Determination to resolve a dispute between Colt and BT about Colt's fixed geographic call termination charges

This is the non-confidential version; redactions are indicated with **[✂]**.

Final determination

22 December 2010

Contents

Section 1

Executive summary

1.1 This dispute relates to the proposed charges payable by British Telecommunications plc ("BT") for the termination of fixed geographic calls on Colt Technology Services' ("Colt") network.

1.2 Until 30 September 2009, Colt's termination rate was set in accordance with a formula contained in an industry-wide agreement, which is commonly referred to as the Reciprocity Agreement. This formula sets Colt's termination rate as a blend of BT's Single Tandem ("ST") and Local Exchange ("LE") termination rates, as published in BT's Carrier Price List.[1] The exact blend was based on the proportions of Colt's outbound traffic that were delivered to BT's tandem and local switches, respectively.

1.3 Following the expiry of this agreement on 30 September 2009, and in the absence of industry consensus on a replacement arrangement, BT has continued to do business with other communications providers ("CPs") (including Colt) according to the terms of the expired agreement. In the remainder of this document, we refer to this as the "expired Reciprocity Agreement".

1.4 On 14 December 2009 Colt issued an Operator Charge Change Notice[2] ("OCCN") to BT. This proposed a new fixed geographic termination rate for calls originating on, or transiting across, BT's network and terminating on Colt's network, which would take effect from 1 March 2010. Colt's proposed rate was based on the expired Reciprocity Agreement formula, and was a blend of BT's ST and LE termination rates. However, Colt's proposal adapted the formula to take into account, in the calculation of the blend of ST and LE rates, traffic originated by Colt for termination on BT's network but sent via a third party transit provider.[3] Colt's proposed methodology for including this third party transit traffic in the calculation would result in an increase in its termination rate of about **[✂]**%. This would increase Colt's termination receipts by about **[✂]**[4] per year.

1.5 On 18 December 2009 BT formally rejected Colt's OCCN of 14 December 2009. Following some further negotiations between the parties, on 10 August 2010 we received a submission from Colt requesting that Ofcom handle, consider and determine, as a dispute under section 185 of the Communications Act 2003 (the "Act"), whether the rate proposed by Colt would be fair and reasonable in accordance with the requirements of Significant Market Power ("SMP") Condition BC1.[5]

1.6 In accordance with section 186(4) of the Act, on 2 September 2010 we decided that it was appropriate for us to handle this dispute, informed the parties to the dispute of

[1] Colt's proposed termination rate from 1 March 2010 was: **[✂]** pence per minute ("ppm") daytime; **[✂]**ppm evening; **[✂]**ppm weekend. Colt's current rate was agreed with BT under the expired Reciprocity Agreement: 0.2455 ppm daytime; 0.1124 ppm evening; 0.0885 ppm weekend.

[2] A Network Operator OCCN – a notice issued by an operator proposing a change to its charges.

[3] Under the expired Reciprocity Agreement, this traffic would not have been taken into account in calculating the blend of ST and LE rates for Colt's termination rate.

[4] The figure is based on Ofcom calculations using data provided by Colt in response to our section 191 notice (see paragraph 3.55). Colt's dispute submission of 10 August 2010 reported the revenue impact at circa **[✂]** p.a.

[5] CPs subject to SMP Condition BC1 are required to provide network access – in this case, fixed geographic call termination – on terms, conditions and charges that are fair and reasonable.

our decision and published a Competition and Consumer Enforcement Bulletin ("CCEB") entry setting out the scope of the dispute.[6]

Scope of the dispute

1.7 The scope of the dispute is:

> "to determine whether the fixed geographic termination rate proposed by Colt to BT in its OCCN of 14 December 2009, with effect from 1 March 2010, for terminating on Colt's network calls originating on, or transiting across, BT's fixed network is fair and reasonable in accordance with SMP Condition BC1; this rate being equivalent to Rate A, calculated as per the expired Reciprocity Agreement between Colt and BT, but treating traffic routed by Colt via a third party transit provider as traffic delivered by Colt to BT at Single Tandem level for the purposes of that calculation."

The key issues

1.8 The majority of BT traffic is delivered to Colt's network at its tandem switches. This requires Colt to incur the additional cost of tandem to local conveyance on its network to terminate calls to its customers connected to its local switches.

1.9 Under the expired Reciprocity Agreement, CPs operating multiple switching layers could apply for so-called Multi-Switched Operator ("MSO") status, which provided for an uplift to their termination rate based on the proportion of BT traffic delivered to their higher tier of switches.

1.10 However, under the expired Reciprocity Agreement, charging a higher rate in these circumstances was conditional on BT being able to avoid such additional conveyance rates by building out to the CP's local switches. In submitting this dispute, Colt explained that it did not seek such an uplift to its termination rate because it required most geographic call traffic from BT to be handed over at its tandem switches in order to support a resilience service provided to its customers.[7]

1.11 Instead, Colt argued that it should be entitled to a higher termination rate because the way its previous blended rate was calculated was unfair and unreasonable. As noted above, under the expired Reciprocity Agreement, a CP's termination rate was determined by the mix of traffic it sent to BT's tandem and local switches. So, a CP sending half its traffic to BT's local switches and half to BT's tandem switches, would in turn receive a termination rate which was a 50/50 mix of BT's LE rate and ST rate.[8]

1.12 Colt had however previously chosen to send some of its outbound traffic to BT[9] via a third party transit operator (for which it pays less than BT's ST termination rate). Under the terms of the expired Reciprocity Agreement this traffic was not included within the calculation of Colt's termination rate (instead it was counted as traffic "belonging" to the transit provider and was included in the calculation of that provider's termination rate). Almost all Colt's traffic to BT was therefore seen as

[6] See: http://stakeholders.ofcom.org.uk/enforcement/competition-bulletins/open-cases/all-open-cases/cw_01054/
[7] Colt dual-hosts some customers' geographic telephone numbers on **[✂]** local switches and therefore requires traffic to be delivered to its tandem switches in order to deliver calls to the called party over these local switches.
[8] BT's ST rate is higher than its LE rate.
[9] The traffic which it might otherwise have sent to BT's tandem switches as the traffic was destined for a BT local switch to which Colt did not have a direct connection.

being delivered to BT's local switches resulting in Colt's 'blended' termination rate being close to BT's LE rate.

1.13 Colt maintained that its choice to use a transit provider should make no difference to the rate BT pays Colt for terminating calls on its network. Moreover, Colt alleged that excluding such transit traffic from the formula for calculating its termination rate distorts the transit market. Therefore, in Colt's opinion, as the Reciprocity Agreement had expired, any new agreement between it and BT should rectify this defect by treating this transit traffic as traffic delivered directly by Colt to BT's tandem switches within the formula in the expired Reciprocity Agreement, in order to determine a fair and reasonable termination rate.

1.14 As part of our ongoing policy work, we published a consultation document on 16 September 2010 (the "September 2010 Consultation"), in which we set out our proposed guidance on fair and reasonable fixed termination rates and sought views on options – and put forward a preferred option – which would replace the calculation of rates as previously set by the now expired Reciprocity Agreement. While this guidance is subject to industry consultation, we also proposed in the September 2010 Consultation that, in the interim period until any new guidance takes effect, arrangements should continue on the basis of the expired Reciprocity Agreement unless there had been some material changes of fact since its expiry.[10]

1.15 While Colt submitted this dispute before the publication of the September 2010 Consultation, in light of this ongoing programme of work, Colt only requested the application of its proposed approach for the interim period until this new guidance takes effect.

1.16 In contrast, BT considered that in advance of Ofcom's final guidance on fixed termination rates, it would be inappropriate for Ofcom to decide on the rates that should apply to traffic between BT and Colt as the result of the dispute. It said that, absent any industry-wide agreement on any alternative arrangements, it is fair and reasonable in the interim to continue to act in accordance with previously agreed principles and not to deviate from them on a bilateral basis.

1.17 In reaching our conclusions we have considered whether Colt's proposed rates are fair and reasonable by framing our analysis within the six principles of pricing and cost recovery, which we have used in previous disputes.[11] We have also considered our general statutory duties and Community obligations under sections 3 and 4 of the Act to ensure that our decision is consistent with those duties.

Consultation on the draft determination

1.18 Based on our analysis, we provisionally concluded that Colt's proposal set out in its OCCN of 14 December 2009 was not fair and reasonable in line with SMP Condition BC1. We issued a draft determination for consultation on 19 November 2010 and

[10] See paragraph 1.39 of the September 2010 Consultation, http://stakeholders.ofcom.org.uk/binaries/consultations/778516/summary/condoc.pdf.

[11] See for example: 'Determination under Section 190 of the Communications Act 2003 and Direction under Regulation 6(6) of the Telecommunications (Interconnection) regulations 1997 for resolving a dispute between Orange Personal Communications Services Ltd. ('Orange') and BT concerning the cost sharing arrangements for Customer Sited Interconnect ('CSI') links connection and rental charges', 19 November 2003. See also 'Direction concerning ADSL Broadband Access Migration Services; and a Draft Determination to resolve a dispute between Tiscali, Thus and BT concerning ADSL Broadband Access Migration Services', 9 August 2004; 'Determination to resolve a dispute between BT and Telewest about geographic call termination reciprocity agreement', June 2006; 'Dispute between Cable and Wireless and T-Mobile about mobile termination', May 2009.

published a non-confidential version of this draft determination on the CCEB on 22 November 2010. In response, we received submissions from BT, Colt, Verizon and two companies, **[✂]** and **[✂]** who asked to remain anonymous.

Our final conclusions

1.19 Having considered the responses to our draft determination we have decided not to change our provisional conclusion set out in that document. We have therefore concluded, based on our analysis under the six principles and consideration of responses thereon, that Colt's proposed termination rates as set out in its OCCN of 14 December 2009 are not fair and reasonable.

1.20 In particular, we consider that there is mixed evidence as regards the principles of cost minimisation and effective competition, but our analysis does not provide clear or unambiguous support for Colt's proposals. We consider that the principle of reciprocity is not determinative in this dispute. Our analysis of the principles of cost causation, distribution of benefits and practicability do not support Colt's proposal.

1.21 Having rejected Colt's proposal, our determination set out in Annex 1 requires the parties to revert to the previous terms on which they did business, unless and until they agree other terms. We note that such terms might be modified to reflect any changes to BT's ST and LE rates in the interim and any re-sampling of Colt's traffic delivered to BT's local and tandem switches, and that this is a matter on which the parties have not yet engaged in commercial negotiations.

1.22 The background to this dispute is set out in Section 2; the history to this dispute is set out in Section 3. Section 4 sets out the analysis upon which we consulted in the draft determination and Section 5 sets out the detailed comments we received in response to the draft determination. In this document we have not amended Sections 2, 3 and 4,[12] but have instead provided further consideration of our analysis, where necessary to address responses made to our draft determination, in Section 5. Our formal determination of this dispute is set out in Annex 1.

[12] We have not amended Sections 2, 3 and 4 of this document from those Sections that were published in our draft determination with the exception of the noted amendments to paragraphs 3.7, 3.33, 3.63, 4.16, 4.22, 4.30 and to footnotes in paragraphs 3.63 and 4.16. Also the assessment of our conclusions against Ofcom's statutory duties and Community requirements that appeared in Section 4 of the draft determination has been updated and incorporated into Section 5.

Section 2

Ofcom's powers and the policy background to this dispute

Dispute resolution

Ofcom's duty to handle disputes

2.1 Section 185(1)(a) of the Act provides (in conjunction with section 185(3)) that in the case of a dispute relating to the provision of network access between different CPs, any one or more of the parties to such a dispute may refer it to Ofcom. Similarly, section 185(2)(a) (in conjunction with section 185(3)) provides that in the case of a dispute between CPs relating to the rights and obligations conferred or imposed under Part 2 of the Act, any one or more of the parties to such a dispute may refer it to Ofcom.[13]

2.2 Section 186 of the Act provides that where a dispute is referred to Ofcom in accordance with section 185, Ofcom must decide whether or not it is appropriate to handle it. Section 186(3) further provides that Ofcom must decide that it is appropriate for it to handle a dispute unless there are alternative means available for resolving the dispute, a resolution of the dispute by those means would be consistent with the Community requirements set out in section 4 of the Act, and those alternative means would be likely to result in a prompt and satisfactory resolution of the dispute.

2.3 In summary therefore, where a dispute which falls within section 185(1)(a) and/or section 185(2) of the Act is referred to Ofcom, and Ofcom cannot identify alternative means which meet the criteria set out above, it has a duty to decide that it is appropriate to handle that dispute.

2.4 Section 188 of the Act provides that where Ofcom has decided that it is appropriate for it to handle a dispute, Ofcom must make a determination resolving the dispute within four months, except in exceptional circumstances.

Ofcom's powers when determining a dispute

2.5 Ofcom's powers in relation to making a dispute determination are limited to those set out in section 190 of the Act. With the exception of disputes relating to the management of the radio spectrum, Ofcom's main power is to do one or more of the following:

- Make a declaration setting out the rights and obligations of the parties to the dispute;
- Give a direction fixing the terms or conditions of transactions between the parties to the dispute;
- Give a direction imposing an obligation to enter into a transaction between themselves on the terms and conditions fixed by Ofcom; and

[13] Provided the dispute is not excluded pursuant to section 185(7).

- Give a direction requiring the payment of sums by way of adjustment of an underpayment or overpayment, in respect of charges for which amounts have been paid by one party to the dispute, to the other.

2.6 A determination made by Ofcom to resolve a dispute binds all the parties to that dispute (section 190(8)). Whilst Ofcom's dispute resolution powers can therefore only bind the parties to a dispute on a bilateral basis, we would expect dispute determinations to be read across and followed in situations where other parties who were not a party to the dispute, are facing similar questions vis-à-vis one of the parties to the dispute which has been determined.

Ofcom's duties when determining a dispute

2.7 The dispute resolution provisions set out in sections 185-191 of the Act are functions of Ofcom. As a result, when Ofcom resolves disputes it must do so in a manner which is consistent with both Ofcom's general duties in section 3 of the Act, and (pursuant to section 4(1)(c) of the Act) the six Community requirements set out in section 4 of the Act, which give effect, amongst other things, to the requirements of Article 8 of the Framework Directive.[14]

Call termination – wholesale arrangements

2.8 This dispute relates to the charges payable by BT for the termination of fixed geographic calls on Colt's network from 1 March 2010, as proposed by Colt[15].

2.9 CPs buy call termination services from each other in order to provide their customers with end-to-end calls between different networks. In the case of this dispute, BT pays Colt for termination of calls on Colt's network.

2.10 The network to which the caller is connected is called the 'originating network' and the caller's CP is known as the Originating Communications Provider ("OCP"). Similarly the network on which the call terminates is called the 'terminating network' and the CP is known as the Terminating Communications Provider ("TCP"); not all originating networks have a direct connection to all terminating networks. Some OCPs therefore pass calls for termination via other networks (most commonly BT's network), purchasing a transit service from that operator to do so. In the case of originating networks purchasing transit via BT's network to a third party's network, the total charge payable to BT by those OCPs will reflect charges for transit across BT's network and the charges BT has to pay for buying termination on the TCP's network.

SMP in fixed geographic call termination

2.11 On 28 November 2003 Ofcom published the findings of its review of fixed geographic call termination markets ("the 2003 Market Review").[16]

2.12 In the 2003 Market Review, Ofcom found that the provision of fixed geographic call termination services on each CP's network constitutes a separate market. Ofcom designated each of the CPs as having SMP in the markets for fixed geographic call

[14] Directive 2002/21/EC of 7 March 2002.

[15] In its submission of 10 August 2010 (page 4), Colt additionally asked Ofcom to direct BT to make payments on the basis of the same proposal for the period since 1 October 2009.

[16] Review of fixed geographic call termination markets, Identification and analysis of markets, determination of market power and setting of SMP conditions: Final Explanatory Statement and Notification, 28 November 2003 http://stakeholders.ofcom.org.uk/binaries/consultations/750148/Eureviewfinala1.pdf

termination on their own networks and imposed certain SMP conditions on those CPs, as set out in the notification which accompanied that review.

2.13 The fixed geographic call termination market was reviewed again as part of Ofcom's 2009 Review of the fixed narrowband services wholesale markets, published on 15 September 2009 ("the 2009 Market Review").[17]

2.14 In the 2009 Market Review, Ofcom again found that each CP's network constitutes a separate market, that each of the CPs held SMP in the markets for fixed geographic call termination on their own networks and imposed SMP conditions on those CPs that broadly mirrored the SMP conditions that had previously been imposed on CPs under the 2003 Market Review. The full SMP conditions are set out in the notification which accompanied that review.[18]

2.15 BT is subject to SMP Condition BA1[19] which requires it to provide network access (in this case, fixed geographic call termination) on terms, conditions and charges that are fair and reasonable.

2.16 In addition, BT is subject to SMP Condition BA3[20], which requires it to base its charges for fixed geographic call termination on forward looking long run incremental costs ("LRIC")[21], and SMP Condition BA4[22], which imposes a charge control on BT's fixed geographic call termination charges.

2.17 Other CPs[23] (including Colt) were also designated as having SMP in the market for fixed geographic call termination on their respective networks. These CPs are consequently subject to SMP Condition BC1[24] which requires them to provide network access (in this case, fixed geographic call termination) on terms, conditions and charges that are fair and reasonable. This condition ensures that these other CPs are not able to exploit the SMP they enjoy in respect of fixed geographic call termination on their own networks by the imposition of excessive charges, the harmful effects of which would ultimately be borne by consumers.

BT's charges for terminating calls on its network

2.18 In seeking to comply with these obligations and similar obligations in place prior to changes in regulatory rules introduced in 2003, BT publishes a Carrier Price List ("CPL"). Among other things, this sets out at section B1, part 1.01, the charges for "BT Telephony Calls to the BT System" – i.e. the charges BT applies to OCPs for terminating fixed geographic calls on the BT network. Different pence per minute charges are applied to each call depending on the time of day the call is made and the level within the BT network that the call is handed over to BT by the OCP:

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[17] http://stakeholders.ofcom.org.uk/binaries/consultations/wnmr_statement_consultation/summary/main.pdf

[18] Please see the 2009 Market Review, http://stakeholders.ofcom.org.uk/binaries/consultations/wnmr_statement_consultation/summary/main.pdf and the corrections to the 2009 Market Review published on 22 October 2009 at http://stakeholders.ofcom.org.uk/binaries/consultations/wnmr_statement_consultation/corrections.pdf

[19] As set out at part 2 of Schedule 1 of the Notification to the 2009 Market Review.

[20] As set out at part 2 of Schedule 1 of the Notification to the 2009 Market Review.

[21] This allows an appropriate mark up for the recovery of common costs – i.e. LRIC+

[22] As set out in Schedule 2 of the statement on the 2009 Market Review.

[23] The CPs named under Annex A to Schedule 3 of the Notification to the 2003 Market Review and Annex A to Schedule 3 of Annex 7 of the 2009 Market Review.

[24] As set out at part 2 of Schedule 3 of the Notification to the 2003 Market Review and part 2 of Schedule 3 of the Notification to the 2009 Market Review.

- The "Call Termination Local Exchange" rate[25] applies to calls handed by the OCP to BT at the local switch for the network termination point relevant to that call;

- The "Single Tandem Call Termination" rate[26] applies to calls handed by the OCP to BT at the tandem exchange connected to the relevant local switch for that call; and

- The "Double Tandem Call Termination" rate applies to calls handed by the OCP to BT at other tandem switches within the BT network, with different charges applying dependent on the radial distance between the tandem exchange to which the call is handed and the tandem exchange connected to the relevant local switch for that call:

  - "Double Tandem (short)" rates apply when the radial distance is less than 100km;

  - "Double Tandem (medium)" rates apply when the radial distance is between 100km and 200km; and

  - "Double Tandem (long)" rates apply when the radial distance is greater than 200km.

History of reciprocity

Network Topology

2.19 Annex C to the 1997 Network Charges Statement[27] published by Oftel discussed Oftel's approach to the reciprocal charges for call termination on OLO[28] networks (i.e. OLOs' termination rates being set on a reciprocal basis to BT's termination rates).

2.20 In that document[29], Oftel noted that:

> "OLO's tend to have a different topology to BT. For example, typically in a cable operator's network, one switch covers a catchment area larger than that covered by a BT local switch. Therefore the call termination service on an OLO network corresponds to two services on BT's network: local exchange and Single Tandem. In such circumstances, theoretically the competitively neutral position would be that the OLO would receive a mix of local exchange segment and Single Tandem rates, depending on what the composition of interconnect calls to OLO tandem and local switches would be if, hypothetically, the OLO were to have both local and tandem switches. Since the correct charge for each call minute depends upon a counterfactual it cannot be known with accuracy".

2.21 Later in this Annex, Oftel discussed potential approaches for the application of reciprocity to call termination but noted that it was for BT and industry to negotiate

[25] Referred to throughout this document as "Local Exchange rate" or "LE rate".
[26] Referred to throughout this document as "Single Tandem rate" or "ST rate".
[27] Network Charges from 1997: Annexes to the Statement, Oftel, July 1997, http://www.ofcom.org.uk/static/archive/oftel/publications/1995_98/pricing/nccjulap.htm.
[28] Other Licensed Operators, i.e. term used to categorise networks other than BT under the pre-2003 regulatory regime legislated under the Telecommunications Act 1984.
[29] Annex C, paragraph C.12, ibid.

and agree on an approach for setting OLOs' termination charges given a set of key objectives.[30]

Reciprocal charging

2.22 Following the publication of this Oftel document, industry negotiated and agreed an approach to reciprocal charging. This was set out in an agreement which has become known as the Reciprocity Agreement. This agreement has been renewed twice in the intervening period (in 2001 and in 2005), but industry's approach to reciprocity has remained broadly the same throughout.

2.23 Since 1997 charges for fixed geographic call termination on networks other than those of BT and KCOM (in the Hull Area) have therefore been calculated on the basis of a principle of reciprocal charging. Under this principle, TCPs charges for fixed geographic call termination services are based on BT's equivalent regulated, cost-oriented charges.

2.24 In both the 2003 and 2009 Market Reviews and in other decisions[31] Oftel and Ofcom said that they considered that fixed geographic termination rates that were not reciprocal to BT's termination rates were unlikely to be fair and reasonable, while nevertheless noting that any dispute would need to be reviewed on its relative merits.

2.25 In 2005, industry consensus was reached on the terms of the now expired Reciprocity Agreement, which was to apply for a further period of 4 years from 1 October 2005 to 30 September 2009. [32]

2.26 One CP, Telewest, rejected the terms of this Reciprocity Agreement and put forward its own proposal for calculating its termination charges. Telewest's proposal was to set its charges for single switched termination at the prevailing BT ST rate. In its determination[33] of this dispute, Ofcom said that as far as Single Switch Operator ("SSO") charges were concerned, the terms proposed by BT (i.e. the Reciprocity Agreement terms) broadly complied with one of the approaches to reciprocity identified by the Director General in the 1997 statement, specifying that:

> "This approach involves calculating a single charge for other CPs' call termination as a weighted average of BT's local exchange segment and Single Tandem segment charges, using actual volumes of other CP to BT traffic to compute the weights. Furthermore, the approach recognises the topological differences between the networks of BT and the other CPs' since call termination on other CPs' networks can be characterised as corresponding to two interconnection services on BT's network: local

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[30] See paragraph C31. Oftel believed that these key objectives were: "promoting effective competition by ensuring competitive neutrality; providing operators with sound make or buy investment signals; giving strong incentives for operators to minimise costs; and choosing an approach that is practical to implement".

[31] See Ofcom's Resolution of a dispute between BT and Telewest about reciprocal charging arrangements for call termination rates, 16 April 2004, http://stakeholders.ofcom.org.uk/binaries/enforcement/competition-bulletins/closed-cases/all-closed-cases/cw_710/tw_bt_res.pdf; Determination to resolve Dispute between Opal Telecom and BT about Opal's Fixed Geographic Termination Rates, 26 October 2009, paragraph 2.2 http://stakeholders.ofcom.org.uk/binaries/consultations/draft_deter_opal_telecom_bt/Final_determination.pdf.

[32] BT payments to fixed operators for fixed telephony' (Annex to BT's Standard Interconnect Agreement). http://www.btwholesale.com/pages/static/service_and_support/service_support_hub/online_pricing_hub/cpl_hub/cpl_pricing_hub/reciptory_offer.html

[33] Determination to resolve a dispute between BT and Telewest about geographic call termination reciprocity agreement, Ofcom, 16 June 2006, http://stakeholders.ofcom.org.uk/binaries/enforcement/competition-bulletins/closed-cases/all-closed-cases/cw_890/determination.pdf

exchange and Single Tandem segment. Other CPs' call termination charges should therefore be a combination of BT's charges for these two services"[34].

2.27 As explained above, this Reciprocity Agreement remained in place until 30 September 2009. Industry has so far failed to agree a replacement and, since 1 October 2009, BT has essentially continued to do business with other CPs according to the terms of the expired Reciprocity Agreement.

2.28 On 26 October 2009 Ofcom published its final determination in relation to a dispute between Opal Telecom and BT about Opal's fixed geographic termination rates.[35] In this dispute Opal argued that BT was delivering traffic to the equivalent of Opal's tandem switches and that Opal should therefore be receiving BT's ST rate. Our analysis demonstrated that BT could not deliver traffic to a lower point within Opal's network and therefore BT's ST rate was not appropriate.

How the expired Reciprocity Agreement worked in practice

2.29 The expired Reciprocity Agreement contained a mechanism for calculating charges for the termination of calls originated on BT's network (or transiting across it) and terminated on Colt's network. The expired Reciprocity Agreement distinguished between CPs with single-switch status (SSOs) and those with multi-switch status (MSOs). Single switch status referred to networks to which BT handed calls at the CP switch on which the call terminated (i.e. the switch to which the called customer of the CP was directly connected). Multi-switch status referred to networks to which BT handed a proportion of calls to a CP switch other than that to which the called customer was connected, so that multiple switches in the terminating networks were used by the CP to complete a call.

2.30 CPs other than BT with more than a certain proportion (specifically 10%) of multi-switched calls could apply for MSO status. Under the agreement, BT paid these MSOs a higher termination charge to reflect the additional switching and conveyance required to terminate such calls. All other CPs received termination payments from BT based on the single switch call charge.

2.31 This single switched call charge (Rate A) was calculated as a weighted average of BT's ST and LE conveyance rates. The weights that applied to this calculation mirrored the mix of geographic call termination traffic sent from the CP to the relevant BT tandem and local exchange switches[36]. Specifically, the proportion sent by the CP to BT's local exchange switches (the 'X' ratio) and tandem switches (1-X) were the weights applied to the corresponding BT rates, LE and ST, in the BT CPL. These proportions were calculated on the basis of a sample of traffic taken each May and November, and then applied to the charge which was activated in October. Thus the X ratio could change over time (with a slight time lag) and was tailored to each network depending on how that network interconnected with the BT network.

[34] See paragraph 86, Ibid.
[35] http://stakeholders.ofcom.org.uk/binaries/consultations/draft_deter_opal_telecom_bt/Final_determination.pdf
[36] Account is also taken of Carrier Pre Selection Same/Adjacent DLE (CPS SAD) traffic where CPS calls that originate on BT's network and which terminate on the same DLE (or an adjacent DLE directly connected to the originating DLE) are routed end to end on the BT network rather than being handed over to the other CP.

2.32 For MSOs, the multi-switched call charge (Rate B) was a weighted average of Rate A (determined as in the previous paragraph) and BT's Double Tandem (short) rate[37]. The weights used to determine Rate B were (1-Y) and Y, where Y was the number of multi-switched minutes handed over by BT to the CP divided by the total number of minutes handed over by BT to the CP (i.e. both single switched and multi-switched).

2.33 From the above it can be seen that the expired Reciprocity Agreement covered more than just termination – it included charges for switching and conveyance stages which were not related to the switching and conveyance from the switch closest to the called customer.

2.34 Table 1 below sets out the calculation of Rates A and B.

Table 1 - calculation of fixed geographic termination rates

Rate A – Single Switch Operator rate
The CP's May invoice from BT is analysed to identify: • Total number of minutes sent to BT at local exchange rate • CPS local exchange call minutes • Total number of minutes sent to BT at Single Tandem rate This data is then used to calculate the weighting factor 'X', where: • X = (Total number of minutes sent to BT at local exchange rate + CPS local exchange call minutes)/(Total number of minutes sent to BT at local exchange rate + CPS local exchange call minutes + total number of minutes sent to BT at Single Tandem rate) Then a rate for each time of day is calculated: • Rate A = (X x BT Call Termination Local Exchange rate) + ((1 – X) x BT Single Tandem Call Termination rate) Rate A will change whenever the rates in BT's Carrier Price List change. X will be set for 12 month period from 1 October based on the May call analysis.
Rate B – Multi-Switch Operator rate
Ratio Y is the percentage of all "relevant minutes" sent by BT to the CP which are minutes terminated as Multi-Switched Calls. Ratio Y is checked and calculated twice yearly in May and November. If Y falls below lower threshold of 7.5% for two consecutive calculations, then the CP loses MSO status and rate A will apply until Y exceeds 10% as set out above. Rate B is calculated as:

[37] These charges are published at Section C1 of BT Wholesale's Carrier Price List at http://www.btwholesale.com/pages/cmsjsps/service_and_support/service_support_hub/online_pricing_hub/cpl_hub/cpl_pricing_hub/cpl_browsable_sections/cpl_browsable_sectionb_c.jsp.

- Rate B = (Y x BT Double Tandem (short) rate) + ((1-Y) x rate A)

Rate B changes when BT's Carrier Price List conveyance charges change and when Rate A changes in line with recalculation of X.

Y is recalculated twice a year using May and November data.

Ofcom's 2010 review of fixed geographic termination

2.35 The 2009 Market Review noted that, in the past, industry had used the Reciprocity Agreement as the mechanism for setting termination charges.[38] We also said that it would be appropriate for industry to renegotiate a new agreement rather than Ofcom imposing it as a regulatory requirement.[39]

2.36 Following the expiry of the Reciprocity Agreement in 2009, negotiations between CPs failed to identify a way forwarding because of diverging views. We recognised that fixed network operators may find it difficult to reach satisfactory agreement on all aspects of a new reciprocity agreement by commercial negotiation alone. The resulting uncertainty could be disruptive to the industry and result in a number of disputes between CPs. In order to help operators in their negotiations, we have undertaken a policy review with the aim of providing guidance on how termination rates should be set between fixed networks.

2.37 In our September 2010 Consultation we proposed guidance to industry on how we would interpret the obligation in SMP Condition BC1 for CPs' termination charges to be 'fair and reasonable' in future. [40] We also recognised that some uncertainty may persist as to what was fair and reasonable to charge in the period between the expiry of the Reciprocity Agreement on 30 September 2009 and the point at which we will apply our new guidance (which may follow a period of time for industry adjustment). In discussing what is fair and reasonable for this period, we referred to our 2009 Market Review. There, we adopted a position which was a continuation of the approach taken in previous market reviews, i.e. that other CPs charges which were not based on BT's charges were unlikely to be "fair and reasonable" as BT's costs are used as a proxy for an efficient network.[41]

2.38 Our provisional view on arrangements for this interim period is set out in paragraph 6.6 of the September 2010 Consultation as follows:

> "Until such time as we publish our final guidance, we consider that, unless a party's circumstances have materially changed since the expiry of the last Reciprocity Agreement, it is unlikely to be fair and reasonable to charge for fixed call termination on something other

[38] This refers to TCPs who have used the expired Reciprocity Agreement under a consensus approach.
[39] See paragraph 12.85 of the consultation document on the Review of the fixed narrowband services wholesale Markets, Consultation on the proposed markets, market power determinations and remedies, 19 March 2009, http://stakeholders.ofcom.org.uk/binaries/consultations/review_wholesale/summary/fnwm.pdf
[40] Fair and reasonable charges for fixed geographic call termination, a consultation on draft guidance, published 16 September 2010, http://stakeholders.ofcom.org.uk/binaries/consultations/778516/summary/condoc.pdf. We intend to publish final guidance, once we have given careful consideration to responses received to the consultation, early in 2011.
[41] See http://stakeholders.ofcom.org.uk/binaries/consultations/wnmr_statement_consultation/summary/main.pdf , paragraphs 12.70 to 12.73.

than the same basis and terms as were provided for under the expired Reciprocity Agreement."

Section 3

History of the dispute

3.1 This Section sets out the general background and context to this dispute, including the history of negotiations on a new Reciprocity Agreement.

Negotiations on a new Reciprocity Agreement

3.2 As set out in the previous Section, the Reciprocity Agreement expired on 30 September 2009, but prior to this industry had attempted unsuccessfully to negotiate a revised agreement. The chronology of negotiations between Colt and BT, and other cross-industry negotiations are set out in Table 2 below. We have included relevant comments from Colt's dispute submission in this table.

Table 2 History of commercial negotiations on reciprocity and Colt's OCCNs

Date	Event	Comments from Colt
19 March 2009	2009 Market Review consultation published by Ofcom	
2 June 2009	Industry meeting hosted by BT at which Cable and Wireless ("C&W") presented ideas for the future of reciprocity arrangements.	C&W proposes a "right switch, wrong switch" formula where the termination charges made by CPs would reflect those made by BT. Delivery of traffic to the wrong switch would be charged at Tandem rates and delivery to the right switch would be charged at LE rates. BT proposed keeping the existing framework but with any changes in Local Tandem if it was deregulated.
30 June 2009	Industry only pre-meeting chaired by Colt.	
2 July 2009	Industry and BT meeting, chaired by BT.	
3 July 2009	C&W circulated a draft proposal for a new reciprocity arrangement.	

13 July 2009	C&W published a draft of their "right switch, wrong switch" proposal for reciprocity.	
23 July 2009	Further industry plus BT meeting held.	C&W pushed for their proposal to be considered as a serious alternative to the BT proposal. C&W committed to revise their proposal in light of CP comments.
5 August 2009	C&W circulated a revised proposal for reciprocity arrangements.	
5 August 2009	BT wrote to CPs stating that it was going to roll over the expired Reciprocity Agreement to the new period of charge control beginning 1 October 2009.	
30 September 2009	Reciprocity Agreement expired.	
2 October 2009	BT issued ACCN 978 announcing an increase in BT geographic termination rates.	
5 November 2009	BT sent via email an OCCN to COLT, and all other affected CPs, setting out higher termination rates that it would pay as a result of ACCN 978 (issued 2 October 2010).	
11 November 2009	BT issued Briefing ref 338-09 stating that BT would continue to roll over the expired Reciprocity Agreement on the new rates from January 2010. BT stated that it would continue to progress discussions for a new reciprocity agreement.	
3 December 2009	Colt and BT held a conference call	BT stated that it was proposing to make an offer to industry where SSO and MSO status would be removed and all CPs would

		receive the same termination rate. The termination rate would be based on the industry average split between DLE delivery (75%) and ST delivery (25%).
14 December 2009	Colt issued BT with an OCCN proposing new geographic termination rates based on Colt's mix of traffic sent to BT's geographic numbers.	
16 December 2009	BT withdrew the OCCN issued on 5 November from all CPs which did not accept it, including Colt. Their existing termination rates continued to apply.	
18 December 2009	BT rejected the 14 December OCCN.	
23 December 2009	Colt sent BT an OCCN proposing new geographic termination rates based on BT's proposal for an industry-wide X ratio, as put forward in the meeting between BT and Colt on 3 December 2009.	
18 January 2010	Colt and BT had a meeting to discuss Colt's termination rate and the meeting ended in deadlock.	

Source: Ofcom

Colt's OCCN of 14 December 2009

3.3 This dispute is about Colt's notification to BT via its OCCN of 14 December 2009 of proposed charges payable by BT to Colt for traffic originating on BT's network, or transiting across it, and terminating on Colt's network.

3.4 The revised rates set out in the 14 December 2009 OCCN are set out in Table 3 below:

Table 3

Existing Charge(s)			Proposed Charge(s)			
Daytime PPM	Evening PPM	Weekend PPM	Daytime PPM	Evening PPM	Weekend PPM	Effective Date(s)
.2455	.1124	.0885	[✂]	[✂]	[✂]	01/03/10

3.5 Colt provided reasons in the OCCN for the charge change as follows:

> "On 15 September 2009 Ofcom published a Policy Statement on BT's Network Charge Controls. The new period of Charge Control began on 1 October 2009 and BT has announced an increase in its conveyance charges from 1 January 2010. Under the previous period of charge control BT operated a system of "reciprocity" to determine operator termination rates. The reciprocity agreement expired on 30 September 09 with the end of the previous Charge Control.
>
> In May-July 2009 COLT participated in industry discussions to determine what the new reciprocity arrangements should be. These discussions concluded without industry agreement. BT has stated that it is currently considering making a revised proposal for "modified reciprocity" to industry in 2010.
>
> Under the previous formula of reciprocity BT measured the split between Local Exchange (DLE) and Tandem (ST) geographic traffic terminated by BT from Colt. BT used this formula to impose termination rates on Colt for traffic originated or transited by BT and terminated on Colt's network.
>
> In comparison to other CPs Colt was disadvantaged by this formula since Colt's Tandem traffic was sent to BT via a third party Tandem CP. This meant that the tandem traffic was not measured by BT and therefore the termination rate imposed by BT on Colt was made up of nearly 100% of the DLE rate. Colt has measured its DLE and ST traffic in the sample month of May 2009 and has calculated termination rates using BT's reciprocity formula."

3.6 BT rejected Colt's OCCN on 18 December 2010 as it was of the view that "it is neither a fair nor reasonable rate for termination of calls on the Colt network."[42]

3.7 As set out above, after the submission by Colt of an alternative OCCN on 23 December 2009 and its rejection by BT, the parties met on 18 January 2010 to discuss Colt's termination rate but concluded that their negotiations were deadlocked. During the enquiry phase of this dispute we sought to clarify with Colt which termination rates it was seeking to define as fair and reasonable, i.e. those contained in the OCCN of 14 December 2009 or the OCCN of 23 December 2009. In its letter of 26 August 2010, Colt stated: "This dispute is therefore simply about Colt's

[42] Colt's dispute submission of 10 August 2010, page 25.

right to include the **[✂]** LTT traffic in the reciprocity formula (...)" and that "We are therefore defining the OCCN of 14 December as being fair and reasonable."[43]

Colt dispute referral to Ofcom

3.8 Colt submitted its dispute to Ofcom on 10 August 2010.

3.9 Following the initial submission from Colt, we have received additional comments from both parties, as a result of which we concluded that a genuine deadlock existed between Colt and BT and that it was appropriate for us to accept the dispute.

Ofcom's decision to open a dispute

3.10 On 2 September 2010 we informed Colt and BT of our decision that it was appropriate for us to accept the dispute for resolution on the basis of section 186(3) of the Act. We did not consider that there were alternative means available for resolving the dispute which could provide a prompt and satisfactory resolution.

Scope of the dispute

3.11 After considering Colt's original submission and BT's response[44], we concluded that our proposed scope of the dispute would be to:

> "determine whether the fixed geographic termination rate proposed by Colt to BT in its OCCN of 14 December 2009, with effect from 1 March 2010, for terminating on Colt's network calls originating on, or transiting across, BT's fixed network is fair and reasonable in accordance with SMP Condition BC1; this rate being equivalent to Rate A, calculated as per the expired Reciprocity Agreement between Colt and BT, but treating traffic routed by Colt via a third party transit provider as traffic delivered by Colt to BT at Single Tandem level for the purposes of that calculation."

3.12 In line with our standard procedures, we published the proposed scope on the Competition and Consumer Enforcement Bulletin and invited comments from Colt, BT and any other interested parties.

Colt's dispute submission

3.13 Colt considered the formula under the expired Reciprocity Agreement to be "a relic and distortive of competition, particularly in relation to Local-Tandem Transit ("LTT") and conveyance".[45] In its submission, Colt requested that Ofcom determine the form in which reciprocity should be applied in the interim period from 1 October 2009 up to such time as new arrangements take effect as a result of Ofcom's policy work on reciprocity in geographic termination rates (see paragraphs 2.35-2.38 above).

3.14 Colt requested that Ofcom should direct BT to pay Colt's termination rates as specified in the OCCN of 14 December 2009. Whilst Colt's OCCN of 14 December

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[43] In our draft determination we said that "Colt has confirmed to Ofcom that it does not wish us to consider the second OCCN issued on 23 December 2009 as part of this dispute". In its response to our draft determination Colt disagreed with this characterisation and this paragraph has therefore been amended.
[44] Both Colt and BT confirmed that they had no comments on the scope of the dispute.
[45] Colt's submission of 10 August 2010 "Geographic termination charges: dispute between Colt and BT", paragraph 8.1.

2009 would only apply from 1 March 2010, Colt asked Ofcom in its dispute submission to direct BT to make payments on the same basis for the period since 1 October 2009.[46] These rates had been calculated using Colt's traffic figures from May 2009; and in accordance with the formula in the expired Reciprocity Agreement except that Colt traffic sent to BT using **[✂]**for LTT is treated as traffic delivered to BT's tandem switches.

3.15 Colt's proposal therefore essentially continues to apply the mechanism of the expired Reciprocity Agreement of setting its termination rate as a blend of BT's LE and ST rates weighted according to how Colt's traffic is delivered to BT, the only change being the treatment of third party provided LTT traffic. In its submission Colt stated that it does not seek to challenge the current principle and BT's application of reciprocity in this dispute.

3.16 Colt stated that its proposal was aimed at correcting what it considered to be a competitive distortion created by the expired Reciprocity Agreement between LTT provided by third party transit operators and Local-Tandem Conveyance ("LTC") provided by BT.

Colt's network

3.17 Colt operates a tandem-structured network which covers part of the UK, predominantly London. **[✂]** tandem switches are fully meshed with **[✂]** DLE switches. Colt had SSO status under the expired Reciprocity Agreement both because Colt agreed not to seek MSO status for a period after a network reorganisation in 2000 (see paragraphs 3.65 to 3.71 below) and because Colt considered that its technical requirements could not be met under the expired Reciprocity Agreement.

Figure 1 [✂]

3.18 Figure 1 shows how Colt's network interconnects with BT's at two levels. Where it is lower cost (on the basis of costs or charges incurred by Colt) Colt interconnects with BT at its local switches. This requires Colt to incur the expense of building or renting links to extend its network to BT local switches. In these cases the cost to Colt of extending its network to the BT local switch is offset by reducing its out-payments to BT's lower LE termination rate rather than the ST rate. When it is not privately profitable to extend out to one of BT's local switches, Colt has the option of either delivering traffic to BT's tandem switches, or sending the traffic to a third party network to deliver to the relevant BT local switch. In the second option, the third party is providing a transit service (specifically LTT). Colt believes it is important for competition and customers for there to be a choice between LTT and LTC provided by BT.

3.19 Colt presently interconnects with **[✂]** BT local switches. Local switch interconnection accounts for **[✂]**% of Colt's traffic to BT fixed lines. Instead of sending the remaining **[✂]**% to BT's tandem switches, since 2005 Colt has passed this traffic to a third party LTT provider which delivers it using its own direct connections to BT's local switches.

3.20 Because Colt has chosen to route traffic to BT in this way, the termination rate Colt receives under the formula set out in the expired Reciprocity Agreement (see Table 1 above) is close to BT's LE rate. Colt's OCCN of 14 December 2009 sought to include

[46] Colt's submission of 10 August 2010 "Geographic termination charges: dispute between Colt and BT", page 4.

traffic sent via its LTT provider in the (1-X) part of the formula, which would result in a formula where X was equal to **[✂]** and therefore (1-X) was equal to **[✂]**.

3.21 Table 4 below sets out BT's termination rates for traffic delivered to local and tandem switches[47], the reciprocal rate that would be paid to a CP where there is a **[✂]** split between traffic delivered to local and tandem switches (i.e. Colt's proposed blended rate), and the current rate paid to Colt. Colt's proposed rates are about **[✂]**% higher than the current rates it receives.

Table 4 Comparison of BT and Colt termination rates

	Day (ppm)	Eve (ppm)	Weekend (ppm)
DLE conveyance (inc. PPP)	0.2453	0.1123	0.0884
Single Tandem conveyance	0.3608	0.1652	0.1301
Colt's proposed **[✂]** blended rate	**[✂]**	**[✂]**	**[✂]**
Rates Colt presently receives from BT	0.2455	0.1124	0.0885

Source: Ofcom

3.22 Colt's dispute submission also stated that as BT delivers most of its traffic to Colt for termination at Colt's tandem switches, it would be fair if BT were to pay Colt the full ST rate for termination rather than a blended rate. However, Colt has not proposed this to BT by way of an OCCN, nor has it asked Ofcom to set its termination rate equal to BT's ST rate during this dispute.

Colt's view on the evolution of the market since 1997

3.23 Colt considered that the market had changed enormously since 1997. It noted that in 1997 it was relatively new to the switched services business and had a fraction of the business that it has now. At that time Colt had a different network topology where all the switches were configured as local switches. As traffic volumes grew, and as the number of interconnect partners increased, Colt found it necessary in 2000 to add a tandem layer. Prior to this BT had interconnected to Colt's local switches. Since the re-organisation, BT has primarily interconnected at Colt's tandem layer. The re-organisation did not result in any extra geographic termination revenues for Colt both because of the terms of the formula in the expired Reciprocity Agreement and also because Colt agreed not to seek MSO status for a period (see paragraphs 3.65 to 3.71 below).

3.24 In 1997 Colt did not use a third party LTT provider, instead sending all of its traffic directly to either BT's tandem or local switches. Colt noted that at that time there were no third party transit providers in the UK, and only relatively recently **[✂]**has been **[✂]**, third party provider of transit.

[47] These rates were applicable from 01/01/2010 to 30/9/2010.

3.25 Colt said that where CPs' geographic call termination rates were probably of relatively little significance for competition and consumer welfare in 1997, they are clearly much more relevant now.

Colt's submission on how the dispute should be resolved

3.26 Colt noted the Competition Appeal Tribunal's statement that the starting position for any section 185 dispute analysis should be the reasons given by each party proposing or resisting the contractual terms, as appropriate.

3.27 Colt believed that its reasons were clear from its correspondence with BT (including its OCCNs) and from submissions provided to Ofcom. Details of the reasons given in the OCCN are set out in paragraph 3.5. Colt described the formula under the expired Reciprocity Agreement to be a "relic and distortive of competition, particularly in relation to LT transit and conveyance".[48]

3.28 Colt considered that BT's reasons for resisting the proposed terms were opaque and without merit. Colt cited BT's rejection of the OCCN, which stated that BT believed the proposed rate was neither fair nor reasonable for the termination of calls on Colt's network.

3.29 In contrast, Colt argued that the arrangements under the expired Reciprocity Agreement were not "fair and reasonable" since they distorted competition without any justification. Colt considered that there was no reason why a loss of revenue to BT as a result of competition from LTT should require Colt to receive lower rates from BT for termination.

3.30 After BT's rejection of Colt's OCCN, Colt submitted a second OCCN on 23 December 2009 which proposed termination rates which were based on the application of the expired Reciprocity Agreement to a CP delivering traffic to BT with a split of 75% local switch termination and 25% tandem switch termination. This split represented the industry-wide average that BT, on 3 December 2009, had informed Colt it was likely to propose to industry early in 2010. According to Colt BT rejected this OCCN stating:

> "BT rejects the proposed rates at this time, on the basis that they are not fair and reasonable because they are inconsistent with the rates charged by other operators which are calculated on a different basis."

3.31 In Colt's opinion, BT should, in principle, have been prepared to accept a proposal which it had said it intended to make to industry. Colt rejected BT's reliance on the fact that there is no common agreement between all CPs as to how geographic termination rates should be calculated, saying that the same could be said of any proposal. Colt further argued that there is no requirement that termination rates should be calculated in the same manner for all CPs and the impact of changing reciprocity arrangements will affect CPs in different ways.

3.32 Colt considered that, in any event, BT's objection of a lack of consensus would not appear to be relevant to Colt's first OCCN of 14 December 2009. Colt stated that it is not aware of any objection from any CP to this proposal in relation to the treatment of LTT traffic. Colt noted that insofar as third party transit is available to all CPs, its proposal would be of benefit to all.

[48] Colt's dispute submission of 10 August 2010, page 18.

3.33 At the beginning of the dispute process, Colt confirmed that it was seeking to define its first OCCN of 14 December 2009 as being fair and reasonable. We therefore proposed that the scope of the dispute would relate only to this first OCCN and Colt confirmed that it was happy with this scope.[49] Consequently, this dispute relates only to Colt's OCCN of 14 December 2009.[50]

Colt's view on the expired Reciprocity Agreement

3.34 Colt pointed out that, under the expired Reciprocity Agreement, if it does not send traffic directly to BT (as opposed to sending traffic via an LTT provider) Colt and that third party transit provider must accept lower geographic termination rates[51].

3.35 Colt argued against following the approach adopted in 1997. In its submission, Colt referred to arguments made by C&W regarding reciprocity. Although Colt did not provide a clear source for these arguments, we have taken them at face value and considered them to be made by Colt for the purposes of this dispute. These are set out below:

> "The guiding principle behind reciprocity – rather than imposing numerically the same rates as BT on OLOs / [other CPs] OCPs -was that there should be recognition of the differences in network topology, specifically the smaller number of [local switches] with larger catchment areas. The reason for doing so was to recognise that an otherwise equally efficient operator would nevertheless have higher termination costs for calls if it had fewer, larger [local switches]. Those considerations have not changed and remain relevant.
>
> In 1997, overall traffic levels between BT and OLOs (including Colt) were much lower and virtually all traffic was sent to BT's ST level. For both reasons, the precise details of the Reciprocity Agreement were much less material than now. Even if Colt and other OLOs had had the negotiating strength to stand up to BT, they would have had limited incentives to do so.
>
> As it was, the particular form of reciprocity adopted at the time was adopted by consensus (not as the product of a considered final judgment by the regulator) and was acknowledged to suffer from a "major defect" in terms of the potential to distort "build or buy" decisions.
>
> With the increase in DLE interconnects and development of third party LT transit, geographic termination rates payable to Colt have dropped significantly even though there has been little change in its termination costs or efficiency relative to BT. In one respect, this paradoxical result is exactly what Oftel feared could arise. The possibility of third party LT transit does not appear to have been considered at all in 1997 though.

[49] Email from Alastair Dixon to Phil Jones, 3 September 2010.

[50] The paragraph has been amended following Colt's comments in its submission to our draft determination– see footnote 43.

[51] We note that in our meeting on 1 November 2010 Colt argued the contrary; that if their traffic was taken out of **[✂]** traffic to BT it would not have a material impact on **[✂]** termination rate.

> In any event, the legislative framework has also changed entirely since 1997 and it cannot be assumed that even if a proposal would have satisfied Oftel's duties in 1997 that it would also satisfy Ofcom's duties in 2010."

3.36 Colt considered that for these reasons it would be unfair between the parties simply to re-introduce the exact same approach as applied under the expired Reciprocity Agreement. It added that the circumstances have changed materially and those changes need to be reflected in the contractual arrangements.

Recovery of costs

3.37 Colt doubted the relevance of cost recovery to this dispute given that reciprocity was not necessarily designed to result in all CPs recovering their costs. Colt also noted that the six principles of pricing and cost recovery commonly applied by Ofcom in resolving disputes might therefore be considered of limited relevance on this occasion. At the same time, however, Colt made brief submissions on the application of each of the principles which we set out in Section 4.

Ofcom's policy review of reciprocity

3.38 Colt explained that that it was aware of Ofcom's impending policy consultation on fair and reasonable charges for fixed geographic call termination[52] and that this dispute arose prior to Ofcom's announcement to undertake the review. Colt emphasised that the current dispute was not intended to affect this policy review and that Colt's input to the review would be in the form of a response to the consultation.

3.39 Colt stated that it anticipates that the output of Ofcom's review will take a forward-looking position, rather than a retrospective one that would address the interim period after 30 September 2009, when the original arrangements expired and Colt's dispute arose.

BT's response

3.40 BT provided an initial response to Colt's dispute submission on 20 August 2010.

3.41 In BT's view "it would be inappropriate and unnecessary use of Ofcom's resources to investigate the dispute at this time, in view of the forthcoming Ofcom consultation and guidance on reciprocity."[53] BT also considered that in advance of Ofcom's consultation on fair and reasonable charges for fixed geographic call termination and the industry guidance that will follow, it would be inappropriate for Ofcom to decide on rates that should apply to traffic between BT and Colt as the result of a dispute. BT argued that this would prejudice the outcome of the wider debate on reciprocity and be contrary to Ofcom's stated objectives[54] and the interests of industry as a whole.

3.42 BT considered that the impending consultation would provide a prompt and satisfactory alternative means of resolving the issues raised about reciprocity in this complaint and, in accordance with its dispute resolution powers, Ofcom should not open a dispute if there are alternative means available to it. BT also disagreed with Colt's assertion that commercial negotiations had been exhausted. It believed that

[52] Ofcom issued its September 2010 Consultation after Colt's dispute submission was received. See paragraphs 2.35 – 2.38 above for more detail.
[53] BT response to Colt's dispute submission, 20 August 2010.
[54] Paragraph A1.41, Ofcom's Annual Plan 2010/11, http://www.ofcom.org.uk/files/2010/06/annplan1011.pdf

discussions between CPs had been put on hold while industry awaited Ofcom's consultation and guidance.

3.43 BT set out its view that the previous reciprocity agreements in place up until 30 September 2009 were fair and reasonable. It believed that, absent any industry wide agreement on any alternative arrangements, it is fair and reasonable, in the interim, to continue to act in accordance with previously agreed principles and not to deviate from them on a bilateral basis.

Further information sought from Colt

3.44 We wrote to Colt on 23 August 2010 seeking clarification on some of the matters raised in its dispute submission. Colt responded on 26 August 2010 (paragraphs 3.45 – 3.54).

3.45 Colt considered that BT had "fallen into the trap of believing that Colt's dispute is about forward looking termination rates". Colt reiterated that this dispute is about Colt's termination rates in the interim period from 1 October 2009 to the implementation of the new arrangements. Colt argued that the forthcoming consultation was not a way of resolving the dispute, as Colt understood it would only address reciprocity in geographic termination rates from 2011 onwards[55].

3.46 Colt noted that it had been careful to frame the dispute so that it would have no effect on Ofcom's planned consultation on fair and reasonable charges for fixed geographic call termination; and that it is fully supportive of an industry-wide reciprocity agreement that rewards efficient investment in infrastructure. Colt believed that it had framed its request to Ofcom in a way which avoids Ofcom being required to fetter its discretion during the forward looking policy review.

3.47 Colt stressed that it was requesting that in the interim period its termination rate be calculated using the expired Reciprocity Agreement formula, but that the LTT traffic sent via a third party transit provider be included in the calculation. Colt used its response to repeat its view that it had been disadvantaged by the old reciprocity arrangements for many years in receiving most of BT's traffic at its tandem switches whilst receiving rates close to BT's LE rates.

3.48 Colt's letter of 26 August 2010 set out further details of commercial negotiations between itself and BT and stated that these broke down on 18 January 2010. At the meeting of 18 January 2010 BT and Colt agreed that they were in deadlock.

3.49 Colt's letter of 26 August 2010 provided details of rates payable by Colt to a third party transit provider for LTT compared with those which would be payable for BT ST, effective as at 1 October 2010.

	Day	Evening	Weekend
Cost of delivery to BT at ST level	0.3715	0.1701	0.1339
Cost of delivery to	[✂]	[✂]	[✂]

[55] Whilst Colt stated in its 26 August 2010 letter that it expected the new guidance to only address termination rates from 2011 onwards, we have proposed in our September 2010 Consultation both new guidance that should apply from October 2012 onwards. These proposals are subject to industry consultation.

BT using **[✂]** LTT			

Source: Colt

3.50 Colt stated that it does not recover its costs when it receives traffic at its tandem level and only receives the LE rate. It noted that traffic received from BT at its tandem switches uses two extra switch ports and an Inter-Machine Trunk ("IMT") channel for conveyance between its tandem switches and **[✂]** of the **[✂]** local switches to which BT does not deliver traffic directly. Colt stated that this cost recovery problem has existed since Colt started sending traffic to a third party transit provider. In addition, in a meeting with Ofcom on 1 November 2010 Colt stated **[✂]**.

3.51 In its letter of 26 August Colt set out the rates it charges **[✂]** for delivery of traffic to the tandem layer:

Day	Evening	Weekend
[✂]	**[✂]**	**[✂]**

Source: Colt

3.52 Colt also provided further information on its reasons for not seeking MSO status. Colt's growth in voice traffic meant that it needed to move from a 'flat' network to a tandem-structured network in 2000. This resulted in **[✂]** of the switches (which BT had been delivering traffic to) being redesignated from local switches to tandem switches. Colt explained that "it could be that BT felt that the goal posts had been moved" and Colt therefore agreed not to seek MSO status for a period of time, although correspondence from 2006 indicates that BT believed that this agreement was in perpetuity.

3.53 Colt stated that MSO status was discussed again with BT between 2006 and 2008, but the fact that Colt dual-hosts certain numbers for customers who require a high level of resilience means that the routing is too complicated for BT's Element Based Charge ("EBC")[56] table to handle (see paragraphs 3.65 - 3.71 for further detail). Colt argued that it had not sought to challenge this position in this dispute and had not claimed that it should be afforded MSO status.

3.54 Colt also confirmed that it is seeking to define its OCCN of 14 December 2009 as being fair and reasonable. However, it noted that since BT had announced increases to its LE and ST termination charges from October 2010, Colt would expect to receive an increase to the rates as shown in the following table.

	Day	Evening	Weekend
Jan – Sep 2010	0.2994	0.1346	0.1056
Oct 2010 onwards	0.3101	0.1395	0.1095

Source: Colt

[56] Service providers are required to pay BT based on the number of legs of the BT network that a customer's call is carried over, under a structure known as EBC.

3.55 On 23 September 2010, we sent Colt a formal notice under section 191 of the Act requiring them to provide information in connection with the dispute.[57] This included information relating to MSO status, Colt's resilience product, Colt's termination rates and termination volumes and the impact of sending traffic via **[✂]**.

3.56 We received a response from Colt on 4 October 2010 and had a meeting with Colt on 1 November 2010 to clarify some of the information provided in response to the information request.

3.57 Details of Colt's response to the formal information request are set out in the relevant parts of our analysis in Section 4.

BT response to Ofcom's request for stakeholder information and evidence

3.58 On 23 September 2010 BT wrote to us setting out its views on Colt's dispute submission. BT reiterated its view that the previous reciprocity agreements were fair and reasonable and that, in the absence of an industry-wide alternative agreement, it is fair and reasonable, in the interim, to continue to apply the previously agreed principles. BT believed that it was essential that rates were set on a consistent basis to avoid any undue discrimination.

3.59 In support of its position, BT referred to Ofcom's provisional view, as set out in the September 2010 Consultation[58] - namely that arrangements based on the expired Reciprocity Agreement should continue to apply in the interim period, unless there have been some material changes of fact. BT considered that there has been no such material change in the case of Colt.

3.60 BT argued that the rates proposed by Colt were not consistent with the previously agreed principles which made no provision for the inclusion of traffic delivered via third parties at ST rate in the calculation of the X ratio. According to BT, this was reflected in the 2006 Telewest termination rate dispute[59] where the question of a CP's "build or buy" decision was considered. BT noted that it was Ofcom's view in that dispute that:

- the X ratio calculation was based on traffic sent directly to BT for termination at the local exchange and single tandem level;
- the CP would need to have regard to the fact that use of a third party transit operator would also change X in the reciprocity formula; and
- the benefits to the CP of reduced out-payments for outbound traffic to BT would need to be balanced against the reduced receipts for inbound traffic which would result from changes to X within the formula.

3.61 BT pointed out that in the 2006 Telewest dispute, Ofcom had also noted Oftel's acknowledgement of the distortive effects of the X ratio on a CP's routing decision as a drawback of this approach and their assertion that this was more than offset by other advantages, for example, competitive neutrality.

[57] These requests were sent in draft on 17 September 2010.
[58] Fair and Reasonable charges for fixed geographic call termination, Consultation, 16 September 2010.
[59] Determination to resolve a dispute between BT and Telewest about geographic call termination reciprocity agreement, 16 June 2006.

3.62 BT argued that the rates proposed by Colt are unfair and unreasonable because they are not reciprocal or symmetric, they distort the "buy or build" decision and are impractical. BT also pointed to a number of practical difficulties with Colt's proposal. All the above mentioned arguments are discussed in more detail in the relevant parts of our analysis in Section 4.

The context behind Colt's requested increase in its termination rate

3.63 BT delivers the majority of its traffic at Colt's tandem switches. Under current arrangements however, Colt receives termination rates that are close to the BT LE rate. When the traffic is received at the tandem level there is an additional cost to Colt incurred in LTC on its network. The LE rate is based on BT's costs as a proxy for a hypothetically efficient operator providing local call termination on a national network. As a result Colt suggests that the LE rate may be lower than its costs of providing interconnection where the point of hand-over will involve Colt incurring the costs of termination (at its local switches) plus LTC on its network. Colt stated in its letter of 26 August 2010 that "Colt does not recover its costs when it receives traffic at tandem level but is only paid the DLE rate". Colt has not provided the level of analysis necessary to support its claim of cost under-recovery.[60]

Colt's network configuration and termination rates

3.64 Before assessing Colt's proposal, we summarise below the key developments in Colt's network design, the implications for traffic hand-over and impact on Colt's termination rates under the expired Reciprocity Agreement.

Colt's network and MSO status

3.65 In 1997 all the switches in Colt's network were configured as local switches. As traffic volumes grew, and as the number of interconnect partners increased, Colt chose in 2000 to reconfigure its network and create a tandem layer.

3.66 Prior to this rearrangement of Colt's network BT had interconnected to all of Colt's local switches. Colt's network reorganisation led to BT only interconnecting at Colt's tandem layer. The reorganisation, however, did not increase geographic termination revenues for Colt, as termination revenues were a function of the formula in the expired Reciprocity Agreement and because Colt did not apply for MSO status.

3.67 As set out in paragraphs 2.29 to 2.34, under the terms of the expired Reciprocity Agreement if Colt requested MSO status it must first open its local switches to receive traffic from BT. In 2006 Colt applied for MSO status which led to BT in turn requesting access to Colt's local switches. Colt subsequently withdrew its request for MSO status as it became clear that the delivery of traffic by BT to Colt's local switches would undermine Colt's "resilient" hosting which it provides to some of its customers.

3.68 Colt's resilience arrangements host customer's number(s) on **[✂]** of Colt's **[✂]** local switches so, for example, if one local switch were to fail the customer would continue to have a working connection through another local switch. But interconnecting networks typically route calls to each other based on large blocks of numbers (typically 10,000). So, to make this service work Colt needs to receive calls

[60] In its response to our draft determination, Colt highlighted that it had not undertaken cost recovery analysis as to do so would be akin to full regulatory accounting which it considered disproportionately expensive. This point is dealt with further at paragraph 5.18 below.

to the relevant customer numbers at its tandem layer so that its own network can route the call to either of the local switches. As Colt noted in its response of 4 October 2010 to our information request "it is not industry practice for a terminating network to expect an originating network to route to a level of detail greater than 10k number ranges (or 1k in certain circumstances)."

3.69 As a result of these resilience arrangements Colt withdrew its request for MSO status. In an email to BT formally withdrawing the request Colt's **[✂]**, stated:

> "After much debate it was decided that the effort involved would not justify the cost benefits that would be achieved..."[61]

3.70 The email went on to request that BT continue with the plans to interconnect to **[✂]** of Colt's local switches **[✂]** in Colt's network not involved in hosting numbers using these resilience arrangements. We understand that BT continued with that work and now delivers traffic directly to **[✂]** of Colt's local switches. It is also clear from the email that Colt recognised this decision would have an effect on its termination rate.

3.71 For traffic destined for Colt geographic number blocks which contain numbers hosted on **[✂]** local switches, BT has to deliver the traffic to Colt's tandem layer. Because BT has no effective choice but to deliver this traffic to the tandem layer Colt was not eligible for MSO status under the terms of the expired Reciprocity Agreement.

Colt's current termination rate

3.72 As Colt does not have MSO status under the expired Reciprocity Agreement Colt's current termination rate derives from the formula for CPs with SSO. As explained in Section 2, this means that Colt's termination rate is set with reference to the proportions of traffic it sends to BT's local and tandem switches only. Colt told us that, as of May 2009, when the last sampling for the expired Reciprocity Agreement was carried out Colt delivered **[✂]**% of its traffic bound for BT directly to BT's local switches. For almost all of the other BT-bound traffic, Colt sends the traffic to a third party transit provider which in turn sends Colt's traffic to BT's local switches.

3.73 This arrangement is beneficial to Colt as the price it pays for LTT is lower than BT's charges for LTC which Colt would need to pay if the traffic were delivered directly to BT's tandem layer[62]. However, for the purposes of the expired Reciprocity Agreement the traffic delivered to BT by the third party transit provider is not treated as traffic belonging to Colt, so Colt's termination rate is calculated on the basis of the traffic delivered directly by Colt to BT only. As a consequence Colt's termination rate is very close to the BT LE rate, with only a small increase to reflect the small amount of traffic delivered direct by Colt to BT's tandem layer.

Stakeholders interested in the outcome of the dispute

3.74 It has been our practice to allow stakeholders that are not parties to a dispute, but that are materially affected by the issues raised in the dispute, to register their interest in the outcome of a dispute and, where appropriate, make representations to us. We received expressions of interest from Virgin Media, Magrathea Telecommunications, Verizon Business, British Sky Broadcasting Group PLC, Cable and Wireless Worldwide, and **[✂]** on 3, 6, 7, 8, 15 and 16 September, respectively.

[61] **[✂]**

[62] Based on figures provided by Colt in response to our section 191 notice (see paragraph 3.55) we estimate that Colt **[✂]** per year on its origination costs as a result of this transit arrangement.

Section 4

Ofcom's assessment of the issues

Purpose of this Section

4.1 This Section sets out our analysis of the matters in dispute and our provisional conclusions.

Issues to be resolved

4.2 The scope of the dispute is to determine whether the fixed geographic termination rate proposed by Colt to BT in its OCCN of 14 December 2009 is fair and reasonable.[63] As discussed in paragraph 3.13 *et seq* above, Colt's proposal is based on the expired Reciprocity Agreement and sets its termination rate as a blend of BT's LE and ST rates weighted according to how Colt's traffic is delivered to BT, except that Colt's proposal treats the traffic Colt sends to BT via a third party transit provider as if it were traffic delivered to BT's tandem switches.

Analytical framework

The six principles of pricing and cost recovery

4.3 In a number of previous disputes both Oftel and Ofcom have used the six principles of pricing and cost recovery as an analytical framework to assess charge setting. The six principles were developed by Oftel in the context of number portability and were endorsed by the Monopolies and Mergers Commission[64] and have subsequently been used in analysing various disputes.[65]

4.4 The principles are:

- **Cost causation**: costs should be recovered from those whose actions cause the costs to be incurred;
- **Cost minimisation**: the mechanism for cost recovery should ensure that there are strong incentives to minimise costs;
- **Effective competition**: the mechanism for cost recovery should not undermine or weaken the pressures for effective competition;

[63] Please see paragraph 3.11 for the detailed scope of the dispute.
[64] Telephone Number Portability: A Report on a reference under s13 of the Telecommunications Act 1984 (MMC, 1995)
[65] See for example: 'Determination under Section 190 of the Communications Act 2003 and Direction under Regulation 6(6) of the Telecommunications (Interconnection) Regulations 1997 for resolving a dispute between Orange and BT concerning the cost sharing arrangements for Customer Sited Interconnect ('CSI') links connection and rental charges', 19 November 2003. See also 'Direction concerning ADSL Broadband Access Migration Services; and a Draft Determination to resolve a dispute between Tiscali, Thus and BT concerning ADSL Broadband Access Migration Services', 9 August 2004; 'Determination to resolve a dispute between BT and Telewest about geographic call termination reciprocity agreement', June 2006; 'Dispute between Cable and Wireless and T-Mobile about mobile termination', May 2009; 'Dispute between Opal Telecom and BT about Opal's Fixed Geographic Termination Rates', 26 October 2009; 'Determination to resolve a dispute between Stour Marine and O2 about termination rates', 11 June 2010.

- **Reciprocity**: where services are provided reciprocally, charges should also be reciprocal;

- **Distribution of benefits**: costs should be recovered from the beneficiaries especially where there are externalities; and

- **Practicability**: the mechanism for cost recovery needs to be practicable and relatively easy to implement.

4.5 The application of any one of these principles to the relevant circumstances can sometimes point in a different direction to the other principles. But the set of principles provides a framework to identify such trade-offs and to facilitate the use of judgment to strike an appropriate balance in reaching our conclusions while also considering the wider context relevant to a dispute.

4.6 We believe that the use of these principles of pricing and cost recovery is consistent with our obligations, in particular our duties set out in section 3 of the Act, the Community requirements set out in section 4 of the Act and our general obligations under administrative law.

4.7 We have also taken into account previous decisions we have made, in particular in the 2006 Telewest dispute,[66] where we have noted that the SMP obligation on the TCP (in this case Colt) is that the charges are required to be 'fair and reasonable' and not that the charges are optimal or free of all distortions.

Colt's views on the relevance of the six principles of pricing and cost recovery

4.8 Colt argued that the six principles of cost recovery commonly applied by Ofcom in resolving disputes may be considered to be of limited relevance to this dispute. It went on to say that reciprocity is not necessarily designed to result in all operators recovering their costs. Nevertheless, Colt made brief submissions on the application of each of the principles, which are set out in the relevant paragraphs below.

4.9 Colt noted that even if Ofcom were minded to apply the six principles of pricing and cost recovery, they are only a tool and not a substitute for compliance with Ofcom's statutory duties.

Use of the six principles

4.10 We recognise Colt's view that the six principles are not a substitute for compliance with our statutory duties. The six principles provide a useful framework here, as they have in disputes previously, for us to evaluate the proposals and arguments put forward by the parties, as well as other reasoning which we consider relevant. As explained in paragraphs 4.98 to 4.105 of the draft determination, we consider that our proposed determination of this dispute is fully consistent with our statutory duties.

[66] Determination to resolve a dispute between BT and Telewest about geographic call termination reciprocity agreement, June 2006

Assessment under the six principles of pricing and cost recovery

Cost causation

Rationale

4.11 The cost causation principle maintains that costs should be recovered from those whose actions cause them to be incurred at the margin. The costs of terminating a call are caused by the network originating the call, hence BT (as either originator of the call or transit operator) should pay a termination charge to Colt. [67] Charges which reflect the efficient level of costs incurred when a call is terminated are likely to be consistent with cost causation.

Colt's view

4.12 Colt considered that the current arrangements are unlikely to allow it to recover all its termination costs unless it is assumed that Colt's termination via tandem switch and conversion from TDM to IP[68] is less costly than termination by BT purely at a local switch. Colt stated that if it does actually recover all its costs then it is only because it is much more efficient than BT but is being denied the opportunity to obtain the full benefit of that extra efficiency.

BT's view

4.13 BT did not make any specific submission on the cost causation principle.

Ofcom's provisional view

4.14 We consider the fact that BT should pay a termination charge to Colt is not a matter of dispute between the parties. The key issue relating to cost causation in this dispute is whether, by delivering traffic to Colt's tandem layer rather than its local switches, BT is causing Colt to incur the cost of LTC on its own network. As explained above, because Colt does not qualify for MSO status, it is unable to set a charge designed to explicitly recover this LTC cost under the expired Reciprocity Agreement formula, as Colt receives a termination rate which is close to BT's LE rate.

4.15 We also note that Colt's proposal involves an increase in its termination rates to BT of about **[✂]**%. As a consequence, Colt's proposals may result in callers to Colt's network paying higher retail prices.

Colt's potential under-recovery of its costs of termination

4.16 Although we recognise that the current arrangements between Colt and BT could potentially result in cost under-recovery by Colt, we note that Colt has not provided the level of analysis necessary to support its claim of cost under-recovery.[69]

[67] While the costs of termination are caused by the calling party initiating a call, the level of termination costs is clearly determined by the TCP. This issue is explained under the heading of cost minimisation below.
[68] TDM to IP conversion is the change in signalling required to convert signals from a Time Division Multiplex (TDM) network to those suitable for a network that uses Internet Protocol (IP).
[69] In its response to our draft determination, Colt highlighted that cost recovery accounting was not included in its dispute submission as it had clearly stated that the dispute was not based on any under-recovery of costs. This point is dealt with further at paragraph 5.18 below.

4.17 In any case, as explained above, under the terms of the expired Reciprocity Agreement, CPs have the ability to request MSO status which is designed to compensate those CPs which receive traffic from BT at the tandem layer.

4.18 As set out in paragraph 3.67, in 2006 Colt applied to BT to be awarded MSO status and BT duly requested interconnection with Colt's local switches. Subsequently, the two parties began a project to examine the possibility of BT delivering its traffic to Colt's local switches instead. However, in 2008 while this project was still ongoing Colt withdrew its request for MSO status as it became clear that the delivery of traffic by BT to Colt's local switches would undermine Colt's dual hosting of some customer numbers on more than one local switch.

4.19 Because Colt has chosen not to open **[✂]** of its local switches to receive traffic from BT, BT is compelled to deliver traffic destined for those local switches at Colt's tandem level and so is unable to exercise choice in a 'build or buy' decision. It is therefore our view that, were such an under-recovery of Colt's termination costs found to exist, it would be as a result of choices Colt has made in arranging its network and the costs caused would be unavoidable by the originating party because of Colt's market power in termination and the determination of the point of hand-over (i.e. termination) on its network.

4.20 Colt's decision not to receive traffic from BT at **[✂]** of its local switches arises from the dual hosting it provides to some of its customers. **[✂]**[70] However the principle of cost causation would suggest that the cost should be met by the parties primarily responsible for causing the costs (i.e. Colt's customers using dual hosting).

Provisional conclusions on cost causation

4.21 While it is not an argument that Colt has chosen to make in this dispute, the cost causation principle could (in a narrow sense) lead to a conclusion that Colt should receive an increased termination rate to reflect the fact that it has to undertake LTC within its own network for the majority of the traffic it receives from BT. However it could also be argued that it is Colt's customers of the resilience service which cause the additional costs to be incurred on the Colt network. **[✂]** the resilience service, the dual hosting this involves results in all calls to customer numbers hosted on the switches in question being handed over at the tandem level (even when the called party is not a resilience service customer). BT, as an OCP, does not have the opportunity to make a 'build or buy' decision' and cannot avoid the additional conveyance costs to be incurred on the Colt network because Colt has SMP in termination on its network and determines the point of traffic exchange.

4.22 We also note that the additional costs caused to BT from Colt's proposal to increase its termination charges by about **[✂]**% may result in an increase in the price faced by consumers for calls to Colt's network.[71]

4.23 We have therefore provisionally concluded, given the particular facts of this case, that the principle of cost causation does not support Colt's proposal.

[70] See section 2 of Colt's response to our section 191 notice, 4 October 2010.
[71] Following Colt's response on this issue (see paragraph 5.10), we have clarified our position on this point, see paragraphs 5.13 and 5.14.

Cost minimisation

Rationale

4.24 This principle implies that termination charges should be set so as to encourage efficiency and cost minimisation on the part of the TCP. While the provision of call termination is driven (or caused) by the originating network, the level of costs incurred is determined by the TCP. Therefore, by divorcing a CP's call termination charges from a measurement of its incurred costs and using instead BT's charges, CPs are given strong incentives to minimise costs. Where CPs are more efficient than BT, they are rewarded through greater profit margins, which provide the incentive to achieve greater productive (i.e. cost) efficiency.

4.25 BT is seen as the appropriate proxy for a reasonably efficient operator as its charges for termination are subject to cost orientation obligations and charge controls, with the latter designed to align charges with unit costs for an efficient network.

4.26 We also consider under this principle the incentives on Colt in its 'build or buy' decisions when it is in its role as an OCP, deciding how to route its traffic for termination on BT's network. This is influenced by the arrangements for Colt's termination charges, because both Colt's OCCN and the expired Reciprocity Agreement derive the weights for ST and LE in the calculation of the termination rates Colt receives from the routing of Colt's traffic for termination on BT's network.

Colt's view

4.27 Colt considers that the expired Reciprocity Agreement disincentivises the minimisation of origination costs, as building infrastructure to BT's local switches and using a lower cost LTT provider is penalised by a CP receiving a lower termination rate under the agreement.

4.28 Colt has also highlighted[72] that BT's charge for the LTC element of the ST rate has not been subject to a charge control imposed by Ofcom following the conclusion of the 2009 Market Review.

BT's view

4.29 BT argued that Colt's proposal would introduce a perverse incentive on CPs to use third party LTT in preference to building their networks out to BT's local switches. This is because self build results in the traffic delivered over these links being included in the X ratio of the expired Reciprocity Agreement at the (lower) LE rate. According to BT, this would result in CPs not necessarily choosing the least cost option for delivery of their outbound traffic to BT, because of the impact on their termination rate.

4.30 BT further added that this could disincentivise LTT providers from routing their own originated traffic directly to BT's local switches. Instead, LTT providers might use another CP to transit their own traffic to BT in order to increase their termination revenues. Under Colt's proposal, this re-routed traffic would then be included in the (1-X) ratio (i.e. at the higher ST rate) in the calculation of the LTT provider's termination rate. BT considered that this would distort competition in the LTT/LTC

[72] In a meeting with Ofcom on 1 November 2010.

market and would not drive cost minimisation because of the increased cost of the indirect routing that would result.[73]

Ofcom's provisional view

4.31 The 'build or buy' decision for Colt (and other CPs) is essentially between the following choices:

(a) Build out its own network to BT's local switches; or

(b) Buy LTC from BT; or

(c) Buy LTT from a transit operator.

4.32 Colt's proposal changes the treatment of LTT traffic that is bought from a transit operator, i.e. category (c), compared to the expired Reciprocity Agreement. It does not change the treatment of the other two categories of traffic *per se* (although, as discussed below, it may affect the incentives on the CP to choose (a) or (b) relative to (c)).

4.33 As explained further below, Colt's argument is that the expired Reciprocity Agreement provides it with a disincentive to build its own network or to buy LTT from a transit operator in favour of buying LTC from BT, i.e. it favours the choice of (b) over (a), and favours the choice of (b) over (c).

4.34 BT's first argument is that Colt's proposal would provide a disincentive on CPs to build their own network in favour of buying LTT from a transit operator, i.e. it favours the choice of (c) over (a).

4.35 BT's second argument builds on the first by suggesting Colt's proposal would provide a similar disincentive for the transit operator, which is also an OCP and has its own traffic, to use its own network in favour of using another transit operator for its own traffic sent for termination on BT's network, i.e. it favours the choice of (c) over (a) for other CPs even if they have already built out their networks. BT also argued that Colt's proposal would provide a disincentive to buy LTC from BT in favour of LTT, i.e. it favours the choice of (c) over (b).

4.36 First, considering the incentives for own-network build versus buying LTC from BT, i.e. (a) versus (b), we acknowledge Colt's critique of the way the expired Reciprocity Agreement can disincentivise CPs to build out to BT's local switches (the so-called "build or buy" distortion). This fact has long been recognised by Ofcom and Oftel before it.[74] At the same time, however, Colt's proposal maintains a similar distortion to incentives as the more traffic is sent via LTC or a third party LTT provider, rather than directly to BT's local switches, the higher the termination rate a CP would receive.

[73] In its response to the draft determination, Colt disagreed with this argument. Our further consideration of this point is contained in paragraphs 5.22-5.25.

[74] See Oftel statement, 'Network Charges from 1997', published July 1997, available at http://www.ofcom.org.uk/static/archive/oftel/publications/1995_98/pricing/ncct797.htm; 'Determination to resolve a dispute between Telewest and BT about geographic call termination reciprocity agreement', 16 June 2006, available at http://stakeholders.ofcom.org.uk/binaries/enforcement/competition-bulletins/closed-cases/all-closed-cases/cw_890/determination.pdf ; 'Fair and reasonable charges for fixed geographic call termination, a consultation on draft guidance', 16 September 2010, available at http://stakeholders.ofcom.org.uk/binaries/consultations/778516/summary/condoc.pdf

4.37 Second, considering the incentives for buying LTC from BT versus buying LTT from a transit operator, i.e. (b) versus (c), Colt similarly criticises the expired Reciprocity Agreement because it incentivises a CP to use BT's LTC product rather than using LTT provided by a third party, even where the third party LTT product might be lower cost than BT's LTC product. The incentive arises because if the CP delivers traffic to BT's tandems and pays LTC then it will consequently receive a higher termination rate for the traffic it receives from BT. In contrast, if the CP delivers traffic to BT local switches via a third party LTT provider then that traffic is not included within the formula that sets the CP's termination rate under the expired Reciprocity Agreement. Colt argues that this incentive to use LTC over a potentially lower cost LTT product is contrary to the principle of cost minimisation. BT has not provided arguments to the contrary. We recognise that there is merit in Colt's argument on this particular point. But the importance or materiality of any distortion is also relevant.

4.38 Third, Colt's proposal continues to rely on the pattern of outbound traffic to set a CP's incoming termination rate. Therefore, as BT noted, Colt's proposal also potentially creates an incentive for CPs to favour buying LTT from a transit operator over building their own network, i.e. favouring (c) over (a). This is because, under Colt's proposal, if a CP buys LTT rather than building its own network to BT's local switches, it would receive a higher termination rate from BT. This will not necessarily be the true least resource cost routing and in our view may represent a distortion caused by Colt's proposal similar to the distortion between (a) and (b) noted in paragraph 4.36.

4.39 Fourth, BT has also argued that there is a similar incentive for LTT operators to route their own-originated traffic to BT via a third party in order to attract a higher termination rate, while still delivering their transit customers' traffic directly to BT's local switches.

4.40 When we consider the practical implications of applying Colt's proposal to its own termination rates we are aware of the need to avoid double counting traffic for the purposes of Colt's termination rate and the termination rate of its third party transit provider. In this regard if Colt's proposal was applied by other CPs an LTT operator's termination rate would be set wholly in relation to its own originated traffic (as the traffic originating on its transit customers' networks would instead be attributed to those customers for the purposes of calculating their termination rates). This would increase the incentive for LTT operators to route traffic to other transit providers. To the extent that there is a material incentive on transit providers to use other transit providers to affect the termination charge they receive from BT, rather than on the basis of least cost routing decisions, this is not efficient.

4.41 However, in our meeting of 1 November 2010 Colt argued that if their proposal was put into effect across the industry, BT would be incentivised to reduce the level of its LTC charge (which has been deregulated following our 2009 Market Review) in order to retain traffic from CPs who would otherwise use a cheaper LTT service. Colt argued that this would remove the distortion set out in paragraph 4.37 and put LTC and LTT on a level playing field. In these circumstances, if LTC were equally priced with LTT, we would expect the incentive set out in the previous paragraph to also apply to the use of LTC (i.e. transit providers would be incentivised to use (b) or (c) over (a)). Again, this is inefficient if it materially incentivises transit providers to route traffic other than on the basis of least cost routing decisions.

4.42 Fifth, in the meeting of 1 November 2010, Colt noted that some CPs have chosen not to merge their component networks following the takeover of one company by another. Colt highlighted that these CPs are able to, in effect, use one network for ingress to their network(s) and another network for egress to BT. Colt argued that this created a situation where, under the expired Reciprocity Agreement, the common parent company of the two networks could route incoming and outgoing traffic in a way that minimises its origination costs while also maximising termination revenue.

4.43 While we have not investigated the accuracy of Colt's assertion in the context of this dispute, Colt's proposal would also seem to generate an incentive to arbitrage traffic routing in order to maximise termination revenues. That is, Colt's or another CPs', routing decisions will be influenced by the impact on their own termination rate, which may distort the most efficient (least resource cost) outbound routing.

4.44 We have therefore provisionally concluded that:

- Colt's proposal does not affect the CP's choice between building its own network or buying LTC from BT, as both of these types of traffic are treated in the same way to calculate the termination rate that the CP receives under both Colt's proposal and the expired Reciprocity Agreement; and,

- whilst it may address one potential distortion in relation to least-cost routing decisions (i.e. the disincentive to use LTT operators, compared to buying LTC from BT, even when LTT might be the true least cost option), Colt's proposal may create other potential distortions (i.e. excessive incentive to use LTT or potentially LTC for both CPs and transit operators, compared to using the CP's own network, even when these may not be the least resource cost option).

4.45 As such, we have provisionally concluded that the principle of cost minimisation does not provide clear or unambiguous support for Colt's proposal.

Effective competition

Rationale

4.46 This principle requires that charges imposed should not undermine the pressure for effective competition (whether competition between those already in the market or competition via entry by efficient operators).

Colt's view

4.47 In its submission, Colt set out Ofcom's range of duties to promote competition and highlighted their importance to the current dispute. Colt argued that Ofcom's duties in relation to competition had pre-eminent importance and it is those duties that are most keenly engaged in this dispute.

4.48 Colt noted that, in 1997, Oftel (rightly in Colt's opinion) recognised a risk of distortion of competition in relation to "build or buy" decisions in the approach taken by the expired Reciprocity Agreement. Colt noted that, all else being equal, competition is more intense where competitors are able to reduce their costs of production and one way to reduce costs is to build one's own infrastructure. For this reason, Colt believes it is important that regulation does not distort the costs or benefits that could be achieved from infrastructure investment.

4.49 Colt observed that another way of reducing costs is to use a third party's services and that costs in the market overall will reduce if there is competition between providers of the relevant services. Colt highlighted that the expired Reciprocity

Agreement incentivised CPs to use BT's LTC instead of third party LTT to deliver traffic to BT's local switches as this delivered an increase in termination revenue.

4.50 Colt pointed out that no previous assessment of reciprocity had taken account of the impact on competition in LTT/LTC, a market that has only just been deemed competitive by Ofcom.[75] Colt considered the impact on competition in LTT is at least as important as the impact on "build or buy" infrastructure decisions, and arguably more so since it will affect costs beyond geographic call termination. Colt further added that the impact on "build or buy" decisions had not adequately been taken into account in the past.

BT's view

4.51 BT was of the opinion that Colt's proposal would drive all CPs to use third party LTT in preference to self build because of the impact on their own termination rate. BT argued this would distort competition in the LTT/LTC market as CPs would be incentivised to avoid using BT's LTC.

Ofcom's provisional view

Distortion in local-tandem transit/conveyance

4.52 As noted under the discussion of cost minimisation, we recognise that the expired Reciprocity Agreement has the potential to incentivise some CPs to use BT LTC rather than third party LTT. Nevertheless, the 2009 Market Review concluded that the market for LTT/LTC had developed to the extent that BT no longer had SMP.

4.53 The development of competition in the LTT/LTC market took place over a period when the expired Reciprocity Agreement was in force. This suggests a limit to the materiality of any potential distortion that existed (or continues to exist).

4.54 In relation to BT's arguments, we note that, as set out in the discussion on cost minimisation above, there is the potential for Colt's proposals to have other distortive effects on "build or buy" decisions and the choice between LTT and LTC.

Addressing these distortions

4.55 All of the potential distortions referred to above derive from the linkage, in both the expired Reciprocity Agreement and in Colt's proposal, between the CP's build or buy decisions for the traffic sent for termination on BT's network and the termination rate that the CP obtains for traffic it receives from BT for termination on its own network. Therefore, one way to avoid the potential distortions of both the expired Reciprocity Agreement and Colt's proposal could be to separate the termination rate for non-BT CPs from their outbound routing decisions. This option has been proposed in our September 2010 Consultation.[76] However, this proposal is subject to consultation with industry and if it remains the preferred solution, it will be implemented after an appropriate period of transition.

Provisional conclusions on effective competition

[75] Review of the fixed narrowband services wholesale markets: statement on the markets, market power determinations and remedies including further consultation, Ofcom, 15 September 2009.
[76] Fair and reasonable charges for fixed geographic call termination, consultation on draft guidelines, 16 September 2010, http://stakeholders.ofcom.org.uk/binaries/consultations/778516/summary/condoc.pdf

4.56 As set out above, while Colt's proposals may address one potential distortion in competition between LTT and LTC under the expired Reciprocity Agreement, the evidence suggests that it has not been sufficiently material to prevent the market for LTT/LTC from becoming effectively competitive. This suggests a limit to the extent of any harm to competition or consumers.

4.57 We have therefore provisionally concluded that, while there may be some evidence that Colt's proposals are supported by the principle of effective competition, the evidence is mixed. Considering all of the potential distortions, it is unclear to us that there is necessarily a net advantage of Colt's proposals in terms of competition, and even if there were, there are limits on the scale of any such advantage.

Reciprocity

Rationale

4.58 As set out above, Ofcom has supported the principle of reciprocal charging for CPs' call termination charges in policy statements and previous disputes. The aim of reciprocity in this context is to ensure competitive neutrality between BT and other CPs by removing the distortive effects of the call termination externality, and to minimise costs.

Colt's view

4.59 Colt considered that its proposal is in line with the principle of reciprocity because it continues to use BT LE and ST rates as the basis for calculating Colt's termination rates.

BT's view

4.60 BT noted that, under Colt's proposal, symmetry of rates would not be achievable between Colt and BT. This is because BT would only be paid the LE rate for the call minutes sent via a third party transit operator, while the call minutes would attract the ST rate in the calculation of Colt's termination rate. It went on to say that this would undermine commercial neutrality and the principle of reciprocity.

4.61 BT argued that if commercial neutrality and symmetry were to be achieved through inclusion of call minutes sent via third party transit operators, then traffic delivered by a third party should be included as LE rated rather than ST rated as this would be reflective of what each operator was being paid for the termination of the calls. According to BT, it had put forward this proposal in the 2009 reciprocity discussions and it was rejected by CPs as they believed that assignment of call minutes to any party other than the party handing the call over to BT was impractical to implement. Having concerns itself regarding practicality, BT withdrew the proposal. BT added that this problem could be resolved by Options 2 and 3 as set out in Ofcom's September 2010 Consultation.

4.62 Options 2 and 3 in the consultation document referred to by BT are:

- **Option 2**. Set fixed termination rates for other CPs on an equal basis but higher than BT's termination rate. This option would involve establishing a new mechanism for calculating an industry averaged blend of BT's ST and Local Exchange Segment ("LES") rates in order to derive a single higher rate for all other CPs.

- **Option 3**. Set all fixed termination rates equal to BT's termination rate (currently the LES rate). Under this option the rates for wholesale fixed geographic call termination on each individual network in the UK (except the Hull Area) would be the same.

Ofcom's provisional view

4.63 Ofcom's (and previously Oftel's) policy on fixed geographic termination rates has been that other CPs' rates are unlikely to be fair and reasonable if they are not based on BT's regulated charges. Both Colt's proposal and the way in which its rates are currently determined (by the expired Reciprocity Agreement) link its termination rate to BT's LE and ST rates.

4.64 BT notes that, if levels of traffic were equal between the parties, Colt's proposal would not lead to both parties being paid the same for equivalent services. However, this problem is one that equally exists under the expired Reciprocity Agreement for SSO CPs which receive the ST rate because they send no traffic to BT's local switches (e.g. because they send all of their traffic via a third party LTT operator or because they have not built out themselves to any BT local switches).

4.65 We therefore do not consider the principle of reciprocity to be determinative in this dispute.

Distribution of benefits

Rationale

4.66 A key focus of this principle is to ensure that all benefits, including positive externalities, are taken into account. It also asks how the benefits of the change in charges are distributed, i.e. between the firm terminating the call, the firm originating the call, and to their respective customers.

Colt's view

4.67 Colt considered that this principle does not appear to be relevant to the present dispute save to the extent it would be relevant in relation to call termination generally.

BT's view

4.68 BT did not make any specific submission on the distribution of benefits point.

Ofcom's provisional view

4.69 In the context of this dispute, the distribution of benefits factor is most relevant to the question of which party benefits from Colt's provision of its resilience service. The form of resilience chosen by Colt has the impact of effectively increasing the cost of terminating all calls to customers on the local switches in question on its network – even where the called party does not use the resilience service - since calls to any customer on **[✂]**out of **[✂]** of Colt's local switches must be routed via a Colt tandem switch.

4.70 The primary beneficiary of the resilience service is clearly the party selecting it, i.e. the Colt customers in question. **[✂]** [77] The impact of Colt's resilience service is to

[77] **[✂].**

raise the switching and routing costs of many calls to Colt's customers. If combined with the increase in Colt's termination charges that would result from the implementation of its proposal, calling parties (and originating networks on their behalf) could not avoid paying the higher call termination charges.

4.71 For these reasons, we do not consider that the distribution of benefits favours Colt's proposal when the originating network is unable to avoid traffic hand-over at Colt's tandem layer.

Practicability

Rationale

4.72 This principle suggests that the termination rate determined should be practicable and relatively easy to implement.

Colt's view

4.73 Colt considers that its proposal is practicable and easy to implement.

BT's view

4.74 BT's submission of 23 September 2010 set out some practical issues relating to Colt's proposal and it elaborated further on these at a meeting on 23 September 2010. BT pointed out the following practical difficulties with Colt's proposal:

- IA, CPS and ported numbers make it impossible to identify whether calls should be attributed to the range holder or a third party transit provider;
- where a CP is using a third party transit provider but is also itself a third party transit provider, there will be a cascade of call minute assignment through multiple CPs;
- it is difficult to envisage correct application of call minutes to CPS and avoid double counting of call minutes – minutes delivered via a third party transit provider would need to be removed from the X ratio of the party providing the transit;
- the mechanism to administer such a complicated principle would almost certainly be expensive and time consuming, and result in increased costs.

4.75 As noted above, BT also told us that it made a similar proposal during industry negotiations. BT's proposal would have required identification of the call originator and cascading of minutes back through the call chain in a similar fashion to that now being proposed by Colt. BT stated that the other CPs it consulted on these proposals, including Colt, believed that assignment of call minutes to any party other than the party handing the call to BT was impractical to implement.

Ofcom's provisional view

4.76 Colt's OCCN and its dispute submission did not set out any proposals as to how the traffic volumes originating on Colt's network and delivered to BT via its third party transit provider would be measured and verified in order to calculate its termination rate.

4.77 In a meeting with Ofcom on 1 November 2010, Colt stated that it envisaged making a declaration to BT regarding the volume of traffic it sent to BT via its third party transit provider in order to allow BT to calculate Colt's termination rate. Colt suggested that BT could verify such a declaration by identifying Colt's Caller Line Identities ("CLIs") for originating traffic delivered via a third party transit provider. However, even assuming CLI verification as suggested by Colt was technically feasible, such an approach would not account for:

i) chargeable minutes from Colt customers using imported geographic numbers (or, in the case of exported Colt geographic numbers, incorrectly accrue minutes to Colt for the purposes of its termination rate calculation), or

ii) those Colt customers served by BT exchange lines using CPS or IA to make outbound geographic calls over the Colt network.

4.78 Colt went on to suggest that another way of carrying out this verification would be for Ofcom to collect this data using its formal information gathering powers under section 135 of the Act and report these traffic figures to BT for the purposes of calculating Colt's termination rate. Our powers under section 135 of the Act are limited to gathering information which we consider relevant for the purposes of our functions under Chapter 1 of Part 2 of the Act. We are unconvinced that an information request for these purposes would fall within the scope of our legal powers. In any event, we consider that it would be an inappropriate use of Ofcom's resources (which are funded by industry at large) for us to become directly involved on a recurrent basis in the commercial billing arrangements between two CPs.

4.79 It is therefore unclear to us whether it would be practicable and easy to implement Colt's proposal as between Colt and BT.

4.80 As set out in relation to our consideration of cost minimisation, we are also aware of the need to avoid double counting traffic for the purposes of Colt's termination rate and the termination rate of its third party transit provider. To avoid double counting, the traffic volumes used in the calculation of the termination rate of Colt's transit provider would need to be adjusted to remove traffic originating on Colt's network.[78] Again, there would be an issue of auditing and verifying traffic figures which would need to be agreed between Colt, BT and the transit provider.

4.81 We also note that there are potentially wider implications of Colt's proposal. While Colt's proposal only relates to how its own termination rate is calculated, if this were implemented we would expect other CPs to seek the same or similar treatment of their traffic in the calculation of their termination rates. Therefore the outcome of this dispute could potentially have an impact across the industry.

4.82 If a wider implementation of Colt's proposal did take place, the calculations of Rate A would require traffic delivered by transit operators to BT's local switches to be split by each OCP in order to correctly calculate a termination rate for each individual CP. As BT notes, in some cases this might involve cascading of billing minutes back through more than one transit operator. As noted above, ported numbers, IA and CPS are likely to increase the complexity of the process.

[78] We raised this issue with Colt in our meeting of 1 November 2010. Colt suggested that removing its traffic would have little practical effect on the level of its transit provider's termination rate. However, Colt did not question, in principle, our view that this exercise would need to be carried out so as to avoid double-counting. We have not taken a view on whether this type of adjustment would have a material impact in practice.

4.83 It is difficult to envisage a way that all of these practicability issues could be taken into account without significant system and billing changes being required to identify the OCP for each call arriving at BT's switches. This view is supported by Colt and other CPs' apparent rejection of an earlier BT proposal to use traffic routed via third parties in the calculation of termination rates on the grounds of practicability, as noted in paragraphs 4.74-4.75 above.

4.84 We note that while the approach to setting termination rates under the expired Reciprocity Agreement has some complications, the industry has, over time, developed the systems and processes required to handle these complexities.

4.85 We consider that the potential level of disruption to industry practices which would be caused by the implementation of Colt's 14 December 2009 OCCN, at a time when we are consulting on a future regime for geographic termination rates, is significant (as noted above, we believe that if Colt's proposals were implemented then other CPs may be incentivised to seek similar changes to their termination rates). The outcome of Ofcom's September 2010 Consultation could also lead to any changes arising from this dispute being reversed in a relatively short period of time if Ofcom's preferred policy option is adopted.

4.86 Our reluctance in this dispute potentially to subject industry to short-term, and possibly costly changes, is consistent with the approach we adopted in the recent 0845 dispute,[79] in which we stated that:

> "[…] There is a distinction between current industry practice and regulatory policy. In our analysis in this Dispute we consider it appropriate to accept existing regulatory policy as a given, and an appropriate background against which to assess new charges for calls to 0845/0870 numbers. We do not take current industry practice as given in the same way. However, we consider it relevant to take account of the consequences of substantial changes to current practice due to NCCNs 985 and 986.
>
> We have not used the NGCS Review as sufficient reason in itself for not finding NCCNs 985 and 986 to be not fair and reasonable. However, we do consider that various aspects of the policy review should be taken into account. For example, as we pointed out in paragraph 2.163 of the Supplementary Consultation, NCCNs 985 and 986 could impose material disruption to the industry in advance of a possible further set of changes introduced following the conclusion of the NGCS Review.[…]."[80]

4.87 As set out above, we consider it is appropriate in dispute resolution to take existing regulatory policy as given, and do not consider it would be appropriate for dispute resolution to be used as a tool to change regulatory policy. This is because disputes typically involve only a sub-set of those who might be affected by a change in wider regulatory policy. Changes to regulatory policy should therefore in our view be made following consultation with all of those affected. By contrast, we do not consider that established industry practice (i.e. the expired Reciprocity Agreement) need necessarily be taken as given. Nevertheless, in our view established industry practice

[79] Ofcom's Determination to resolve a dispute between BT and each of Vodafone, T-Mobile, H3G, O2, Orange and Everything Everywhere about BT's termination charges for 0845 and 0870 calls, 10 August 2010, paragraphs 8.193-194.

[80] http://stakeholders.ofcom.org.uk/binaries/enforcement/competition-bulletins/closed-cases/all-closed-cases/761146/Final_Determination.pdf

and declared future policy proposals provide relevant context, even if they are not in themselves determinative of how we would resolve a dispute. We consider that in individual cases (of which in our view this is one) they are likely to be relevant considerations that we should take into account in resolving disputes.

4.88 Taking all the above considerations into account, our provisional conclusion is that the principle of practicability does not support Colt's proposal.

Provisional conclusions on the six principles

4.89 The issues relating to the principles of cost minimisation and effective competition are closely related in the context of this dispute. We consider that, while Colt's proposal may alleviate one potential distortion, it may lead to other potential distortions. We have therefore provisionally concluded that the principle of cost minimisation does not provide clear or unambiguous support for Colt's proposals. While there may be some evidence that Colt's proposals are supported by the principle of effective competition, the evidence is mixed and it is unclear to us that there is necessarily a net advantage of Colt's proposals in terms of competition, and even if there were, there are limits on the scale of any such advantage.

4.90 Our provisional conclusion is that the principles of cost causation, distribution of benefits and practicability do not support Colt's proposal. The principle of reciprocity is not determinative in this dispute.

4.91 We have therefore provisionally concluded that, on balance, the six principles of pricing and cost recovery do not support Colt's proposal.

Benchmarks

4.92 We have also considered if there are any benchmarks that are relevant in this dispute.

4.93 Our policy on the interpretation of SMP Condition BC1 was re-stated in the 2009 Market Review. Although it does not mandate that charges should be based on BT's charges, it highlights that charges not based on BT's rates are unlikely to fair and reasonable (BT's rates being a proxy for the costs of an efficient operator). For this reason we consider that the relevant benchmarks in this dispute are BT's termination charges and that examination of other benchmarks (such as fixed termination rates in other countries) is unlikely to prove helpful in determining this particular dispute.

4.94 We note that, whilst Colt's dispute submission included an annex detailing regulatory regimes for fixed termination in other EU territories, Colt made no direct reference to this annex in its submissions. What is more, the remedy that Colt specifically seeks is a blended rate of BT's LE and ST rates based on the inclusion of LTT traffic in the calculation of Rate A for Colt under the reciprocity formula. Colt makes it very clear from the outset of its dispute submission that it "does not seek to challenge the current principle (…) This dispute between the parties is concerned solely with the form in which reciprocity has been given effect by BT in the interim period."[81]

4.95 We therefore do not consider it informative to examine any benchmarks beyond those provided by BT's rates.

[81] Section 1 of Colt's dispute submission of 10 August 2010.

Provisional conclusions of Ofcom's analysis

4.96 Based on the analysis set out above, our provisional conclusion is that Colt's proposal set out in its OCCN of 14 December 2009 is not fair and reasonable in line with SMP Condition BC1. This is therefore reflected in our draft determination set out at Annex 1.

4.97 If, as we provisionally propose, we reject Colt's proposal, we will require the parties to revert to the previous terms on which they did business, unless and until they agree other terms. We note that such terms might be modified to reflect any changes to BT's ST and LE rates in the interim and that this is a matter on which the parties have not yet engaged in commercial negotiations.

Section 5

Consideration of the responses to the draft determination

5.1 In this Section we summarise the responses which we received to our consultation on the draft determination and our consideration of those responses. We also set out our final conclusions on the issues raised in this dispute, having taken into account the parties' responses and our statutory duties as discussed below.

Responses to the consultation

5.2 Ofcom received responses to its draft determination from:

- Colt;
- BT;
- **[✂]** who asked not be named;
- **[✂]** who asked not be named; and
- Verizon.

5.3 We also had a meeting with Colt on 1 December 2010 to discuss Colt's comments on the issues raised in our draft determination.

General comments

5.4 Colt stated that it was "disappointed" with our provisional conclusion. In contrast, BT, **[✂]** and **[✂]** were supportive of the conclusions reached in our draft determination. Verizon disagreed with our approach and reasoning. However, it stated that it "does not totally support the mechanism proposed by Colt for addressing this issue but the principle is certainly correct", as in Verizon's view the existing arrangements by which BT determines geographic termination rates are not fair and reasonable. It said that BT's behaviour undermined "the ability for CPs to route traffic by an alternative provider". Verizon considered that "whilst not necessarily upholding Colt's dispute" our determination should "at least" tackle "the problems around how transit traffic is managed". Verizon stated that its preferred arrangement was for an "industry average" weighting to be used in the X ratio as proposed by Colt's OCCN of 23 December 2009.

5.5 BT supported the view set out in the September 2010 Consultation that until any new guidance takes effect "arrangements should continue on the basis of the expired Reciprocity Agreement unless there have been some material changes of fact since its expiry".[82]

5.6 A respondent who asked not be named[83] said that we should make clear in any final determination that Colt's decision to use a third party to deliver traffic to BT should

[82] BT's response to draft determination, page 1.
[83] **[✂]**

not be held against it, however in the absence of a practical way to measure such traffic it was appropriate to remain with the status quo. Another respondent who asked not to be named[84] expressed support for our proposed outcome without making detailed comments on our analysis.

Approach to addressing issues raised in responses

5.7 In the following paragraphs we group the consultation responses around three themes and then set out our view on each of these themes. Our analysis includes any required clarifications and revisions of the analysis set out in Section 4.

5.8 The themes around which we have grouped the consultation responses are as follows:

- Ofcom's assessment under the six principles
- Comments and links to Ofcom's policy review
- Reversion to the parties' previous terms of business

Ofcom's assessment under the six principles

5.9 BT agreed that the six principles of pricing and cost recovery provided an appropriate framework to consider this dispute but did not make any specific submission on the individual principles. None of the other respondents commented in their submission on the general framework we applied.

Cost causation

Consultation responses

5.10 Colt considered it extremely unlikely that an increase in its termination rates by **[✂]** would result in callers to Colt's network paying higher retail prices. It said that it was not aware of any CP that charges differential retail rates for calling geographic numbers based on the identity of the range holder. Colt argued that such a pricing strategy would be confusing to retail customers and immensely complex to achieve in billing systems because of the huge numbers of ranges that would need to be given differential pricing.[85]

5.11 In reference to paragraph 4.21, in which we discuss a potential narrow interpretation of the principle of cost causation, Colt said that it was surprised that we should consider and discuss an argument that Colt had not made in the dispute. It seemed to Colt that during the investigation period we were preoccupied with the question of MSO status and tandem switching, when all Colt was asking for was to have LTT traffic included in the calculation of the 'X' ratio in the reciprocity formula. Colt said that the 'geographic footprint' arguments described in section 6.4 of its dispute submission should prevail and that smaller CPs should have a lower 'X' factor.[86]

[84] **[✂]**
[85] Colt's response to draft determination, page 2.
[86] Ibid.

5.12 Whilst Colt reiterated that it was not basing the dispute on the recovery of costs, it submitted some illustrative cost data that it said could demonstrate that it did not recover its costs at the tandem layer.[87]

Ofcom's view

5.13 We accept that CPs are unlikely to commence charging differential retail prices for calls to different range holders, if Colt's termination rates charged to BT were raised by approximately **[✂]**. However, the increase in termination rates would increase the marginal costs to BT (and CPs using BT as a transit provider) of sending calls to Colt. In principle, such an increase in costs would (at least to a significant extent) ultimately be passed-through to retail consumers. The effect may not be on a higher price for calls specifically to Colt's network, given the typical practice of not setting differential prices, but the increase in costs may affect other prices. This is especially so, given that BT no longer has SMP in the retail market.[88]

5.14 In addition, there is a point about the potential wider applicability of Colt's proposal. As stated in paragraph 4.81, if Colt's proposal were implemented, we would expect other TCPs to seek the same or similar treatment of their traffic in the calculation of their termination rates. An increase in the termination rate of a single TCP may have a relatively small impact on the costs faced by OCPs (when taken across all calls originated on its network), particularly if the TCP's network is limited in size relative to all other fixed networks. However, if applied across a number of other TCPs, increases in termination rates would cause a larger increase in costs and so might have a larger impact on retail prices. Therefore the outcome of this dispute could potentially have an impact across the industry even where retail prices are typically not differentiated by terminating network.

5.15 Colt said that it was surprised by our consideration of arguments that Colt had not itself put forward.[89] However, we believe the discussion around MSO status and the reason behind traffic being delivered to Colt's tandem switches to be an important element in our consideration of cost causation. We resolve disputes as the regulator in light of our statutory duties and are not limited to the arguments put forward by the parties.

5.16 In section 6.4 of its dispute submission, Colt described the genesis of the expired Reciprocity Agreement and Oftel's related comments about the differences in network topology between BT's and OLO's networks and the need to uplift OLO termination rates to reflect what Oftel saw as two services (i.e. tandem and local switching) being provided by OLO switches.[90] As set out in paragraph 2.26, the expired Reciprocity Agreement takes account of these 'geographic footprint' considerations by providing TCPs with a blend of BT's LE and ST rates. Colt's current termination rate remains a blend of those rates.

[87] Ibid, page 2-3.

[88] In competitive markets changes in marginal costs would be passed through to downstream prices. However, where services are sold as part of a bundle, an increase in the upstream price (in this case termination) may no longer feed-through fully to the corresponding downstream price (in this case calls to fixed geographic numbers). Such an effect has been observed in other termination markets – for example mobile termination, see paragraph A13.45-A13.46 and paragraph A13.150 of Ofcom's April 2010 consultation: *Wholesale mobile voice call termination*. Nevertheless, if originating networks do not pass on increases in termination rates to downstream customers (whether directly via relevant call charges or indirectly via other charges) the originating networks would have to absorb the loss.

[89] See paragraph 4.21 above.

[90] See paragraphs 2.19 to 2.21 above.

5.17 To the extent that Colt is submitting that it should receive an increase to its current (blended) termination rate due to the geographic footprint of its switches[91], then there are a number of reasons why we do not think this provides a strong case for concluding that Colt's proposed methodology is fair and reasonable:

5.17.1 First, even if Colt's switches serve a greater geographic footprint than BT's, Colt has not provided evidence that the associated costs of termination would be higher.

5.17.2 Second, Colt's proposed methodology (i.e. uplifting its termination rate so that its own-originated LTT traffic counts towards ST rate weighting) would be an imprecise proxy for such additional costs as might be incurred – in so far as Colt's switch footprint is larger than BT's and that this larger footprint actually generates higher costs for termination on Colt's network.

5.17.3 Third, Colt has not been resting its case for a higher termination rate on cost under-recovery. Where it has referred to the prospect of cost under-recovery, this has been in the context that the traffic is delivered at its tandem layer but under the expired Reciprocity Agreement Colt receives a rate much closer to the BT LE level.[92] We have dealt with the implications of this situation in Section 4.[93]

5.18 In response to Colt's concern set out in its response to the draft determination that we should recognise that cost recovery analysis was not included in the scope of Colt's submission, this is duly noted. For the avoidance of doubt, we fully accept that Colt is not resting its case on cost recovery. In its response to our draft determination Colt provided an estimate of its tandem layer switching cost per minute. While this provides an indication of the potential level of tandem layer costs, it does not provide clear evidence of cost under-recovery.[94]

5.19 For the reasons set out in Section 4 and above, we continue to believe that the principle of cost causation does not support Colt's proposal.

Cost minimisation

Consultation responses

5.20 In its submission, Colt expressed its views on BT's arguments that we set out in paragraphs 4.29 and 4.30. In particular it disagreed with BT's comment that Colt's proposal would introduce a perverse incentive on CPs to use third party LTT in preference to building out to BT's local switches, saying that it did not consider this

[91] We note that neither section 6.4 of Colt's dispute submission nor its response to our draft determination sets out an explicit argument to this effect, but we understand this to be the basis for Colt's reference to 'geographic footprint' arguments in the context of the cost causation principle.

[92] Both Colt's submission of 10 August 2010 (page 21) and of its letter of 26 August 2010 (page 3) suggest that Colt's position on cost under-recovery is around the issue of the point of hand-over rather than geographic footprint.

[93] See paragraphs 4.14-4.21.

[94] The cost per minute estimated by Colt appears to relate only to the switching costs at the tandem layer and not to the costs of the local-tandem link on its network, nor to the switching and conveyance costs at the local level. Only by comparing the unit costs of these network elements to the termination rate which Colt receives can the first level of cost recovery analysis be assessed. However, the full cost recovery analysis would also need to consider the appropriateness of calling parties paying all these costs when it is Colt's number hosting decisions for a subset of called customers which effectively raises the cost of call hand-over for originating CPs for all calls to Colt's network. We have dealt with this latter issue under the headings of cost causation and distribution of benefits in Section 4.

incentive as "any more 'perverse' than the present arrangements where the reduction in termination revenue incentivises the use of ST instead of LTT."[95]

5.21 Colt further referred to BT's suggestion that LTT providers might use another CP to transit their own traffic to BT in order to increase their termination revenues. It argued that this was a theoretical possibility but it was unlikely that any CP would follow this course of action as, in Colt's view this would not produce any significant or lasting benefits in light of the proposals set out in our September 2010 Consultation. Colt then went on to explain the necessary arrangements and costs associated with re-routing the traffic and concluded that the benefit to a CP would be marginal and may be negated by the costs of implementing the temporary solution.[96]

<u>Ofcom's view</u>

5.22 In our view Colt's proposal maintains the distortion in build versus buy decisions that Colt had highlighted in relation to the expired Reciprocity Agreement, because Colt's proposal retains a link between outbound traffic and a CP's own termination rates.

5.23 We note Colt's comments challenging BT's argument that Colt's proposal might incentivise LTT operators to use another CP to transit their own traffic to BT in order to increase termination revenue. Decisions to change traffic routing in the way BT suggested are unlikely to be costless for the CP in question. However, this is likely to be the case for any change of traffic routing between the three options set out in paragraph 4.31. The balance of costs and benefits and hence the incentives to switch identified by BT are likely to differ for each CP. Neither Colt nor BT has provided evidence of the materiality of the potential switching effects between the choices (a) to (c) in paragraph 4.31, i.e. to build own infrastructure to BT local switches; buy LTC from BT; or buy LTT from a transit operator.

5.24 We therefore continue to consider that the potential incentive identified by BT cannot be discounted from consideration under the principle of cost minimisation. Even if the concern identified by BT were not material in practice, there remains a potential distortion between buy and build decisions, because Colt's proposal maintains a link between a CP's outbound and inbound traffic.

5.25 We therefore remain of the view that the principle of cost minimisation does not provide clear or unambiguous support for Colt's proposal.

Effective competition

<u>Consultation responses</u>

5.26 Colt stated that, from the point of view of a mid-size CP, the market for LTT is effectively 'killed' by the expired Reciprocity Agreement. Colt also said that in our 2009 Market Review we did not take into account (or at least mention or discuss) the effect on termination rates when LTT is used instead of LTC. [97]

5.27 Verizon disagreed with what it characterised as our view that competition in LTC and LTT was not affected by the current arrangements. It quoted a section from the 2009 Market Review saying that Ofcom believed that the ability of CPs to route traffic via an alternative LTT provider was the key determinant of whether BT had SMP in this

[95] Colt's response to the draft determination, page 3.
[96] Ibid.
[97] Colt's response to draft determination, page 4.

market. Verizon argued that "BT's behaviour" undermined any such ability and that this allowed BT to "leverage dominance from the local markets in which BT was still designated as [sic] SMP into the newly-liberalised and closely related local tandem markets". Verizon said that, as such, this "potentially undermines the (comparatively new and fragile) competition in those markets".

5.28 In Verizon's view, the exclusion of LTT minutes sent from a CP to BT from the calculation of that CP's termination rates distorted the transit market and put other operators at a competitive disadvantage when offering the transit service.[98] However, Verizon also accepted our provisional conclusion in relation to the principle of effective competition (paragraph 4.57) in the context of this specific dispute.[99]

5.29 One of the respondents who asked not to be named also disagreed with what it perceived as our assessment that the current reciprocity arrangements are "not adversely impacting competition in the geographic transit market". It said that BT was taking an increasingly assertive approach to this market **[✂]**. **[✂]** it believed that it was unfair that an OCP utilising LTC would see no adverse impact on their own termination rates, but one using LTT would see their own termination revenues reduced. The respondent went on to say that this situation would persist until the linkage between inbound termination rates and outbound traffic was removed, as proposed in the September 2010 Consultation.[100]

Ofcom's view

5.30 In response to Colt's comments about the assessment of competition in the 2009 Market Review, we note that the relevant market was considered as a whole and not segmented according to differently sized operators.[101]

5.31 As Colt has noted, our assessment of competition in the LTC/LTT market in the 2009 Market Review did not discuss the effect on termination rates when LTT is used instead of LTC, since the review formed the basis for *ex ante* regulation and the Reciprocity Agreement was due to expire.[102]

5.32 Nevertheless, we concluded that the market had become sufficiently competitive and that it was appropriate to remove price regulation on BT. This competition assessment was based not just on a forward look but also market evidence (such as market share evidence and switching evidence) from historic periods when the expired Reciprocity Agreement was active and had been so for a number of years.[103] Moreover, the decision in the 2009 Market Review came after we had previously relaxed regulation on BT in the LTC market in our Review of BT's Network Charge Controls in 2005 – i.e. because competition had at that point increased.[104] Since then we judged that there was further evidence of the evolution of competition, such as a fall in BT's share of external LTC supply from around 80% in 2003/4 to around 30% in 2008/9.[105]

[98] Verizon's response to draft determination, page 2.
[99] Verizon's response to draft determination, page 3.
[100] **[✂]** response to draft determination, page 1.
[101] See paragraphs 8.1-8.9 of the 2009 Market Review - http://stakeholders.ofcom.org.uk/binaries/consultations/wnmr_statement_consultation/summary/main.pdf
[102] See paragraph 8.69 *et seq* of the 2009 Market Review.
[103] See paragraph 8.18 and paragraphs 8.33-8.37 of the 2009 Market Review.
[104] See paragraphs 6.46-6.53 of the Review of BT's Network Charge Controls in 2005- http://stakeholders.ofcom.org.uk/consultations/charge/statement/
[105] See Figure 8.1, page 63 of the 2009 Market Review.

5.33 Both Verizon's and **[✂]** comments suggest that we claimed that the expired Reciprocity Agreement has had no effect on competition in transit. This is not our position. We recognised the potential for the expired Reciprocity Agreement to incentivise some CPs to use BT LTC rather than third party LTT. However, the evidence from the evolution of competition from the 2005 and 2009 Market Reviews suggests a limit to the extent of any harm to competition or consumers (as any such potential distortion as might arise has not had a sufficiently material impact on competition to prevent the market for LTT/LTC from becoming effectively competitive). This is why we concluded at paragraph 4.57 of the draft determination that the evidence is mixed and it is unclear to us that there is necessarily a net advantage of Colt's proposals in terms of competition. This continues to be our view having considered the responses above.

Reciprocity

5.34 None of the respondents raised any specific comments in their submission relating to our analysis of the reciprocity principle. Our position therefore remains as set out in the draft determination (see paragraphs 4.63-4.65).

Distribution of benefits

<u>Consultation responses</u>

5.35 One of the respondents who asked not to be named supported Ofcom's conclusions on the distribution of benefits principle. It said that it appeared that Colt's requirement to tandem traffic on its network was an optional one that Colt had chosen to undertake for its own purposes, which provides direct benefit to Colt's customers. It believed that the cost of this optional routing should not be borne by the originating CP, but by Colt.[106]

5.36 Colt did not provide any comments on this issue.

<u>Ofcom's view</u>

5.37 In light of the above comment and our analysis set out in paragraph 4.69 to 4.71, we remain of the view that the distribution of benefits principle does not favour Colt's proposal.

Practicability

<u>Consultation responses</u>

5.38 One of the respondents who asked not to be named agreed with our concerns around practicability. In particular, it said that if traffic routed via third party transit providers were included in the formula for an OCP's termination rate as Colt suggested, there would not be any practical way to measure the traffic in question as it would be routed using the transit provider's network. Further, the respondent pointed out that it was unclear what would actually be measured; the actual traffic routed via the transit provider or the theoretical amount of traffic that Colt would otherwise have directed to BT's tandem layer.[107]

5.39 Colt did not provide any comments on this issue.

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[106] **[✂]** response to our draft determination, page 2.
[107] **[✂]** response to our draft determination, page 2.

Ofcom's view

5.40 We agree with the respondent's concerns about practicability.

5.41 Based on our analysis in paragraphs 4.76-4.88 and the responses to the draft determination, we continue to be concerned that it would not be practicable and easy to implement Colt's proposal. We are therefore of the view that the principle of practicability does not support Colt's proposal.

Comments and links to Ofcom's policy review

Respondents' views

5.42 A number of respondents commented on Ofcom's September 2010 Consultation relating to fair and reasonable charges for fixed geographic call termination. We have not summarised all of the views expressed, except where relevant to this dispute.

5.43 In its response to our draft determination, Colt observed that our provisional findings would keep Colt's termination rate "at DLE level" which it noted is the same rate as our preferred option (Option 3 – to set all termination rates equal to BT's LE rate) in our September 2010 Consultation.[108]

5.44 Verizon's response suggested that we had fettered our discretion in dealing with Colt's dispute (and other potential disputes) having published our preferred approach for setting fair and reasonable charges for fixed call termination in our September 2010 Consultation[109]. Verizon also disagreed with our statement at paragraph 4.55 of the draft determination, saying that this paragraph asserted that the best way to address distortions created by the linkage between outbound traffic to BT and the CP's rate for terminating traffic from BT was the adoption of Option 3 in our September 2010 Consultation[110].

5.45 As set out in paragraph 5.4 above, Verizon considered that "whilst not necessarily upholding Colt's dispute" our determination should "at least" tackle "the problems around how transit traffic is managed". Verizon stated that it viewed Colt's second OCCN of 23 December 2009 as "a much fairer mechanism" for determining termination rates. However, Verizon recognised that this proposal was being considered as part of the September 2010 Consultation and therefore this issue "is for another day".

Ofcom's view

5.46 The termination rate Colt presently receives from BT and BT's LE rate during the period 1 January to 30 September 2010 are shown in the table 4 at paragraph 3.21. Colt's current rate is slightly above BT's LE rate derived, as explained in Section 2, through the application of the formula set out in the expired Reciprocity Agreement which includes traffic rated at both the LE and ST rate. Our provisional conclusion in the draft determination was to reject Colt's proposal for calculating its termination rate, set out in its OCCN of 14 December 2009, and that the parties should revert to the previous terms on which they did business, i.e. a rate based on the terms of the expired Reciprocity Agreement. This provisional conclusion is clearly not the same as

[108] Colt's response to draft determination, page 2.
[109] Verizon's response to draft determination, page 1.
[110] Ibid, page 3.

Option 3 in the September 2010 Consultation which would have involved us requiring Colt to set a termination rate no higher than BT's LE rate.

5.47 While we do not consider that a comparison with the options set out in our September 2010 Consultation was relevant, were such a comparison to be made our determination would result in the parties reverting to an outcome (until the parties agree otherwise) closer to Option 1 in the September 2010 Consultation. That is, by reverting to the previous terms on which the parties did business, the resulting termination rate would essentially be as determined by the expired Reciprocity Agreement (at least as based on historic values for the prices and weights used in the formula).

5.48 We do not accept that, as Verizon alleged, we have fettered our discretion in dealing with Colt's dispute by publishing our September 2010 Consultation. Our determination shows very clearly how we have assessed this dispute, defined by its scope and on its own particular facts, against the six principles of pricing and cost recovery and how we reached our conclusion taking our statutory duties and Community requirements into consideration. As noted in paragraph 5.61, we consider this determination to be consistent with previous decisions in relation to fixed geographic call termination such as the June 2006 Telewest dispute and October 2009 Opal dispute.

5.49 Verizon also criticised the timing of our September 2010 Consultation saying that we should have determined Colt's and any other potential disputes first. It should be noted that we signalled our intention to provide guidance on the interpretation of the fair and reasonable obligation in the fixed call termination markets in our January 2010 Statement on Next Generation Networks and confirmed this in our Annual Plan (published 31 March 2010). We received Colt's dispute submission on 10 August 2010. By that time our policy work around proposed guidance on fair and reasonable termination charges was at a fairly advanced stage (we published our September 2010 Consultation shortly after accepting Colt's dispute for resolution). Delaying our consultation until we had disposed of Colt's and any other potential disputes would have undermined the key reasons for providing guidance i.e. to settle uncertainty and avoid disputes given industry's failure to agree a way forward following the expiry of the Reciprocity Agreement in September 2009. We have no control over the timing of dispute submissions, and it would not be appropriate for us to delay policy work which affects stakeholders more widely because a dispute has been brought to us.

5.50 We also refute Verizon's characterisation of our position in the draft determination. According to Verizon, we said that the best way of addressing distortions arising from the linkage between outbound traffic to BT and CP's termination rates is to adopt Option 3 in the September 2010 Consultation. However, in paragraph 4.55 of our draft determination we simply noted that "one way" to avoid the potential distortions of both the expired Reciprocity Agreement and Colt's proposal was to separate the termination rate CPs receive from their outbound routing decisions and that we had proposed such an option in our September 2010 Consultation.

5.51 In response to Verizon's comments relating to Colt's second OCCN of 23 December 2009, we consider that the issue is outside the scope of the current dispute.

Reversion to the parties' previous terms of business

Respondents' views

5.52 In its response, Colt referred to our provisional conclusion that we would require the parties to revert to the previous terms on which they did business. Colt said that it would prefer Ofcom to state that "BT is obliged to pay Colt its termination rates, calculated according to the reciprocity agreement". Colt also noted that BT had not in fact rolled over the expired Reciprocity Agreement in full since it did not take measurements in May 2009 or May 2010.[111]

Ofcom's view

5.53 We have set out the scope of the dispute in paragraph 3.11 and, as noted in paragraph 3.12, we invited comments from the parties on the wording of this scope. The scope is limited to whether the fixed geographic termination rate proposed by Colt to BT in its OCCN of 14 December 2009, with effect from 1 March 2010, is fair and reasonable.

5.54 In our draft determination[112] we also explained that if Colt's proposal were rejected, "we will require the parties to revert to the previous terms on which they did business, unless and until they agree other terms". We noted at paragraph 1.29 of the draft determination that BT's termination rates had changed during the period covered by the dispute and that, following the resolution of the dispute, the parties may seek to negotiate on how this should now be taken into account in Colt's termination rate. As the parties have not yet held negotiations on the issue, or held discussions regarding the requirement for a re-sampling of Colt's traffic delivered to BT, we do not consider it would be appropriate for us to determine this matter.

Final conclusions

5.55 For the reasons set out in Sections 4 and 5 of this determination, we conclude that there should be no change to the provisional conclusions on which we consulted. Our final conclusions are therefore as follows:

- Colt's proposed termination rates as set out in its OCCN of 14 December 2009 are not fair and reasonable.

- On balance the six principles of pricing and cost recovery do not support Colt's proposal. There is mixed evidence as regards the principles of cost minimisation and effective competition, but our application of these principles does not provide clear or unambiguous support for Colt's proposals. Our analysis of the principles of cost causation, distribution of benefits and practicability do not support Colt's proposal. The principle of reciprocity is not determinative in this dispute.

- Having rejected Colt's proposal, we will require the parties to revert to the previous terms on which they did business, unless and until they agree other terms. We note that such terms might be modified to reflect any changes to BT's ST and LE rates in the interim and any re-sampling of Colt's traffic delivered to BT's local and tandem layers and that this is a matter on which the parties have not yet engaged in commercial negotiations.

[111] Colt's response to draft determination, page 4.
[112] See paragraph 1.29.

Assessment of conclusions against Ofcom's statutory duties and Community requirements

5.56 Taking into consideration all the comments from the parties, our assessment of conclusions against Ofcom's statutory duties and Community requirements is set out below.

5.57 In reaching our conclusion, we have carefully considered our general duties in section 3 of the Act and also the six "Community requirements" set out in section 4 of the Act, which give effect, among other things, to the requirements of Article 8 of the Framework Directive.[113] We consider that our final conclusion is consistent with these regulatory objectives.

5.58 Colt has submitted that our duties relating to competition (subsections 3(1), 3(4)(b), 4(3) and 4(7) of the Act) are of pre-eminent importance, and that its proposal removes a distortion of competition in the LTT/LTC market which is caused by the expired Reciprocity Agreement. As noted in paragraphs 4.36 and 5.33, we recognise that the expired Reciprocity Agreement has the potential to incentivise some CPs to use BT LTC rather than third party LTT. However, we consider that there are limits on the materiality of any distortion of competition that existed (or continues to exist). We also consider that our duties to promote competition should not be viewed in isolation, but rather in the context of the impact that competition has on consumers. In this case, we note that the 2009 Market Review found the LTT/LTC market to be effectively competitive which suggests a limit to the extent of any harm to competition or consumers. We also note that there is the potential for Colt's proposal to lead to other distortions (although the materiality of such concerns is uncertain).

5.59 Furthermore, the requirement for Colt's termination rate to be fair and reasonable (SMP Condition BC1) results from the lack of competition in the termination of calls on Colt's network. Our final conclusion ensures that Colt is not able to exploit its market power by the imposition of excessive charges, which could ultimately be borne by consumers. As explained in paragraph 4.19, Colt's conduct, in a market in which it has SMP, prevents BT and other CPs from interconnecting at **[✂]** of Colt's **[✂]** local switches, given current routing technology. If we were to accept Colt's proposal, BT would be subject to a higher termination charge but have no ability to reduce this charge by interconnecting at a deeper level in Colt's network (or using a third party which had itself built out to Colt's local switches). As set out in paragraphs 4.22, 5.13 and 5.14, such an increase in costs faced by BT could in principle result in an increase in prices faced by consumers, in particular if applied more widely.

5.60 We therefore consider that our final conclusion accords with our primary duty to further the interests of citizens and consumers (subsections 3(1) and 3(5) of the Act) as it avoids an increase in Colt's termination charge, which could ultimately be passed onto consumers.

5.61 We have also considered our duty to encourage the provision of network access and service interoperability for the purposes of securing efficiency and sustainable competition in communications markets and the maximum benefit for the customers of communications network and services providers (subsections 4(7) and 4(8) of the Act). We consider this duty to be of relevance since this dispute concerns the service of call termination, which is essential for encouraging interoperability between different networks, so that customers of one network can call the customers of other networks (and the latter receive such calls).

[113] Directive 2002/21/EC.

5.62 We consider that our final conclusion is reasonably practicable (subsection 3(4)(m) of the Act) as we have decided that the parties' existing arrangements should continue to have effect. By contrast, and for the reasons explained in paragraph 5.41, we believe that Colt's proposal is likely to be complex to implement and would therefore not be reasonably practicable.

5.63 We have also had regard to the desirability of encouraging investment and innovation (subsection 3(3)(d) of the Act). Colt has argued that the impact of reciprocity on "build or buy" decisions has not adequately been taken into account in the past, noting that regulation should not distort the costs and benefits to be achieved from infrastructure investment. As noted in paragraphs 4.44 and 5.22, we consider that Colt's proposal maintains the similar distortion in relation to "build or buy" decisions as presently exists. In relation to least-cost routing decisions, whilst Colt's proposal may address one potential distortion, it may create other potential distortions.

5.64 In reaching our final conclusion, we have kept in mind our duty under subsection 3(3)(a) of the 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 conclusions, and the parties have had an opportunity to comment on this in advance of our final determination. We consider that this determination is consistent with previous decisions in relation to fixed geographic call termination.

5.65 Whilst the dispute relates to the basis of calculation of fixed geographic termination rates, which is of relevance to a large number of CPs, our determination is based on the specific facts of the dispute and will only bind the parties.

5.66 Any future cases which raise similar issues would need to be assessed on their own specific facts.

Annex 1

The Determination

Dispute between Colt and BT

Determination under sections 188 and 190 of the Communications Act 2003 ("2003 Act") for resolving a dispute between Colt Technology Services ("Colt") and British Telecommunications plc ("BT") (together the "Parties") about Colt's termination charges for fixed geographic calls introduced through Colt's OCCN of 14 December 2009.

WHEREAS—

(A) section 188(2) of the 2003 Act provides that, where Ofcom has decided pursuant to section 186(2) of the 2003 Act that it is appropriate for it to handle the dispute, Ofcom must consider the dispute and make a determination for resolving it. The determination that Ofcom makes for resolving the dispute must be notified to the Parties in accordance with section 188(7) of the 2003 Act, together with a full statement of the reasons on which the Determination is based, and Ofcom must publish so much of their Determination as (having regard, in particular, to the need to preserve commercial confidentiality) they consider appropriate to publish for bringing it to the attention of the members of the public, including to the extent that Ofcom considers pursuant to section 393(2)(a) of the 2003 Act that any such disclosure is made for the purpose of facilitating the carrying out by Ofcom of any of its functions;

(B) section 190 of the 2003 Act sets out the scope of Ofcom's powers in resolving a dispute which may, in accordance with section 190(2) of the 2003 Act, include—

(i) making a declaration setting out the rights and obligations of the Parties to the dispute;

(ii) giving a direction fixing the terms or conditions of transactions between the Parties to the dispute;

(iii) giving a direction imposing an obligation, enforceable by the Parties to the dispute, to enter into a transaction between themselves on the terms and conditions fixed by Ofcom; and

(iv) for the purpose of giving effect to a determination by Ofcom of the proper amount of a charge in respect of which amounts have been paid by one of the Parties to the dispute to the other, giving a direction, enforceable by the party to whom sums are to be paid, requiring the payment of sums by way of adjustment of an underpayment or overpayment;

(C) on 14 December 2009, Colt issued an Operator Charge Change Notice ("OCCN") to BT, proposing new termination charges, with effect from 1 March 2010, for terminating fixed geographic calls to numbers hosted on Colt's network;

(D) on 18 December 2009, BT rejected this OCCN;

(E) on 10 August 2010, Colt submitted a dispute with BT to Ofcom for resolution;

(F) on 2 September 2010, Ofcom decided that it was appropriate for it to handle the dispute, and informed the Parties of this decision;

(G) on 3 September 2010, Ofcom published details of the dispute on its website and invited comments from stakeholders on the scope of the dispute;

(H) Ofcom set the scope of the dispute to be resolved as to determine whether the fixed geographic termination rate proposed by Colt to BT in its OCCN of 14 December 2009, with effect from 1 March 2010, for terminating on Colts network calls originating on, or transiting across, BTs fixed network is fair and reasonable in accordance with SMP Condition BC1; this rate being equivalent to Rate A, calculated as per the expired Reciprocity Agreement between Colt and BT, but treating traffic routed by Colt via a third party transit provider as traffic delivered by Colt to BT at Single Tandem level for the purposes of that calculation;

(I) A draft determination was sent to the Parties on 19 November 2010 and published on Ofcom's website on 22 November 2010;

(J) In order to resolve this dispute, Ofcom has considered (among other things) the information provided by the Parties and Ofcom has further acted in accordance with its general duties set out in section 3 of, and the six Community requirements set out in section 4 of, the 2003 Act;

(K) A fuller explanation of the background to the dispute and Ofcom's reasons for making this Determination is set out in the explanatory statement accompanying this Determination.

NOW, therefore, Ofcom makes, for the reasons set out in the accompanying explanatory statement, this Determination for resolving this dispute—

I Declaration of rights and obligations, etc.

1 It is hereby declared that, should Colt provide fixed geographic termination to BT on the terms set out in its OCCN of 14 December 2009, such provision would not be regarded as being on fair and reasonable terms, conditions and charges under SMP Condition BC1.

2 Colt and BT should continue to do business on the terms and conditions that have applied so far until they agree otherwise.

II Binding nature and effective date

3 This Determination is binding on Colt 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) **"BT"** means British Telecommunications plc (BT) 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**;**

c) **"Colt"** means Colt Technology Services whose registered company number is 02452736, 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) **"Ofcom"** means the Office of Communications;

e) **"SMP Condition BC1"** means Significant Market Power Condition BC1 as contained in the Ofcom document entitled 'Review of the wholesale fixed narrowband markets: Statement on the markets, market determinations and remedies including further consultation', published on 15 September 2009; SMP Condition BC1 is specifically set out at part 2 of Schedule 3 of the Notification at Annex 7 to that document.

Neil Buckley

Director of Investigations

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

22 December 2010