

Our ref: CW 01052/08/10

7 March 2013

Matthew Marsh
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Regulatory & Competition
British Sky Broadcasting Limited

Neil Buckley
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By email

Dear Matthew

Ethernet disputes: costs

I refer to your email of 31 August 2012 in which you requested that Ofcom, under section 190(6) of the Communications Act 2003 ("the Act"), should require BT to pay Sky's costs incurred in connection with the dispute between BT and Sky about BT's charges for Ethernet services (CW 01052/08/10) ("the dispute"). There were related disputes brought by four other CPs. We refer to the dispute and those other disputes collectively as "the disputes". I also refer to your email of 25 January 2013 in which you set out your further comments in relation to that request. We refer to these emails collectively below as "your costs submission".

As we noted in our letter of 11 January 2013, we would in general expect that disputing parties bear their own costs for the majority of the disputes that we resolve and we therefore do not intend to routinely require costs payments between the parties to disputes.

Having considered the evidence and submissions put forward in your costs submission, we have decided that the circumstances of the dispute and BT's conduct are on balance not such that we should exercise our discretion to direct BT to pay your costs in this case, for the reasons set out below.

Our approach

Section 190(6) of the Act confers on us the power to require a party to a dispute to pay another party's costs and expenses incurred in consequence of the reference of the dispute to Ofcom or in connection with it.

In accordance with section 190(6A) of the Act, Ofcom may not require a party to a dispute to make payments to another party unless Ofcom has considered: (a) the conduct of the party before and after the reference to Ofcom (including, in particular, whether any attempt has been made to resolve the dispute); and (b) whether Ofcom has made a decision in the party's favour in respect of the whole or part of the dispute.

In October 2012 we published for consultation draft guidance on the payment of costs and expenses in regulatory disputes¹. The draft guidance sets out our proposals as to how in the future we expect to deal with applications for costs made by parties to disputes. As noted at paragraph 3.3 of the draft guidance, we decide whether to award costs in a dispute by exercising our discretion on a case-by-case basis. However, in line with the draft guidance, in light of our section 190(6A) obligations, we are likely to have regard to the following factors in exercising our discretion:

- commitment to negotiations or ADR;
- behaviour that increases costs and expenses, such as providing incomplete or inaccurate information and/or failure to comply with deadlines;
- the nature and value of the issues in dispute; and
- the outcome of the dispute resolution process.

As noted in the draft guidance, we would not normally expect to require a party to a dispute to pay another party's costs unless a number of these factors are present which would suggest that payment of costs should be required.

In considering your request for costs we have had regard, in particular, to the following documents:

- Sky's emails of 31 August 2012 and 25 January 2013;

¹ Draft guidance *Payments of costs and expenses in regulatory disputes* dated 29 October 2012 ("the draft guidance")
<http://stakeholders.ofcom.org.uk/binaries/consultations/payment-costs/summary/main.pdf>

- BT's letters of 25 January ("BT's first costs response") and 4 February 2013 ("BT's second costs response") commenting on Sky's request for costs;
- Disputes between each of Sky, TalkTalk, Virgin Media, Cable & Wireless and Verizon and BT regarding BT's charges for Ethernet services, Determinations and Explanatory Statement dated 20 December 2012, ("the final determinations");
- Sky's email of 21 March 2012 and our letter in response of 26 March 2012 regarding an extension of time for BT to provide comments on the draft determination document
- correspondence between BT and Sky regarding negotiations in connection with the dispute appended to TalkTalk and Sky's joint dispute submission dated 27 July 2010;
- BT's letter dated 10 August 2010 providing comments on whether Ofcom should open a dispute; and
- Sky's email dated 1 September 2010 which provided further details of negotiations between Sky and BT.

Sky's submissions

In support of your request for costs, you made the following submissions which we comment on in turn below:

- BT failed to engage in good faith negotiations with Sky;
- BT's behaviour increased the costs and expenses of Sky; and
- the dispute has been determined in Sky's favour.

BT's conduct before the reference to Ofcom – your claim that BT failed to engage in good faith negotiations

With respect to BT's conduct before the reference of the dispute to Ofcom, you suggest in your costs submission that:

"BT repeatedly delayed during bilateral negotiations prior to Sky submitting its request for Ofcom to resolve the dispute. Throughout the process, BT has shown no meaningful commitment to achieving a commercial solution, has refused to engage in the substantive issues and seemed to support intervention by Ofcom rather than bilateral negotiations. In contrast, Sky sought to resolve the dispute with BT and

turned to Ofcom only after it became clear that no agreement with BT could be reached.”

In its first costs response, BT comments that it did not refuse to meaningfully seek to resolve the dispute. BT argues that *“given that the basis of the dispute was an allegation that BT had failed to comply with a regulatory SMP condition, the existence of continuing the associated and relevant PPC 2Mbit/s trunk segment appeals, and Sky’s position on the appropriate compliance test and replacement charge level and, albeit latterly, interest, BT took an entirely appropriate and reasonable position to commercial negotiations”* but *“the gap between BT and Sky (and others) was simply too wide to bridge”*. BT reiterated similar comments in its second costs response.

Ofcom’s views

In assessing Sky’s submissions on this issue, we have reviewed the correspondence between Sky and BT included with your original dispute submission² regarding the negotiations that took place between Sky and BT in relation to the dispute and Sky’s email of 1 September 2010 which gave further details of negotiations. We have also noted BT’s comments in its 10 August 2010 letter³, in which BT stated that it did not consider commercial negotiations with Sky on the issue had reached an impasse by that stage but that the PPC appeal⁴ had had the effect of stalling negotiations, and that it was therefore not appropriate for Ofcom to accept the dispute for resolution.

From the evidence we have reviewed, it is our understanding that TalkTalk and Sky initiated negotiations with BT in connection with the dispute in January 2008 and that these were ongoing until late December 2009/January 2010. We received TalkTalk and Sky’s dispute submission at the end of July 2010, by which point the PPC appeal was ongoing. Prior to the submission of the dispute to Ofcom, we understand there was a chain of correspondence and records of meetings that show attempts by the parties to discuss the substantive issues ultimately raised in the dispute.

² TalkTalk and Sky’s joint submission dated 27 July 2010 requesting that Ofcom resolve a dispute between BSkyB, TalkTalk and BT about BT’s charges for Ethernet services

³ We note this letter is referred to in the CAT’s judgment on BT’s appeal against Ofcom’s decision to accept the Ethernet disputes for resolution, *BT v Ofcom* [2011] CAT 15, see paragraph 24.

⁴ BT’s appeal of Ofcom’s final determinations in disputes concerning BT’s charges for partial private circuits (“PPCs”), which was filed on 14 December 2009. As you are aware, the PPC disputes concerned a similarly worded cost orientation condition and the PPC appeal raised issues which were relevant to the consideration of the cost orientation condition that was the subject of the Ethernet disputes.

It is clear that BT and Sky fundamentally disagreed on a central issue in the dispute, namely whether BT's prices had been cost-orientated and how to assess this. There is evidence that attempts were made by the parties to negotiate on this issue, but they were not successful. We note that BT maintained its position that its charges were cost-orientated. We do not consider that BT's adherence to its position should, in itself, be considered a lack of a genuine commitment to negotiations.

On balance, on the basis of the available evidence, we are not satisfied that there is sufficient evidence of a lack of a genuine commitment to negotiations by BT to justify, in itself, a direction that BT should be required to pay Sky's costs in relation to the dispute.

BT's conduct after the reference to Ofcom – your claim that BT's behaviour increased the costs, expenses and losses of Sky

You claim in your costs submissions that "*following the submission of the dispute to Ofcom on 27 July 2010, BT has continually prevaricated and sought to disrupt the process.*"

You also claim in your costs submissions that:

- "*BT increased Sky's costs and expenses through filibustering, prevarication and delays*"; and
- "*BT repeatedly failed to provide accurate information, causing delays and increasing Sky's losses*".

You also state that in contrast, Sky has sought to achieve a quick conclusion to the dispute.

(1) BT's preliminary issues appeal

You submit that BT's appeal to the Competition Appeal Tribunal ("CAT") of Ofcom's decision to accept the dispute was speculative, but provide no further arguments or evidence to support this assertion.

BT does not comment on this specific assertion regarding the preliminary issues appeal, although BT argues in its first costs response that "*if Sky felt that it was appropriate to seek to recover its costs of those proceedings, it should have applied to the Tribunal*".

Ofcom's views

BT had the right to appeal Ofcom's decision to open the dispute to the CAT, and exercised that right.

(2) Regulatory Financial Statement data

In your costs submission, you argue that:

"BT provided materially inconsistent information to Ofcom. BT provided its initial submissions on cost orientation on 8 December 2010. On 9 May 2011, BT wrote to Ofcom identifying anomalies in its LRIC model. On 20 May 2011, BT wrote to Ofcom stating that it had identified a number of errors in its published DSACs. Ofcom issued its provisional determination on 8 February 2012 – 18 months after the dispute was opened. After the provisional determination, BT submitted yet further information discrediting its own DSACs. Yet throughout this process, BT has failed to provide reliable cost information."

In its second costs response, BT states that *"during the dispute process it was unclear to BT how Ofcom was going to approach its compliance and repayment assessment functions; against this backdrop, in providing the information BT did, it sought to be helpful as possible....Indeed a number of the adjustments proposed by BT were beneficial to the disputing CPs."*

Ofcom's views

As noted in our final determinations, in May 2011 BT wrote to Ofcom informing us of possible anomalies in the Distributed Stand Alone Cost ("DSAC") figures published in its RFS and argued that we should therefore not use the published DSAC figures for 2006/07 to 2009/10 for the purposes of resolving the disputes and instead use new DSAC figures that BT had calculated using a revised methodology.⁵

We note that both BT and several of the Disputing CPs⁶, including Sky, made submissions arguing that certain adjustments needed to be made to BT's published financial data in order to correct for volume errors and to ensure that revenues and costs were appropriately

⁵ This issue is discussed in Section 12 of our final determinations.

⁶ Being TalkTalk, British Sky Broadcasting Limited ("Sky"), Virgin Media Limited, Cable & Wireless Worldwide plc group and Verizon UK Limited

matched.⁷ We also identified, in the course of examining data provided by BT, that certain other corrections to BT's published financial data were required (mostly related to volume errors).

As we explain in the final determinations, we would normally expect to be able to rely on the data published in BT's RFS for the purposes of assessing compliance with BT's regulatory obligations.⁸ In light of both BT's and the Disputing CPs' arguments as to the potential issues with and errors in its published data, Ofcom had to consider the question of what data to use for resolving the dispute in some detail. We consider that this may have led to some delay in resolving the disputes. In our view it is appropriate to give some weight to this factor in our consideration of whether BT should be required to pay costs of other parties, as where we are unable to rely on the data published in the RFS it can have a significant impact on our ability to resolve disputes efficiently.

However, we do not consider that Sky has demonstrated that these issues have led to an increase in its costs in relation to the dispute. In particular, when considered in the round given the nature and complexity of the disputes, we do not consider that the delay that may have arisen as a result of this issue is in itself likely to have led to a material increase in Sky's costs.

We therefore consider that on balance this factor is not sufficient to justify an award of costs in this instance.

(3) Review of draft determination - BT's request for an extension of time

You claim in your costs submission that BT's request for an extension of time to submit comments on our Draft Determinations⁹ was evidence of BT's prevaricating and seeking to disrupt the dispute process:

"BT sought and Ofcom granted an extension in time for respondents to submit comments upon the Ofcom Draft Determination. On 19 March 2012, Ofcom sought Sky's comments on a possible extension. On 21 March 2012, Sky provided comments and stated that it objected to any extension being granted and Sky noted the cost to Sky of each day's delay in the resolution of the dispute was circa £12,916

⁷ This is discussed in Section 13 of the final determinations.

⁸ See, for example, paragraphs 11.22 to 11.24.

⁹ Draft Determinations to resolve disputes between each of Sky, TalkTalk and Virgin Media and BT regarding BT's charges for Ethernet services published 9 February 2010.

(in terms of cost of capital). Therefore the two week extension alone cost Sky £180,824.”

BT did not provide any comment about this point in its costs responses.

Ofcom's views

We considered BT's request for a two week extension to provide comments at the time, and also considered Sky's and other Disputing CPs' submissions on this point. We decided on balance to grant the extension, acknowledging *“concerns expressed by respondents about the detrimental effect of delay and the need for the disputes to be resolved expeditiously.”*¹⁰ In the context of the dispute as a whole, we do not consider these two weeks' delay are likely to have had any material impact on the costs that Sky has incurred in consequence of the reference of the dispute to Ofcom or in connection with it. We did not consider this extension to be, on balance, unreasonable at the time and we do not consider that this request for a two-week extension is, in itself, sufficient evidence to demonstrate that BT has sought to *“unfairly profit”* from delays (as Sky alleges) such that it would justify an award of costs in this instance.

The nature and value of the dispute

In your costs submission, in support of your arguments that Ofcom should direct BT to pay your costs, you describe the dispute as *“historic and therefore largely commercial in nature”*.

In its second costs response, BT argues:

“The basis of the dispute was that BT had failed to comply with a regulatory condition, the basis of charges condition. That allegation required a careful analysis of complex factual, economic, regulatory policy and legal factors, factors concerning, amongst other things, the extent and use of Ofcom's dispute resolution powers, the correct test(s) to be applied for the assessment of cost orientation, including what adjustments it is appropriate to make to BT's published RFS, and the level of repayment, all of which factors will impact on the way that BT prices its products, both now and in the future, and which in turn will have an impact on citizens, consumers and competition.”

¹⁰ Letter dated 26 March 2012 from Ofcom to Sky

Ofcom's views

In considering Sky's request for its costs, Ofcom has had regard to the nature of the disputes. The disputes related to BT's compliance with its regulatory obligations in a market in which we have deemed it to have SMP. Resolution of the disputes is therefore relevant to our core duty to protect consumers, in this case by promoting competition in the markets for AISBO services. We also note that the disputes were complex, multi-party disputes which involved the consideration by Ofcom of a large number of detailed submissions on various regulatory, economic and financial issues. Ofcom does not consider that the disputes raised "purely commercial" issues (as understood in the draft guidance) such that we would be more likely to require a payment of costs on the part of BT in this instance.

The outcome of the dispute

Sky submits in support of its costs submission that *"Ofcom's decision of 20 December 2012 clearly resolved the dispute between BT and Sky in favour of Sky"*.

Ofcom's views

As we note in our draft guidance, when deciding whether to require a party to pay another party's costs, we consider whether a party has "succeeded" in its claims, in the sense that Ofcom has substantially accepted submissions made by a party and accordingly made a determination in its favour.

In this case, the dispute was not resolved in BT's favour. Ofcom determined that BT had overcharged Sky (and the other Disputing CPs) for a number of Ethernet services over a number of years and required BT to repay Sky the full amount of the overcharge which involved a repayment of a large sum of money. We therefore consider that Sky substantially succeeded in its claims. We take this factor into account in our consideration of whether, in the round, it is appropriate to require BT to pay Sky's costs in this case. Overall, we would be more likely to require a party to repay the costs of another party that has overall been successful in its claims. However, we do not consider that it is appropriate to require BT to pay Sky's costs on the basis of this factor alone.

Conclusion

In conclusion, we consider that overall Ofcom made a decision in Sky's favour in respect of the dispute. We also consider that the issues relating to the accuracy or reliability of its RFS data is a factor that may support an award of costs against BT for Sky. We do not, however, consider that there is sufficient evidence to suggest that there was a lack of genuine commitment by BT to negotiations with Sky prior to the submission of the dispute, nor that the circumstances surrounding BT's preliminary issues appeal were such that these factors would justify requiring BT to pay Sky's costs. Having considered the evidence and submissions put forward in your costs submission, and the considerations set out in s190(6A), and weighed up all the various factors, we have decided that the circumstances of the dispute and BT's conduct are on balance not such that we should exercise our discretion to direct BT to pay your costs in this case.

Yours sincerely

A handwritten signature in blue ink, appearing to read "Neil Buckley". The signature is written in a cursive style with a long, sweeping underline.

Neil Buckley

cc. Stuart Murray, BT Legal