nature and effective date

- 3 This Determination is binding on Verizon and BT in accordance with section 190(8) of the 2003 Act.
- 4 This Determination shall take effect on the day it is published.

III Interpretation

- 5 For the purpose of interpreting this Determination —
 - a) headings and titles shall be disregarded; and
 - b) the Interpretation Act 1978 shall apply as if this Determination were an Act of Parliament.
- 6 In this Determination —
 - a) "2003 Act" means the Communications Act 2003 (c.21);
 - b) "2012 Determination" means a determination made in respect of Ofcom case ref: CW/01087/02/12 in respect of a dispute between BT and Verizon regarding BT's charges for Ethernet Services and dated 20 December 2012;
 - c) "BT" means British Telecommunications plc, whose registered company number is 1800000, and any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 1159 of the Companies Act 2006;

- d) "CAT" means the Competition Appeal Tribunal;
- e) "Judgment" means the final judgment given by the CAT in respect of case numbers 1205/3/3/13, 1206/3/3/13 and 1207/3/3/13 and dated 1 August 2014;
- f) "Orders" means the orders given by the CAT in respect of case numbers 1205/3/3/13, 1206/3/3/13 and 1207/3/3/13 and dated 10 December 2014;
- g) "Relevant Services" means the Ethernet services specified in the paragraph 1 of the 2012 Determination;
- h) "Verizon" means Verizon UK Limited whose registered company number is 02776038, and any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 1159 of the Companies Act 2006; and
- i) "Supplementary Judgment" means the supplementary judgment given by the CAT in respect of case numbers 1205/3/3/13, 1206/3/3/13 and 1207/3/3/13 and dated 4 December 2014.

Signed by:

Neil Buckley

Director of Investigations

A person duly authorised in accordance with paragraph 18 of the Schedule to the Office of Communications Act 2002

Annex 9

Draft determination to resolve the dispute between BT and Virgin

Determination under sections 188 and 190 of the Communications Act 2003 (the “2003 Act”) for resolving a dispute between BT and Virgin concerning BT’s charges for Ethernet services

WHEREAS—

- (A) on 20 December 2012 Ofcom determined a dispute between BT and Virgin relating to BT’s charges for certain Ethernet services (the “2012 Determination”) finding that BT had overcharged Virgin for the provision of the Ethernet services specified in the paragraph 1 of the 2012 Determination (the “Relevant Services”) and for the years specified in that explanatory statement to the 2012 Determination, and directed BT to pay Virgin, by way of an adjustment of an overpayment for the Relevant Services, the sum of money set out in the 2012 Determination (the “principal overcharge”);
- (B) on 28 December 2012, BT repaid Virgin the amount of the principal overcharge as required pursuant to the 2012 Determination;
- (C) on 20 February 2013 BT and Virgin lodged appeals with the CAT against the 2012 Determination;
- (D) on 1 August 2014 the CAT gave its Judgment:
- allowing Virgin’s appeal against Ofcom’s decision not to award interest on the amount of the repayment of the overcharge; and
 - allowing BT’s appeal in respect of an adjustment in relation to Excess Construction Charges (ECCs) costs;
- (E) section 195(4) of the 2003 Act requires the CAT to remit the decision under appeal to Ofcom with such directions, if any, it considers appropriate for giving effect to its decision;
- (F) on 4 December 2014 the CAT issued a Supplementary Judgment and on 10 December 2014 the CAT issued Orders setting out directions in respect of the Appeals;
- (G) the Orders remitted to Ofcom pursuant to section 195(4) of the 2003 Act the following matters for it to determine, as soon as reasonably practicable, in accordance with the Judgment and the Supplementary Judgment:
- the repayments to which BT is entitled in respect of the exclusion of excess construction costs from its rental costs;
 - the rate of interest payable in respect of BT’s overcharge for Ethernet services;
 - BT’s claim for interest in respect of the repayment on excess construction costs; and

- the total amount payable as between BT and Virgin.
- (H) in the explanatory statement accompanying this Determination, Ofcom has set out a revised figure for the principal overcharge for the Relevant Services, taking into account the adjustment which needs to be made in relation to ECCs,
- (I) in the explanatory statement accompanying this Determination, Ofcom has also set out that BT should be required to pay interest on the principal overcharge for the period up to 28 December 2012 and has set out the rates applicable and calculated the amounts due from BT to Virgin in respect of this interest.

NOW, therefore, pursuant to the CAT's Orders dated 10 December 2014 Ofcom makes, for the reasons set out in the accompanying explanatory statement, this Determination—

I Declaration of rights and obligations, etc.

- 1 Ofcom gives a direction to BT to pay Virgin, by way of an adjustment of an overpayment for the Relevant Services, the sum of £[~~£~~].
- 2 From 29 December 2012, interest at a rate of Bank of England base rate plus 1% compounded annually shall be payable by BT to Virgin on the amount set out in paragraph 1 above.

II Binding nature and effective date

- 3 This Determination is binding on Virgin and BT in accordance with section 190(8) of the 2003 Act.
- 4 This Determination shall take effect on the day it is published.

III Interpretation

- 5 For the purpose of interpreting this Determination —
 - a) headings and titles shall be disregarded; and
 - b) the Interpretation Act 1978 shall apply as if this Determination were an Act of Parliament.
- 6 In this Determination —
 - a) “2003 Act” means the Communications Act 2003 (c.21);
 - b) “2012 Determination” means a determination made in respect of Ofcom case ref: CW/01052/08/10 in respect of a dispute between BT and Virgin regarding BT's charges for Ethernet Services and dated 20 December 2012;
 - c) “BT” means British Telecommunications plc, whose registered company number is 1800000, and any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 1159 of the Companies Act 2006;
 - d) “CAT” means the Competition Appeal Tribunal;

- e) “Judgment” means the final judgment given by the CAT in respect of case numbers 1205/3/3/13, 1206/3/3/13 and 1207/3/3/13 and dated 1 August 2014;
- f) “Orders” means the orders given by the CAT in respect of case numbers 1205/3/3/13, 1206/3/3/13 and 1207/3/3/13 and dated 10 December 2014;
- g) “Relevant Services” means the Ethernet services specified in the paragraph 1 of the 2012 Determination;
- h) “Virgin” means Virgin Media Limited whose registered company number is 02591237, and any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 1159 of the Companies Act 2006; and
- i) “Supplementary Judgment” means the supplementary judgment given by the CAT in respect of case numbers 1205/3/3/13, 1206/3/3/13 and 1207/3/3/13 and dated 4 December 2014.

Signed by:

Neil Buckley

Director of Investigations

A person duly authorised in accordance with paragraph 18 of the Schedule to the Office of Communications Act 2002