



# Dispute between BT and TalkTalk in relation to BT's historical charges for SFIs and TRCs

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## About this document

This document sets out for comment Ofcom's proposal for resolving a dispute between BT and TalkTalk in relation to allegations that BT's Time Related Charges (TRCs) and charges for Special Fault Investigations (SFIs) were not cost oriented during the period from 1 April 2011 to 30 June 2014, as required by Significant Market Power (SMP) obligations imposed on BT.

TRCs apply where Communication Providers (CPs) request BT to carry out engineering work on lines that is not included within their service level agreements with BT. SFIs are services requested by CPs for further investigation of potential broadband faults on MPF and SMPF lines where no fault has been found using the standard Openreach line test.

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# Glossary of terms

**2003 Act** – the Communications Act 2003.

**2010 WLA Statement** – Review of the wholesale local access market, 7 October 2010.

Available at:

[http://stakeholders.ofcom.org.uk/binaries/consultations/wla/statement/WLA\\_statement.pdf](http://stakeholders.ofcom.org.uk/binaries/consultations/wla/statement/WLA_statement.pdf).

**2012 LLU/WLR Statement** – Charge control review for LLU and WLR services, 7 March

2012. Available at: <http://stakeholders.ofcom.org.uk/binaries/consultations/wlr-cc-2011/statement/statementMarch12.pdf>.

**2013 FAMR Consultation** - Fixed access market reviews: wholesale local access, wholesale fixed analogue exchange lines, ISDN2 and ISDN30 Consultation on the proposed markets, market power determinations and remedies, 3 July 2013. Available at: <http://stakeholders.ofcom.org.uk/binaries/consultations/fixed-access-market-reviews/summary/fixed-access-markets.pdf>.

**2014 FAMR Statement** - Fixed access market reviews 2014: wholesale local access, wholesale fixed analogue exchange lines, ISDN2 and ISDN30, 26 June 2014. Available at:

<http://stakeholders.ofcom.org.uk/telecoms/ga-scheme/specific-conditions-entitlement/market-power/fixed-access-market-reviews-2014/statement/>.

**2016 BCMR Statement** – Business Connectivity Market Review, 28 April 2016. Available at:

<http://stakeholders.ofcom.org.uk/consultations/bcmr-2015/final-statement/>.

**BoE+1%** - Bank of England base rate of interest plus 1%.

**BT** – British Telecommunications Plc.

**CAT** – Competition Appeal Tribunal.

**CP** – Communications provider.

**CRF** – Common Regulatory Framework.

**DLRIC** – Distributed long run incremental cost.

**DSAC** – Distributed stand alone cost.

**Ethernet appeals** – The appeals to the Court of Appeal of the CAT's Ethernet Judgment.

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

[http://stakeholders.ofcom.org.uk/binaries/consultations/ethernet-services/annexes/Ethernet\\_FD.pdf](http://stakeholders.ofcom.org.uk/binaries/consultations/ethernet-services/annexes/Ethernet_FD.pdf).

**Ethernet Judgment** – The CAT's judgment disposing of appeals of the Ethernet Determinations, handed down on 1 August 2014 [2014] CAT 14. Available at:

[http://www.catribunal.org.uk/files/1205-7\\_Ethernets\\_Judgment\\_CAT\\_14\\_010814.pdf](http://www.catribunal.org.uk/files/1205-7_Ethernets_Judgment_CAT_14_010814.pdf) .

**FAC** – Fully allocated cost. An accounting approach under which all the costs of the company are distributed between its various products and services. The fully allocated cost of a product or service may therefore include some common costs that are not directly attributable to the service.

**Gamma Determination** – The determination issued on 25 October 2013 to resolve a dispute between Gamma and BT relating to the 'Ofcom Interest Rate' contained within BT's Standard Interconnect Agreement (SIA). Available at:  
[http://stakeholders.ofcom.org.uk/binaries/enforcement/competition-bulletins/closed-cases/all-closed-cases/cw\\_01108/CW\\_011080613.pdf](http://stakeholders.ofcom.org.uk/binaries/enforcement/competition-bulletins/closed-cases/all-closed-cases/cw_01108/CW_011080613.pdf).

**Interest Guidance** – The guidance set out in Annex 2 to the Gamma Determination regarding Ofcom's approach to interest in the context of resolving disputes involving charges payable under BT's SIA.

**Level 3 Determination** – The determination issued on 16 May 2014 (corrected on 16 July 2014) to resolve a dispute between Level 3 Communications UK Limited and BT relating to historic PPC charges. Available at:  
[http://stakeholders.ofcom.org.uk/binaries/enforcement/competition-bulletins/open-cases/all-open-cases/cw\\_01118/CW1118\\_final\\_determination.pdf](http://stakeholders.ofcom.org.uk/binaries/enforcement/competition-bulletins/open-cases/all-open-cases/cw_01118/CW1118_final_determination.pdf).

**LLU** – Local loop unbundling.

**LRIC** – Long run incremental costs.

**Openreach** – A BT Group business offering CPs products and services that are linked to BT's nationwide local access network.

**PPC Determinations** – The six determinations issued on 14 October 2009 to resolve disputes between BT and each of Cable & Wireless UK, THUS plc, Global Crossing (UK) Telecommunications Limited, Virgin Media Limited, Verizon UK Limited and COLT Telecommunications concerning BT's charges for PPCs  
[http://stakeholders.ofcom.org.uk/binaries/consultations/draft\\_deter\\_ppc/PPC\\_final\\_determination.pdf](http://stakeholders.ofcom.org.uk/binaries/consultations/draft_deter_ppc/PPC_final_determination.pdf).

**PPCs** – Partial private circuits.

**PPC Judgment** – The CAT's judgment disposing of BT's appeal of the PPC Determinations, handed down on 22 March 2011 - [2011] CAT 5. Available at:  
[http://www.catribunal.org.uk/files/1146\\_BT\\_Judgment\\_CAT5\\_220311.pdf](http://www.catribunal.org.uk/files/1146_BT_Judgment_CAT5_220311.pdf).

**PPC Court of Appeal Judgment** – The Court of Appeal's judgment in BT's appeal of the PPC Judgment, handed down on 27 July 2012 - [2012] EWCA Civ 1051. Available at:  
[http://www.catribunal.org.uk/files/1146\\_BT\\_Judgment\\_of\\_the\\_Court\\_of\\_Appeal\\_270712.pdf](http://www.catribunal.org.uk/files/1146_BT_Judgment_of_the_Court_of_Appeal_270712.pdf).

**Parties** – BT and TalkTalk.

**Provisional Conclusions** – this document.

**RFS** – BT's Regulatory financial statements. Available at:  
<http://www.btplc.com/thegroup/RegulatoryandPublicAffairs/FinancialStatements/index.htm>

**Relevant Period** – 1 April 2011 to 30 June 2014.

**SFIs** – Special fault investigation services.

**SIA** – BT's Standard Interconnection Agreement.

**SMP** – Significant Market Power.

**SMP conditions** – Regulatory conditions imposed on a specific CP that has been found to have SMP in a market review conducted by Ofcom.

**TalkTalk** – TalkTalk Telecom Group plc.

**TRCs** – Time related charges.

**WFAEL** – Wholesale fixed analogue exchange lines.

**WLA** – Wholesale local access.

**WLR** – Wholesale line rental.

## Section 1

# Summary

- 1.1 This document (the Provisional Conclusions) sets out for comment our provisional assessment of the matters in dispute.
- 1.2 The dispute, brought by TalkTalk Telecom Group plc (TalkTalk) against British Telecommunications plc (BT) (collectively the Parties) relates to BT's charges for special fault investigation services (SFIs) and time related charges (TRCs) (the Dispute).
- 1.3 TRCs apply where communications providers (CPs) request BT to carry out engineering work on lines that is not included within their service level agreements with BT. SFIs are services requested by CPs for further investigation of potential broadband faults on MPF and SMPF lines where no fault has been found using the standard Openreach line test.<sup>1</sup>
- 1.4 TalkTalk alleges that BT's charges for these services were not cost oriented in the period from 1 April 2011 to 30 June 2014 (the Relevant Period), as required by SMP obligations imposed on BT, and that as a consequence it has been overcharged by £[>]. BT disagrees that its charges were not cost oriented.
- 1.5 During the Relevant Period, BT was under an obligation to ensure that its charges for SFIs and TRCs were cost oriented pursuant to SMP Condition FAA4.1 where those services were reasonably necessary for the use of BT's network access services in the wholesale local access market, including its local loop unbundling and sub-loop unbundling services. SMP Condition FAA4.1 was removed with effect from 26 June 2014.

## Provisional assessment of the matters in dispute

- 1.6 In assessing the cost orientation of the charges levied by BT, we have applied an analytical framework which involves four steps:
  - a) **Step 1:** Has BT satisfactorily demonstrated that its relevant charges were cost oriented in accordance with SMP Condition FAA4.1?
  - b) **Step 2:** If BT has not satisfactorily demonstrated compliance, were BT's relevant charges nonetheless below DSAC?
  - c) **Step 3:** Are there any other relevant factors that we need to consider in order to determine whether BT's charges were compliant with SMP Condition FAA4.1?
  - d) **Step 4:** If the charges were not compliant, should we require BT to make repayments and if so what level should the repayments be?

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<sup>1</sup> There are two main variants of SFIs. The 'Frames Direct' variant is purchased where the CP believes that the fault lies at the local exchange and involves no visit to the end customer premises. The 'End User' variant is purchased where the CP wishes BT to begin the fault investigation at the end customer's premises and is comprised of a series of modules – 'Base', 'Internal Equipment', 'Network Frame', 'Internal Wiring' and 'Coop'.

- 1.7 If we conclude that BT has demonstrated that each of its charges was cost oriented, it is unnecessary for us to assess Steps 2-4 of the analytical framework. However, if we conclude that BT has failed to demonstrate that each of the charges was cost oriented then, in order for us to determine whether overcharging has taken place, we need to assess whether the relevant charges were nevertheless cost oriented in line with the requirements of SMP Condition FAA4.1.
- 1.8 We do this through Steps 2 and 3 of our analytical framework. At Step 2 we assess whether the charges were below DSAC, which we consider to be the most appropriate cost benchmark for our assessment of BT's compliance with the cost orientation obligation for the purposes of resolving this Dispute. We then consider other relevant factors at Step 3, to ensure that the DSAC test is not applied in a purely mechanistic manner. The other relevant factors we have considered in the Dispute are the magnitude and duration by which charges exceeded DSAC and whether, and the extent to which, charges exceeded FAC.
- 1.9 If we find that BT has overcharged, we continue to Step 4 to consider whether we should require BT to make repayments, and if so at what level.
- 1.10 Having applied our analytical framework, we provisionally conclude that BT has not demonstrated to our satisfaction that its TRCs and SFI charges were compliant with SMP Condition FAA4.1 in the Relevant Period.
- 1.11 On the basis of our own assessment of these charges, we provisionally conclude:
- For SFI services:
    - 'Frame Direct'<sup>2</sup> variant: BT's charges were not cost oriented for the period 1 April 2011 to 26 June 2014.
    - 'Base'<sup>3</sup> and 'Internal Equipment'<sup>4</sup> End User modules: BT's charges were cost oriented throughout the Relevant Period.
    - 'Network',<sup>5</sup> 'Frame'<sup>6</sup> and 'Internal Wiring'<sup>7</sup> End User modules: BT's charges were not cost oriented for the period 1 April 2011 to 26 June 2014.
    - 'Coop'<sup>8</sup> End User module: BT's charges were not cost oriented for the period 1 April 2011 to 31 March 2013.

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<sup>2</sup> The Frame Direct variant reflects a standard set of tests and checks that are carried out at the local exchange.

<sup>3</sup> The Base module is mandatory for all End User variant SFI orders and reflects a standard set of steps that an engineer will carry out at the end customer's premises in order to try to identify where the problem might be. The other modules are carried out on the basis of the results of the Base tests.

<sup>4</sup> The Internal Equipment module relates to tests and diagnostic checks carried out on the end customer's router and computer if the results of the Base module tests suggest that the customer's equipment might be the cause of the problem.

<sup>5</sup> The Network module relates to checks and engineering work carried out between the end customer's premises and the distribution point for the line if the Base module tests suggest that this might be the cause of the problem.

<sup>6</sup> The Frame module relates to checks and engineering work carried out at the local exchange if the Base module tests suggest that this might be the cause of the problem.

<sup>7</sup> The Internal Wiring module relates to checks and work carried out on wiring within the end customer's premises exchange if the Base module tests suggest that this might be the cause of the problem.

- For TRC services:
  - BT's visit charges<sup>9</sup> for normal hours were not cost oriented for the period 8 June 2012 to 26 June 2014.
  - BT's visit charges for other times and Sundays/bank holidays were not cost oriented for the period 1 April 2011 to 26 June 2014.
  - BT's hourly charges were not cost oriented for the period 1 April 2011 to 26 June 2014.
  - BT's charges for 'internal and external NTE shift'<sup>10</sup> were not cost oriented for the period 8 June 2012 to 26 June 2014.
  - TRC stores<sup>11</sup> charges for 'internal pack', 'external pack', 'data ext kit' and 'block terminal 92A' were not cost oriented for the period 1 April 2011 to 26 June 2014.
  - TRC stores charges for 'broadband front plate' were not cost oriented for the period 8 June 2012 to 26 June 2014.

1.12 We have identified the amount by which BT has overcharged for each service in each financial year during the Relevant Period and consider it appropriate to direct BT to repay TalkTalk a level of repayment reflecting the full amount of the overcharge for each of these services, plus interest. We do not have information required to calculate the amount of the overcharge by BT and therefore propose to leave it to the Parties to agree the exact levels of repayment that are due.

## Structure of the remainder of this document

- 1.13 In line with Ofcom's Dispute Resolution Guidelines<sup>12</sup> this document sets out for comment the main elements of our provisional reasoning and assessment in relation to the matters in dispute.
- 1.14 We set out the background on the regulatory requirements relevant to the Dispute in **Section 2**. The issues in dispute and Ofcom's duties and powers in resolving disputes are set out in **Section 3**. The analysis underpinning our provisional reasoning and assessment is set out in **Section 4**.

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<sup>8</sup> The Coop module relates to situations where the tests and checks identify that further information is required from the CP in order to identify the cause of the fault.

<sup>9</sup> These charges are raised to cover time spent by engineers repairing faults where this work is not covered under the terms of a service contract with Openreach. A visit charge is incurred on each occasion and covers the cost of the engineer visiting the end customer's premises and carrying out up to one hour's work. Separate hourly charges are incurred if the engineer spends more than one hour repairing the fault.

<sup>10</sup> Internal and external NTE shift charges are incurred when the engineer is required to move the equipment on which the line terminates at the end customer's premises.

<sup>11</sup> These are standard stores items, such as equipment and wiring that are used by BT engineers when carrying out TRC work, which are chargeable to CPs.

<sup>12</sup> <http://stakeholders.ofcom.org.uk/binaries/consultations/dispute-resolution-guidelines/statement/guidelines.pdf>.

## **Next steps**

- 1.15 The Parties and other interested parties have until 5pm on 26 August 2016 to comment on the Provisional Conclusions.
- 1.16 After considering any comments received, Ofcom will make a final determination. Details of how to respond to the Provisional Conclusions are set out in Annexes 1 and 2. Our proposed determination is set out at Annex 3.

## Section 2

# Background and regulation

## Introduction

- 2.1 The Dispute relates to BT's historical charges for TRCs and SFIs in the Relevant Period and the extent to which BT has complied with the applicable cost orientation obligation when setting these charges.
- 2.2 In this section, we provide background on the regulatory requirements relevant to the Dispute and judgments of the Competition Appeal Tribunal (CAT) and Court of Appeal relating to Ofcom's assessment of BT's cost orientation obligations in previous disputes which we consider relevant to our determination.

## Relevant regulatory requirements

- 2.3 The Dispute covers the period from 1 April 2011 to 30 June 2014. This largely coincides with the period covered by Ofcom's 2010 WLA Statement.<sup>13</sup> That statement set out our finding, following a market review, that BT held SMP in the market for wholesale local access services in the UK excluding the Hull area.
- 2.4 As a consequence of this finding, we imposed a number of SMP obligations on BT in that market requiring it, among other things, to provide network access on reasonable request (Condition FAA1). BT was required to provide specific forms of network access including local loop unbundling (LLU) services, sub-loop unbundling services and such ancillary services as may be reasonably necessary to use those services (Conditions FAA9 and FAA10).
- 2.5 The SMP Conditions also included obligations on BT to ensure and to be able to demonstrate that its charges for network access were cost oriented (Condition FAA4.1):<sup>14</sup>

*“Unless Ofcom directs otherwise from time to time, the Dominant Provider shall secure, and shall be able to demonstrate to the satisfaction of Ofcom, that each and every charge offered, payable or proposed for Network Access covered by Condition FAA1 and/or Conditions FAA9, FAA10 and FAA12 is reasonably derived from the costs of provision based on a forward looking long run incremental cost approach and allowing an appropriate mark up for the recovery of common costs including an appropriate return on capital employed. FAA1 requires BT to provide network access on reasonable request from a third party, and also to provide such network access as Ofcom may from time to time direct.”*

- 2.6 TRCs and SFIs are ancillary services which BT was required to provide where they were reasonably necessary for the use of BT's LLU services or sub-loop unbundling services under Conditions FAA9 and FAA10, or otherwise for the provision of network access under Condition FAA1. BT's charges for SFIs and TRCs were therefore subject to the cost orientation obligation under Condition FAA4.1 where

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<sup>13</sup> *Review of the wholesale local access market*, 7 October 2010. Available at: [http://stakeholders.ofcom.org.uk/binaries/consultations/wla/statement/WLA\\_statement.pdf](http://stakeholders.ofcom.org.uk/binaries/consultations/wla/statement/WLA_statement.pdf).

<sup>14</sup> The relevant SMP conditions are set out in full in Annex 4.

they were purchased in relation to network access services falling within Conditions FAA1, FAA9 or FAA10 and could be considered reasonably necessary for the use of those services.

- 2.7 In June 2014, Ofcom published its 2014 Fixed Access Market Reviews (2014 FAMR Statement).<sup>15</sup> Ofcom found that BT continued to have SMP in the provision of wholesale local access services and again imposed a number of SMP obligations on BT. In relation to BT's SFIs and TRCs, Ofcom removed the above cost orientation obligation with effect from 26 June 2014 and instead imposed charge controls on each service, which apply in the period following the Relevant Period.

## The PPC and Ethernet cases

- 2.8 On 22 March 2011 the CAT issued its judgment (the PPC Judgment)<sup>16</sup> disposing of BT's appeal of Ofcom's 2009 determinations (the PPC Determinations)<sup>17</sup> of disputes about the pricing of Partial Private Circuits (PPCs). The CAT dismissed BT's appeal in its entirety and upheld Ofcom's PPC Determinations, concluding that BT's charges for certain PPCs, namely 2Mbit/s PPC trunk services, were in breach of its relevant cost orientation obligation. BT had therefore overcharged for those PPCs and was required to repay to the other parties in dispute the sums they had overpaid.
- 2.9 BT appealed the PPC Judgment to the Court of Appeal and on 27 July 2012 the Court of Appeal handed down judgment dismissing BT's appeal (the PPC Court of Appeal Judgment).<sup>18</sup>
- 2.10 On 1 August 2014, the CAT issued its judgment (the Ethernet Judgment)<sup>19</sup> disposing of three appeals lodged by BT, by Sky and TalkTalk (jointly) and by CWW, Virgin and Verizon (jointly) in relation to Ofcom's determinations (the Ethernet Determinations) of disputes about the pricing of wholesale Ethernet services.<sup>20</sup> The CAT substantially upheld Ofcom's decision that BT's charges for certain wholesale Ethernet services were in breach of its relevant cost orientation obligation, but remitted two issues to Ofcom for determination.
- 2.11 In August 2015, Ofcom was notified that the Court of Appeal had granted BT permission to appeal the CAT's Ethernet Judgment. Ofcom was notified that TalkTalk

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<sup>15</sup> 'Fixed access market reviews 2014: wholesale local access, wholesale fixed analogue exchange lines, ISDN2 and ISDN30', 26 June 2014. Available at: <http://stakeholders.ofcom.org.uk/telecoms/ga-scheme/specific-conditions-entitlement/market-power/fixed-access-market-reviews-2014/statement/>.

<sup>16</sup> *British Telecommunications plc v Office of Communication* [2011] CAT 5. Available at: [www.catribunal.org.uk/files/1146\\_BT\\_Judgment\\_CAT5\\_220311.pdf](http://www.catribunal.org.uk/files/1146_BT_Judgment_CAT5_220311.pdf).

<sup>17</sup> 'Determination to resolve disputes between each of Cable & Wireless, THUS, Global Crossing, Verizon, Virgin Media and COLT and BT regarding BT's charges for partial private circuits', 14 October 2009. Available at:

[http://stakeholders.ofcom.org.uk/binaries/consultations/draft\\_deter\\_ppc/PPC\\_final\\_determination.pdf](http://stakeholders.ofcom.org.uk/binaries/consultations/draft_deter_ppc/PPC_final_determination.pdf).

<sup>18</sup> Case no: C3/2011/1683 *British Telecommunications plc v Office of Communications* [2012] EWCA Civ 1051. Available at:

[http://www.catribunal.org.uk/files/1146\\_BT\\_Judgment\\_of\\_the\\_Court\\_of\\_Appeal\\_270712.pdf](http://www.catribunal.org.uk/files/1146_BT_Judgment_of_the_Court_of_Appeal_270712.pdf).

<sup>19</sup> *British Telecommunications PLC v Office of Communications; (1) British Sky Broadcasting Limited and (2) TalkTalk Group PLC v Office of Communications; (1) Cable & Wireless Worldwide PLC, (2) Virgin Media Limited and (3) Verizon UK Limited v Office of Communications* [2014] CAT 14.

Available at: [http://www.catribunal.org.uk/files/1205-7\\_Ethernets\\_Judgment\\_CAT\\_14\\_010814.pdf](http://www.catribunal.org.uk/files/1205-7_Ethernets_Judgment_CAT_14_010814.pdf).

<sup>20</sup> 'Disputes between each of Sky, TalkTalk, Virgin Media, Cable & Wireless and Verizon and BT regarding BT's charges for Ethernet services', 20 December 2012. Available at:

[http://stakeholders.ofcom.org.uk/binaries/consultations/ethernet-services/annexes/Ethernet\\_FD.pdf](http://stakeholders.ofcom.org.uk/binaries/consultations/ethernet-services/annexes/Ethernet_FD.pdf).

had been granted permission to appeal by the Court of Appeal in November 2015. The appeals are currently scheduled to be heard by the Court of Appeal in March 2017.

- 2.12 The wording of Condition FAA4.1 is equivalent to the cost orientation obligations (Condition H3.1 and Condition HH3.1) considered by the CAT in the PPC Judgment and the Ethernet Judgment and by the Court of Appeal in the PPC Court of Appeal Judgment. We therefore consider that the PPC Judgment, the Ethernet Judgment and the PPC Court of Appeal Judgment are relevant to our determination of the Dispute and refer to them in the Provisional Conclusions, as relevant. BT's pending appeal of the CAT's Ethernet Judgment is also relevant to our consideration of any repayment(s), as explained in Section 4.

### **The Communications Act 2003**

- 2.13 The dispute resolution provisions of the EU common regulatory framework (CRF) are reflected in sections 185 to 191 of the Communications Act 2003 (the 2003 Act). We discuss these provisions in relation to the Dispute referred to us in Section 3.
- 2.14 The 2003 Act sets out the statutory duties and Community obligations that Ofcom must ensure consistency with when carrying out its functions.
- 2.15 Our principal duty in carrying out our functions, as set out in section 3 of the 2003 Act, is to further the interests of citizens in relation to communications matters and to further the interests of consumers in relevant markets, where appropriate by promoting competition. We assess the consistency of our proposed resolution of the Dispute with this and our other duties in Section 4.

## Section 3

# The Dispute

## Issues in dispute

### Submissions from TalkTalk

- 3.1 TalkTalk referred the Dispute to Ofcom on 10 May 2016. TalkTalk alleged that BT's charges for TRCs and SFIs were not cost oriented during the Relevant Period, as required by SMP obligations imposed on BT, and that as a consequence it had been overcharged by £[redacted].<sup>21</sup> Specifically, TalkTalk argued in its dispute submission that BT's TRC and SFI charges were not compliant with SMP condition FAA4.1 during the Relevant Period because they were above FAC as well as DSAC costs.
- 3.2 TalkTalk noted that its cost assumptions were based on publicly available information from the 2014 FAMR Statement. TalkTalk claimed that "*Ofcom concluded that TRC and SFI prices were above FAC costs at least in the period from 1 April 2012 to 31 March 2014*".<sup>22</sup> TalkTalk submitted that it was very likely that BT's TRC charges were also above FAC before 1 April 2012 on the basis that BT's previous twelve months' costs were likely to have been similar to those in the years 2012/13 and 2013/14 which Ofcom had analysed. TalkTalk noted that, for some TRC and SFI services, BT's prices were above or not substantially below those in the years which Ofcom had analysed.<sup>23</sup>
- 3.3 TalkTalk further argued that the nature of TRC and SFI services implied that DSAC is very similar to FAC, when taking into account the proper cost attribution of fixed and common wholesale network costs (which it believed should be zero, as TRC and SFI services are essentially engineering labour).<sup>24</sup>

### Submissions from BT

- 3.4 We provided BT with a copy of TalkTalk's dispute submission on 12 May 2016 and invited BT to comment.
- 3.5 BT provided initial comments on TalkTalk's dispute submission on 18 May 2016, arguing that Ofcom should not accept the dispute as TalkTalk's claims were flawed, insufficiently supported, not well reasoned and/or outside the scope of the dispute resolution process.
- 3.6 Specifically, BT argued that TalkTalk's claim was an attempt to apply retrospectively the charge control price imposed in the 2014 FAMR Statement to the Relevant Period when only a cost orientation obligation applied. BT considered that to be inappropriate as the charge control was forward looking and was intended to address the risk of BT exploiting its SMP through excessive pricing, and to provide efficient incentives.

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<sup>21</sup> TalkTalk submission dated 10 May 2016 (TalkTalk submission), paragraph 1.4.

<sup>22</sup> TalkTalk submission, paragraph 3.8.

<sup>23</sup> TalkTalk submission, paragraph 3.8.

<sup>24</sup> TalkTalk submission, paragraph 3.12.

- 3.7 BT asserted that it had complied with its regulatory obligations regarding TRCs and SFIs and had followed Ofcom guidance. It argued that TalkTalk's submission was inadequate and not well reasoned as it ignored and/or unreasonably disregarded key aspects of BT's explanations, betraying a fundamental misunderstanding of BT's regulatory obligation and BT's way of ensuring compliance.
- 3.8 BT provided a further submission on 16 June 2016, again rejecting TalkTalk's claim that BT's TRC and SFI charges were not cost oriented in the Relevant Period. BT argued that:
- 3.8.1 BT's methodology for calculating TRC and SFI prices in the Relevant Period was consistent with case law and Ofcom commentary:
- a) It used an appropriate cost standard, DSAC, as sanctioned by the CAT.
  - b) BT was not required to set prices at FAC to comply with its cost orientation obligation.
  - c) Cost orientation obligations give BT flexibility in price setting and should not be applied mechanistically, especially regarding historical claims.
  - d) There is no basis for an assumption that prices set for a charge control should be the same as those that would comply with a cost orientation obligation, noting various Ofcom statements since 2010 which BT said made it clear that the change to the charge control in the 2014 FAMR Statement was a deliberate change in how prices should be set and the level of those prices, with no judgment on whether previous prices complied with the cost orientation obligation.
- 3.8.2 Ofcom had previously identified that BT's margins for TRCs before 2012 were in line with what it would expect based on Openreach's normal returns. When revising charges for TRCs and SFIs in 2012 and 2013, BT assessed the proposed charges and satisfied itself that they were in line with the EBIT margin Ofcom reviewed in the Statement on the charge control review for LLU and WLR services (2012 LLU/WLR Statement), as well as below the relevant DSAC.<sup>25</sup>
- 3.8.3 FAC and DSAC are not the same. BT's analysis in pricing papers and published information for similar services demonstrates that DSAC is always higher than FAC for TRCs and SFIs.
- 3.8.4 TalkTalk's claim raises policy risks in that it is effectively seeking to apply retroactively a charge control to a period when BT was subject only to a cost orientation obligation.
- 3.8.5 Ofcom does not, in any event, have the power to order retroactive payments in disputes.

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<sup>25</sup> *Charge control review for LLU and WLR services*, 7 March 2012:  
<http://stakeholders.ofcom.org.uk/binaries/consultations/wlr-cc-2011/statement/statementMarch12.pdf>.

- 3.9 BT requested that Ofcom reject TalkTalk's claim, and declare that BT had complied with SMP Condition FAA4.1 for TRC and SFI charges in the Relevant Period and did not overcharge TalkTalk.

### **Ofcom's duty to handle disputes**

- 3.10 Ofcom has the power to resolve the following types of disputes referred to it by one or more of the parties:
- a) a dispute relating to the provision of network access (section 185(1) of the 2003 Act);
  - b) a dispute relating to entitlements to network access that a CP is required to provide by or under a condition imposed on him under section 45 of the 2003 Act between that CP and a person who is identified, or is a member of a class identified, in the relevant condition (section 185(1A) of the 2003 Act); and
  - c) a dispute between CPs, which is not an 'excluded dispute', relating to rights or obligations conferred or imposed by or under a condition set under section 45 of the 2003 Act or any of the enactments relating to the management of the radio spectrum (section 185(2) of the 2003 Act).
- 3.11 Section 186(1) and (2) of the 2003 Act provide that where a dispute is referred to Ofcom in accordance with section 185, Ofcom must decide whether or not it is appropriate to handle the dispute. Section 186(3) provides that Ofcom must decide that it is appropriate for it to handle a dispute falling within section 185(1A) or section 185(2) unless there are alternative means available for resolving the dispute which would be consistent with the requirements of section 4 of the 2003 Act and would be likely to result in prompt and satisfactory resolution.

### **Ofcom's powers when determining a dispute**

- 3.12 Ofcom's powers in relation to making a dispute determination are limited to those set out in section 190 of the 2003 Act. Except in relation to disputes relating to the management of the radio spectrum, Ofcom's main power is to do one or more of the following:
- a) make a declaration setting out the rights and obligations of the parties to the dispute (section 190(2)(a));
  - b) give a direction fixing the terms or conditions of transactions between the parties to the dispute (section 190(2)(b));
  - c) give a direction imposing an obligation on the parties to enter into a transaction between themselves on the terms and conditions fixed by Ofcom (section 190(2)(c)); and
  - d) 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 (section 190(2)(d)).
- 3.13 A determination made by Ofcom to resolve a dispute binds all the parties to that dispute (section 190(8)).

## Ofcom's duties when determining a dispute

- 3.14 When resolving a dispute under the provisions set out in sections 185 to 191 of the 2003 Act, Ofcom is exercising one of its regulatory functions. 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 2003 Act, and (pursuant to section 4(1)(c) of the 2003 Act) the six Community requirements set out in section 4 of the 2003 Act, which give effect, among other things, to the requirements of Article 8 of the Framework Directive.<sup>26</sup>

## Accepting the Dispute

- 3.15 Having considered TalkTalk's submission and BT's initial response, we were satisfied that the Dispute fell within section 185(1A) of the 2003 Act.
- 3.16 On 2 June 2016 we informed the Parties of our decision that it was appropriate for us to handle the Dispute for resolution in accordance with section 186(3) of the 2003 Act. The scope for the Dispute was published on the Competition and Consumer Enforcement Bulletin on 3 June 2016.<sup>27</sup>

## Scope of the Dispute

- 3.17 We set out the following scope for the Dispute:

*"1) Whether the amount that BT charged TalkTalk for TRCs and SFIs in the relevant period was compliant with SMP Condition FAA4.1; and*

*2) If not, in order to resolve the dispute between the parties, what amount BT should have charged TalkTalk for TRCs and SFIs in the relevant period and whether any repayments should be made."*

- 3.18 Reflecting TalkTalk's submission, the Relevant Period for the Dispute is 1 April 2011 to 30 June 2014. However, as explained in Section 2 above, the relevant cost orientation obligation on BT (SMP Condition FAA4.1) was removed with effect from 26 June 2014. When we come to consider whether BT's charges were compliant with Condition FAA4.1 in Section 4 below, we therefore consider the period from 1 April 2011 to 26 June 2014.
- 3.19 We sought clarification from TalkTalk as to exactly which TRC and SFI services it was in dispute about with BT. Table 3.1 below summarises our understanding of the TRC and SFI services that TalkTalk identified, alongside the relevant charges in the Relevant Period.<sup>28</sup>

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<sup>26</sup> Directive 2002/21/EC of 7 March 2002 (as amended).

<sup>27</sup> See [http://stakeholders.ofcom.org.uk/enforcement/competition-bulletins/open-cases/all-open-cases/cw\\_01182/](http://stakeholders.ofcom.org.uk/enforcement/competition-bulletins/open-cases/all-open-cases/cw_01182/).

<sup>28</sup> Based on TalkTalk's submission of 27 June 2016 (TalkTalk's June submission) in response to the 1<sup>st</sup> s191 Notice dated 15 June 2016 (as clarified by TalkTalk's email to Ofcom dated 8 August 2016), we understand that BT's supplementary visit and supplementary hourly TRC charges are not in dispute.

**Table 3.1: TRC and SFI services and charges in dispute, £ nominal**

Financial year	2011/12	2012/13		2013/14	2014/15
Price periods	1 Apr 2011 – 31 Mar 2012	1 Apr 2012 – 7 Jun 2012	8 Jun 2012 – 31 Mar 2013	1 Apr 2013 – 31 Mar 2014	1 Apr 2014 – 26 Jun 2014
<b>TRCs</b>					
Hourly charge – normal working days	50.00	50.00	57.00	60.00	60.00
Hourly charge – other times ex Sunday/BH	85.00	85.00	85.50	90.00	90.00
Hourly charge – Sundays and BH	100.00	100.00	114.00	120.00	120.00
Visit charge – normal working days	105.00	105.00	115.00	120.00	120.00
Visit charge – other times ex Sunday/BH	130.00	130.00	143.50	150.00	150.00
Visit charge – Sundays and BH	150.00	150.00	172.00	180.00	180.00
<b>TRC stores</b>					
- internal pack	5.88	5.88	6.40	6.70	6.70
- external pack	13.70	13.70	14.90	15.60	15.60
- data ext kit	6.61	6.61	7.20	7.60	7.60
- broadband front plate	5.83	5.83	6.40	6.70	6.70
- block terminal 92A	1.24	1.24	1.40	1.50	1.50
Internal and external NTE shift	-	-	115.00	120.00	120.00
<b>SFI charges</b>					
Frame Direct	105.00	105.00	115.00	120.00	120.00
<b>End User modules</b>					
- Base	105.00	105.00	125.00	130.00	134.25
- Network	75.00	75.00	75.00	80.00	80.00
- Frame	75.00	75.00	70.00	70.00	70.00
- Internal Wiring	50.00	50.00	40.00	40.00	40.00
- Internal Equipment	25.00	25.00	20.00	20.00	20.00
- Coop	25.00	25.00	20.00	15.00	0

Source: Ofcom, based on TalkTalk's response of 27 June 2016 to Ofcom's information request of 15 June 2016. The SFI charges listed cover both MPF and SMPF variants.

- 3.20 In relation to the TRC stores item 'Block terminal 92A (for Redcare use)', BT informed us that this item could only be ordered via wholesale line rental (WLR) currently and is used where a hard wire terminal is required within premises to fit end customers' equipment i.e. alarm systems. BT said that this is not an option that can be ordered on WLA services and it therefore considered that it fell outside the scope of the dispute, since SMP Condition FAA4.1 relates to WLA services only.<sup>29</sup>
- 3.21 However, TalkTalk informed us that BT was charging TalkTalk for this item on its LLU invoice.<sup>30</sup>
- 3.22 Given that it appears BT may have charged TalkTalk for Block Terminal 92A in connection with its LLU services, at this stage we have included Block Terminal 92A in the charges which we assess for compliance with BT's cost orientation obligation. However, we note that even if we find that BT's charges for this item were not cost oriented, the question of whether those charges were compliant with SMP Condition

<sup>29</sup> Email from BT to Ofcom dated 9 August 2016.

<sup>30</sup> Email from TalkTalk to Ofcom dated 10 August 2016.

FAA4.1 also depends on whether the service was reasonably necessary for the use of BT's network access services in the WLA market (see Section 2). This is a question of fact in each case, which we consider the Parties are best placed to resolve (see further paragraphs 4.181-4.182).

### **Interested Parties**

3.23 British Sky Broadcasting plc and Vodafone have expressed an interest in the outcome of the Dispute.

### **Information relied on in resolving the Dispute**

3.24 In resolving the Dispute, we have relied on:

3.24.1 TalkTalk submission dated 10 May 2016;

3.24.2 TalkTalk response dated 27 June 2016 (as clarified by TalkTalk's email of 8 August 2016) to the 1<sup>st</sup> section 191 Notice dated 15 June 2016;

3.24.3 BT's submissions dated 18 May 2016 and 16 June 2016;

3.24.4 BT's responses dated 6, 8, 14 and 29 July and 5 and 9 August 2016 to the 1<sup>st</sup> section 191 Notice dated 15 June 2016; and

3.24.5 BT's responses dated 22 and 27 July to the 2nd section 191 Notice dated 15 July 2016.

3.25 In addition to information provided by the Parties, our analysis refers to previous Ofcom dispute determinations and relevant case law as cited in these Provisional Conclusions. It also refers to data previously provided to Ofcom by BT in connection with the 2014 FAMR Statement and the 2016 BCMR Statement.

## Section 4

# Analysis and provisional conclusions

- 4.1 In this Section we first set out the analytical framework which we propose to use to assess BT's compliance with the cost orientation condition. We then apply this analytical framework to the facts of the case and set out the provisional conclusions we have reached as to whether BT's charges for the services in dispute were cost oriented during the Relevant Period and, if they were not cost oriented, whether we should exercise our discretion to require BT to make a repayment to TalkTalk.

## Analytical framework

### The Parties' views

- 4.2 TalkTalk submitted that during the Relevant Period, BT's charges for TRCs and SFIs were subject to SMP Condition FAA4.1. It submitted that, in line with the CAT's findings in the Ethernet Judgment, *"each individual charge as applied and published by BT should comply with the basis of charges obligation"*.<sup>31</sup>
- 4.3 In its dispute submission TalkTalk set out the basis for its belief that BT's charges for TRCs and SFIs were not cost oriented during the Relevant Period, with reference to certain statements made by Ofcom in the 2014 FAMR Statement.<sup>32</sup> TalkTalk considered that the evidence from these statements *"strongly suggests that prices for all or many TRC/SFI services were significantly above FAC costs throughout or for much of the Relevant Period"*.<sup>33</sup>
- 4.4 In terms of the approach which Ofcom should take to assessing BT's compliance with its cost orientation obligation, TalkTalk stated that it considered that the analytical framework that Ofcom has used in previous disputes relating to BT's compliance with its cost orientation obligations was generally appropriate for Ofcom to use in resolving the Dispute (see further below).<sup>34</sup>
- 4.5 In relation to the cost standard to be used for the purposes of this assessment, TalkTalk noted that Ofcom's normal methodology is to compare BT's charges with their respective DSACs. TalkTalk stated that it *"does not object to the use of the DSAC test as such to individual services"*.<sup>35</sup> However, TalkTalk argued that:

*"on its own, that [DSAC] test is manifestly insufficient to meet Ofcom's duties to promote competition since if BT priced all its services at their DSAC that would result in multiple recovery of common costs. Condition FAA4.1 permits only "an appropriate mark-up for the recovery of common costs." Therefore a further test is required to prevent significant over-recovery of common costs and, without such a test, Ofcom's normal approach conflicts with the proper interpretation of the basis of charges obligations. In any*

<sup>31</sup> TalkTalk submission, footnote 10.

<sup>32</sup> TalkTalk referred to paragraphs 18.38, 18.82, 18.83, 18.91 and 18.93 of the 2014 FAMR Statement. See TalkTalk submission, paragraphs 3.3 to 3.7.

<sup>33</sup> TalkTalk submission, paragraphs 3.3 to 3.9.

<sup>34</sup> TalkTalk submission, paragraph 2.12.

<sup>35</sup> TalkTalk submission, paragraph 2.12.

*event, as will be explained further below, TalkTalk believes that this difference in opinion may well be of limited practical significance in this dispute as the DSAC and FAC values for TRC and SFI services are likely to be very close to each other.*"<sup>36</sup>

- 4.6 BT noted that "*the specific basis of charges obligation does not stipulate the cost standard that a dominant provider should use when setting relevant prices*",<sup>37</sup> and submitted that the cost orientation condition provided BT with a degree of flexibility when setting its charges.
- 4.7 BT therefore argued that DSAC is the appropriate cost measure for Ofcom to use in resolving the Dispute, in line with Ofcom's approach in previous disputes and the findings of the CAT in the PPC Judgment and the Ethernet Judgment. BT stated that this was the basis on which it had set charges for TRCs and SFIs during the Relevant Period.<sup>38</sup> BT considered that TalkTalk's dispute submission "mischaracterised" the cost orientation condition by effectively arguing that BT's compliance should be assessed by reference to a FAC cost standard.<sup>39</sup>
- 4.8 BT further noted that it was important that the DSAC test was not applied mechanistically and that "*Ofcom must be particularly alert to the risk of a mechanistic application of a basis of charges obligation when considering historical compliance*".<sup>40</sup> BT referred to the PPC Judgment in which the CAT stated that:

*"[When] retrospectively seeking to determine compliance with [a basis of charges obligation], it would not be right for Ofcom to apply DSAC (or, no doubt, any test for the allocation of common costs) in a mechanistic way. That would overlook the fact that it is hard in practice for the regulated firm to comply absolutely with whatever test is being used to determine the appropriate allocation of common costs.*

*In other words, when retrospectively assessing compliance with Condition H3.1, OFCOM must guard against the possible injustices of a mechanistic application of a test for the allocation of common costs.*"<sup>41</sup>

### **Ofcom's provisional view**

- 4.9 As noted in Section 2, this is not the first dispute that Ofcom has been asked to resolve in relation to cost orientation obligations imposed on BT in markets in which it has SMP. The wording of these obligations is broadly similar and Ofcom has developed an analytical framework that it has consistently used when assessing BT's compliance with these obligations.<sup>42</sup>

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<sup>36</sup> TalkTalk submission, paragraph 2.12.

<sup>37</sup> BT submission dated 16 June 2016, paragraph 36.

<sup>38</sup> BT submission dated 16 June 2016, paragraphs 3, 37, 38, 41 and 53.

<sup>39</sup> BT submission dated 16 June 2016, paragraph 53.

<sup>40</sup> BT submission dated 16 June 2016, paragraph 35.

<sup>41</sup> *British Telecommunications plc v Office of Communication* [2011] CAT 5 (PPC Judgment) paragraphs 304 and 305. [http://www.catribunal.org.uk/files/1146\\_BT\\_Judgment\\_CAT5\\_220311.pdf](http://www.catribunal.org.uk/files/1146_BT_Judgment_CAT5_220311.pdf).

<sup>42</sup> The CAT upheld Ofcom's use of this analytical framework for the purposes of assessing BT's compliance with cost orientation conditions in both the PPC Judgment, paragraphs 277-307; and the Ethernet Judgment, paragraphs 120-195.

- 4.10 Given the clear similarities and overlaps between the issues in the Dispute and those considered in the PPC Determinations and the Ethernet Determinations, we consider that it would be appropriate to adopt the same analytical framework for the purposes of determining the Dispute.<sup>43</sup> This framework is also consistent with the approach that we said we would take to assessing compliance with BT's cost orientation obligation in the 2010 WLA Statement.<sup>44</sup>
- 4.11 Our proposed analytical framework involves four steps:
- Step 1: Has BT satisfactorily demonstrated that its relevant charges were cost oriented in accordance with SMP Condition FAA4.1?
  - Step 2: If BT has not satisfactorily demonstrated compliance, were BT's relevant charges nonetheless below DSAC?
  - Step 3: Are there any other relevant factors that we need to consider in order to determine whether BT's charges were compliant with SMP Condition FAA4.1?
  - Step 4: If the charges were not compliant, should we require BT to make repayments and if so what level should the repayments be?
- 4.12 The charges in dispute in this case are subject to SMP Condition FAA4.1, which requires "*each and every charge*" to be cost oriented. We therefore propose to consider BT's charges for TRCs and SFIs on a disaggregated basis, i.e. to consider whether BT has secured that each and every disputed charge is cost oriented.<sup>45</sup>
- 4.13 If we conclude at the first stage of our analytical framework that BT has demonstrated that each of its charges was cost oriented, it is unnecessary for us to assess Steps 2-4. However, if we conclude that BT has failed to demonstrate that each of the charges was cost oriented then, in order for us to determine whether overcharging has taken place, we need to assess whether the relevant charges were nevertheless cost oriented in line with the requirements of SMP Condition FAA4.1.
- 4.14 We do this through Steps 2 and 3 of our analytical framework. At Step 2 we assess whether the charges were below DSAC, which we consider to be the most appropriate cost benchmark for our assessment of BT's compliance with the cost orientation obligation for the purposes of resolving this Dispute. In addition to the statements we made in the 2010 WLA Statement<sup>46</sup> and the 2012 LLU/WLR

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<sup>43</sup> In addition to the PPC Determinations and Ethernet Determinations referred to in Section 2, we applied the same analytical framework in determining a dispute between Level 3 Communications UK Limited and BT relating to the cost orientation of BT's charges for PPCs (the Level 3 Determination). Available at: [http://stakeholders.ofcom.org.uk/binaries/enforcement/competition-bulletins/open-cases/all-open-cases/cw\\_01118/CW1118\\_final\\_determination.pdf](http://stakeholders.ofcom.org.uk/binaries/enforcement/competition-bulletins/open-cases/all-open-cases/cw_01118/CW1118_final_determination.pdf).

<sup>44</sup> In the 2010 WLA Statement we stated that that "*Our interpretation of the basis of charges obligation is that BT's prices must, as a first-order test, be between DLRIC and DSAC*" – see paragraphs 5.58, 5.79 and 6.135.

<sup>45</sup> The wording of Condition FAA4.1 is equivalent to that of the SMP Conditions which were considered in the PPC Judgment and the Ethernet Judgment (Condition H3.1 and HH3.1, respectively). In the PPC Judgment and the Ethernet Judgment the CAT found that in assessing BT's compliance with those SMP Conditions Ofcom was correct to consider, discretely, the charges for each relevant service offered by BT: PPC Judgment, paragraphs 209-228; Ethernet Judgment, paragraphs 81-101.

<sup>46</sup> See footnote 44 above.

Statement<sup>47</sup> which explained that we would apply DSAC as a first order test for assessing BT's compliance with the cost orientation condition – we consider that the considerations we have set out in previous disputes<sup>48</sup> also support the use of DSAC for the purposes of resolving this Dispute. These include the need for a regulatory balance to be struck between providing the regulated firm with enough pricing flexibility to recover its costs, including its common costs, in an economically efficient manner and ensuring that this flexibility is sufficiently bounded to prevent the regulated firm from exploiting its market power to set anti-competitive, exploitative or otherwise unreasonable charges. We also need to regulate in a stable and consistent way over time.

- 4.15 At Step 3 of our framework we consider other relevant factors, to ensure that the DSAC test is not applied in a purely mechanistic manner. The specific factors to be taken into account beyond DSAC are dependent on the details of the case under consideration. We set out in paragraph 4.139 the additional factors which we consider are relevant to the Dispute.
- 4.16 If we find that BT has overcharged, we continue to Step 4 to consider whether we should require BT to make repayments, and if so at what level.
- 4.17 In relation to TalkTalk's argument that a further test beyond DSAC is required, we note that TalkTalk has not put forward any suggestion as to what such a test should consist of in this case. Furthermore, we note that we have considered and rejected the use of combinatorial tests of the nature requested by TalkTalk in previous disputes relating to BT's cost orientation obligations. In the PPC Determinations and the Ethernet Determinations we set out several practical and conceptual problems with the application of such tests, which we consider would be likely to apply in this case.<sup>49</sup> In the Ethernet Judgment the CAT found that Ofcom had been correct to reject an aggregate FAC-based test put forward by Sky and TalkTalk.<sup>50</sup>
- 4.18 While we recognise that the DSAC test does not necessarily prevent BT from over-recovering common costs, this potential for over-recovery does not mean that the DSAC test is inappropriate. The potential for BT to over-recover costs in a market is a factor we take into consideration in deciding the appropriate remedies to implement in a market review, including whether to impose a charge control or a cost orientation obligation. The specific argument advanced by TalkTalk, that BT would over-recover common costs if it set all prices at DSAC, is not relevant to the appropriateness of

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<sup>47</sup> 2012 LLU/WLR Statement, paragraph 5.22.

<sup>48</sup> See for example the Level 3 Determination, paragraphs 3.10 - 3.13.

<sup>49</sup> See for example Section 5 of the PPC Determinations and Section 9 of the Ethernet Determinations. In the PPC Judgment CAT found that combinatorial testing using stand-alone cost was "unworkable" because of the sheer number of combinations of services requiring testing (PPC Judgment, paragraph 307). Other conceptual problems include: (i) failure of a combinatorial test does not indicate which service(s) in the combination were overcharged or the extent of overcharging on each service; (ii) combinations that span charge-controlled and non-charge-controlled services may undermine the desired efficiency incentives of price caps; (iii) combinations that span SMP and competitive markets may distort the operator's pricing incentives in competitive and/or SMP markets; and (iv) the underlying economic theory implies that all combinations of services should be considered, but the more aggregated the combination, the greater the unintended risk of imposing rate of return regulation.

<sup>50</sup> Ethernet Judgment, paragraphs 149-195. As noted in Section 2, TalkTalk has appealed the Ethernet Judgment to the Court of Appeal. In addition, applying such a test for the first time in this dispute would not be consistent with fostering regulatory certainty.

the DSAC test, not least because it is extremely unlikely that it could do this for all services and still meet its charge control obligations, where these apply.<sup>51</sup>

- 4.19 We therefore do not accept TalkTalk's argument that it is necessary to apply a further test beyond DSAC as part of our analytical framework to determine whether BT has over-recovered its common costs across all services.

### Appropriate data for our analysis

- 4.20 Each year BT is required to publish detailed Regulatory Financial Statements (RFS). In many cases we have utilised data contained in the RFS, including revenues, volumes and cost calculations, to assess whether products and services were compliant with cost orientation obligations. For example, in the Ethernet Determinations, we explained that in general we would rely on the published RFS for the purposes of determining historical disputes. This is because we would normally expect the RFS to constitute the best available information for us to use in fulfilling our regulatory functions, including dispute resolution.<sup>52</sup>
- 4.21 However, in other cases it might be necessary and appropriate to make adjustments to the data published in BT's RFS for resolving cost orientation disputes to ensure that, as far as possible, we accurately reflect BT's costs and revenues.<sup>53</sup>
- 4.22 In reaching our provisional assessment of whether BT's charges for TRCs and SFIs were cost oriented, we have started by looking at BT's published RFS data for those services. To the extent that the RFS data is incorrect or obviously inappropriate, or where data is not available, we have considered making adjustments to the RFS data or using alternative data sources. This is explained in the relevant sections below, in which we apply our analytical framework to the facts of the case and set out our Provisional Conclusions.

### Step 1: Has BT satisfactorily demonstrated that its relevant charges are compliant with SMP Condition FAA4.1?

- 4.23 SMP Condition FAA4.1 requires that BT secure and be able to demonstrate to Ofcom's satisfaction the cost orientation of each and every charge for network access covered by SMP Conditions FAA1, FAA9, FAA10 and FAA12.
- 4.24 We therefore asked BT to provide any evidence that it considered "*demonstrates that BT has complied with SMP condition FAA4.1 in relation to TRCs and charges for SFIs during the relevant period*".<sup>54</sup> We asked BT to include any justification for the recovery of any common costs in the charges for TRCs and SFIs or for the attribution of common costs in the FAC and DSAC of those products.

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<sup>51</sup> The relevance of this argument has previously been considered and rejected, for example, in our Determination to resolve a dispute between Gamma and BT concerning BT's charges for Interconnect Extension Circuits, 23 May 2014 (see paragraph 3.60). Available at:

[http://stakeholders.ofcom.org.uk/binaries/enforcement/competition-bulletins/open-cases/all-open-cases/cw\\_01119/Final\\_Determination\\_23\\_May\\_NON-CONFIDENTIAL\\_VERSION.pdf](http://stakeholders.ofcom.org.uk/binaries/enforcement/competition-bulletins/open-cases/all-open-cases/cw_01119/Final_Determination_23_May_NON-CONFIDENTIAL_VERSION.pdf)

<sup>52</sup> Ethernet Determinations, paragraph 11.22.

<sup>53</sup> For example, in the PPC Determinations we made adjustments to RFS data in order to: (i) correct for volume errors; (ii) modify assumptions in the RFS that were not appropriate for the services in dispute; (iii) ensure that the revenues of a service were appropriately matched with the costs of the service; and (iv) exclude costs not relevant to the provision of the services in dispute.

<sup>54</sup> Email from Ofcom to BT dated 15 June 2016.

## BT's justification for its charges

- 4.25 BT responded that *“during the Relevant Period, Openreach set its TRC and SFI prices for relevant WLA services in compliance with its basis of charges obligation. Ofcom assessed that margins for TRCs prior to 2012 were in line with what it would expect i.e. ~20%, and when Openreach reviewed the price for TRCs and SFIs in 2012 and 2013 the proposed prices were below the relevant DSAC and the EBIT margin assessed in each pricing paper was in line with the EBIT margin Ofcom reviewed in the FAMR March 2012 statement (~20%).”*<sup>55</sup>
- 4.26 BT relies on two pricing papers, dated 27 February 2012 (the February 2012 pricing paper) and 17 December 2012 (the December 2012 pricing paper) and appeared to argue that it set prices by (i) assessing whether they were below DSAC, and (ii) assessing whether the EBIT margin was around 20%. As explained further below, BT told us that the cost data included in the February 2012 pricing paper was based on the data from the 2010/11 RFS and cost data in the December 2012 pricing paper was based on the 2011/12 RFS.<sup>56</sup> In these papers, BT appears to compare the prices as at 31 March 2011 and 7 June 2012 with the FAC and DSAC data from the February 2012 pricing paper and the prices as at 7 June 2012 (again) and 31 March 2013 with the FAC and DSAC from the December 2012 pricing paper.<sup>57</sup>
- 4.27 Tables 4.1 to 4.4 below summarise the price, FAC, DSAC, DSAC test result and implied FAC EBIT margin<sup>58</sup> for TRC and SFI services included in the February 2012 and December 2012 pricing papers. The DSAC test is the ratio of price to DSAC, so a percentage over 100% implies that price is above DSAC and a percentage below 100% implies that price is below DSAC.

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<sup>55</sup> BT submission dated 16 June 2016, paragraph 2,

<sup>56</sup> BT response dated 22 July 2016 to question 1 of the 2<sup>nd</sup> section 191 notice dated 15 July 2016.

<sup>57</sup> BT submission dated 16 June 2016, paragraphs 48-51.

<sup>58</sup> We assume that price less FAC is broadly equal to the EBIT margin for these services as we understand that there is minimal capital employed associated with TRCs and SFIs.

**Table 4.1: TRC data derived from BT's February 2012 pricing paper**

Price from:	Price £	DSAC £	FAC, £	DSAC test	EBIT margin
<b>TRC visit element (normal days)</b>					
1 April 2011	[X]	[X]	[X]	[X]	[X]
8 June 2012	[X]	[X]	[X]	[X]	[X]
<b>TRC per hour (normal days)</b>					
1 April 2011	[X]	[X]	[X]	[X]	[X]
8 June 2012	[X]	[X]	[X]	[X]	[X]

**Table 4.2: SFI data derived from BT's February 2012 pricing paper**

Price from:	Price, £	DSAC, £	FAC, £	DSAC test	EBIT margin
<b>SFI Base</b>					
1 April 2011	[X]	[X]	[X]	[X]	[X]
8 June 2012	[X]	[X]	[X]	[X]	[X]
<b>SFI frames</b>	[X]	[X]	[X]	[X]	[X]
1 April 2011	[X]	[X]	[X]	[X]	[X]
8 June 2012	[X]	[X]	[X]	[X]	[X]
<b>SFI network</b>	[X]	[X]	[X]	[X]	[X]
1 April 2011	[X]	[X]	[X]	[X]	[X]
8 June 2012	[X]	[X]	[X]	[X]	[X]
<b>SFI Internal Wiring</b>	[X]	[X]	[X]	[X]	[X]
1 April 2011	[X]	[X]	[X]	[X]	[X]
8 June 2012	[X]	[X]	[X]	[X]	[X]
<b>SFI Internal Equipment</b>	[X]	[X]	[X]	[X]	[X]
1 April 2011	[X]	[X]	[X]	[X]	[X]
8 June 2012	[X]	[X]	[X]	[X]	[X]
<b>SFI Co Op</b>	[X]	[X]	[X]	[X]	[X]
1 April 2011	[X]	[X]	[X]	[X]	[X]
8 June 2012	[X]	[X]	[X]	[X]	[X]
<b>SFI Frames Direct</b>	[X]	[X]	[X]	[X]	[X]
1 April 2011	[X]	[X]	[X]	[X]	[X]
8 June 2012	[X]	[X]	[X]	[X]	[X]

Note: Page 9 of BT's February 2012 pricing paper says that the proposed price of SFI Coop is £ [X] but the actual price implemented was £ [X], as set out on page 3 of the February 2012 pricing paper.

**Table 4.3: TRC data derived from BT's December 2012 pricing paper**

Price from:	Price £	DSAC £	FAC, £	DSAC test	EBIT margin
<b>TRC visit element (normal days)</b>					
8 June 2012	[X]	[X]	[X]	[X]	[X]
1 April 2013	[X]	[X]	[X]	[X]	[X]
<b>TRC per hour (normal days)</b>	[X]	[X]	[X]	[X]	[X]
8 June 2012	[X]	[X]	[X]	[X]	[X]
1 April 2013	[X]	[X]	[X]	[X]	[X]

**Table 4.4: SFI data derived from BT's December 2012 pricing paper**

Price from:	Price, £	DSAC, £	FAC, £	DSAC test	EBIT margin
<b>SFI Base</b>					
8 June 2012	[X]	[X]	[X]	[X]	[X]
1 April 2013	[X]	[X]	[X]	[X]	[X]
<b>SFI Frames</b>	[X]	[X]	[X]	[X]	[X]
8 June 2012	[X]	[X]	[X]	[X]	[X]
1 April 2013	[X]	[X]	[X]	[X]	[X]
<b>SFI Network</b>	[X]	[X]	[X]	[X]	[X]
8 June 2012	[X]	[X]	[X]	[X]	[X]
1 April 2013	[X]	[X]	[X]	[X]	[X]
<b>SFI Internal Wiring</b>	[X]	[X]	[X]	[X]	[X]
8 June 2012	[X]	[X]	[X]	[X]	[X]
1 April 2013	[X]	[X]	[X]	[X]	[X]
<b>SFI Internal Equipment</b>	[X]	[X]	[X]	[X]	[X]
8 June 2012	[X]	[X]	[X]	[X]	[X]
1 April 2013	[X]	[X]	[X]	[X]	[X]
<b>SFI Co Op</b>	[X]	[X]	[X]	[X]	[X]
8 June 2012	[X]	[X]	[X]	[X]	[X]
1 April 2013	[X]	[X]	[X]	[X]	[X]
<b>SFI Frames Direct</b>	[X]	[X]	[X]	[X]	[X]
8 June 2012	[X]	[X]	[X]	[X]	[X]
1 April 2013	[X]	[X]	[X]	[X]	[X]

4.28 BT said that the cost data included in its pricing papers was derived from the RFS. We have therefore assessed the appropriateness of that RFS data. In doing so, we first set out what cost information on TRCs and SFIs was included in the RFS during

the Relevant Period before setting out BT's explanation of how it used the RFS data to derive cost data in the pricing papers.

### Reporting of TRCs and SFIs in the RFS during the Relevant Period

- 4.29 BT did not produce cost data for each of the individual TRC and SFI services in its RFS. Until the 2014/15 RFS, costs for TRC and SFI services were reported within Wholesale Residual in the RFS.<sup>59</sup> BT informed us that this means that the service costs would not have been subject to the same level of audit review and audit opinion as other regulated markets.<sup>60</sup> The 2014/15 RFS reported costs for TRCs in the WLA and wholesale fixed analogue exchange line (WFAEL) markets and for SFIs in the WLA market.
- 4.30 During the Relevant Period, all SFI variants were included in two services within the RFS: (i) internal SFIs, and (ii) external SFIs.<sup>61</sup> Until the 2014/15 RFS all TRCs were included in one service in the RFS. In 2014/15 four services were reported relating to the TRCs (internal WLA TRCs, external WLA TRCs, internal WLR TRCs and external WLR TRCs).<sup>62</sup>
- 4.31 Table 4.5 summarises the unit FAC and unit DSAC data reported in the RFS during the period 2011/12 to 2014/15 which are relevant to the Dispute.

**Table 4.5: Unit FAC and DSAC for SFI and TRC services reported in the RFS, £ nominal**

	FAC £				DSAC £			
	2011/12	2012/13	2013/14	2014/15	2011/12	2012/13	2013/14	2014/15
<b>SFIs</b>								
External SFI	[X]							
Internal SFI	[X]							
<b>TRCs</b>								
Openreach TRCs	[X]	[X]	[X]		[X]	[X]	[X]	
WLA TRCs external				[X]				[X]
WLA TRCs internal				[X]				[X]
WLR TRCs external				[X]				[X]
WLR TRCs internal				[X]				[X]

Source: BT response dated 6 July 2016 to question 5a of the 1<sup>st</sup> section 191 notice. The 2011/12, 2012/13 and 2013/14 data is from the restated RFS rather than the originally published RFS for those years (with the exception of the TRC data in 2013/14 which is from the originally published RFS).

- 4.32 BT told us that there were a number of factors that meant that the unit cost data from the RFS could not be reliably compared across years and urged caution in using the

<sup>59</sup> BT response dated 6 July 2016 to question 5 of the 1<sup>st</sup> section 191 notice.

<sup>60</sup> BT response dated 6 July 2016 to question 5 of the 1<sup>st</sup> section 191 notice.

<sup>61</sup> BT response dated 6 July 2016 to question 4 of the 1<sup>st</sup> section 191 notice.

<sup>62</sup> BT response dated 6 July 2016 to question 4 of the 1<sup>st</sup> section 191 notice. An internal residual TRC service was also included in the RFS.

data. These factors included changing policies in relation to SFI volumes, 'anomalies' in relation to SFI volumes in certain years and a lack of routinely reported volume data for TRCs in the regulatory reporting system.<sup>63</sup>

4.33 Table 4.6 shows the DSAC/FAC ratio for each service reported in the RFS during the Relevant Period.

**Table 4.6: DSAC/FAC ratios for SFI and TRC services reported in the RFS**

	2011/12	2012/13	2013/14	2014/15
<b>SFIs</b>				
External SFI	[X]	[X]	[X]	[X]
Internal SFI	[X]	[X]	[X]	[X]
<b>TRCs</b>				
Openreach TRCs	[X]	[X]	[X]	
WLA TRCs – external				[X]
WLA TRCs – internal				[X]
WLR TRCs – external				[X]
WLR TRCs – internal				[X]

Source: Ofcom, derived from BT response dated 6 July 2016 to question 5 of the 1<sup>st</sup> section 191 notice dated 15 June 2016. Consistent with Table 4.5, the 2011/12, 2012/13 and 2013/14 data is from the restated RFS rather than the originally published RFS for those years (with the exception of the TRC data in 2013/14 which is from the originally published RFS).

4.34 The DSAC/FAC ratio for TRCs was over 3 in most years and the ratio for external SFIs was significantly lower at between [X]1.2-1.8].<sup>64</sup> We understand that one reason for the difference in the DSAC/FAC ratios is that SFI services are included within the 'access' increment in BT's LRIC model while TRC services are included in the 'other' increment.<sup>65</sup>

4.35 In the next sub-section we set out BT's explanation for how it used the RFS cost data in its pricing papers.

### February 2012 pricing paper

4.36 BT told us that the FAC and DSAC data for SFI modules in the February 2012 pricing paper was estimated using FAC and DSAC data from the SFI cost component Special Fault Investigation (CO989) reported in the 2010/11 RFS.<sup>66</sup> BT estimated the FAC and DSAC for each module by applying volume and duration information for each module to the RFS information.<sup>67</sup>

<sup>63</sup> BT response dated 6 July 2016 to question 5a of the 1<sup>st</sup> section 191 notice.

<sup>64</sup> We have used the DSAC/FAC ratios for external SFI services reported in the RFS since we consider that that these are more relevant for the purposes of resolving this dispute.

<sup>65</sup> See for examples pages 7 to 9 of BT's 2014 LRIC Relationships and Parameters document: <http://www.btplc.com/Thegroup/RegulatoryandPublicaffairs/Financialstatements/2014/LRICModelRelationshipsandParameters2014.pdf>. In BT's LRIC model costs that are common across all increments are attributed wholly to each increment. Therefore, if the 'other' increment is relatively small compared to the access increment (which seems likely since fewer services are associated with this increment according to BT's documentation) then the common costs and hence the DSAC are likely to be relatively large compared to the FAC of the relevant services.

<sup>66</sup> BT response dated 22 July 2016 to question 1 of the 2<sup>nd</sup> section 191 notice dated 15 July 2016.

<sup>67</sup> BT response dated 22 July 2016 to question 1 of the 2<sup>nd</sup> section 191 notice dated 15 July 2016.

- 4.37 BT was unable to locate the precise calculations used to support its estimates of FAC and DSAC for TRCs in the February 2012 pricing paper.<sup>68</sup> However, it said that if the methodology followed a similar approach to that used in the December 2012 paper, the FAC and DSAC estimates were likely to have been based on (i) FAC and DSAC for the component Time Related Charges (CK981) from the 2010/11 RFS; (ii) breaking down these RFS costs between visit and hours-related elements and (iii) deriving unit costs by reference to relevant volumes.<sup>69</sup>
- 4.38 BT said that the DSAC/FAC ratio for TRC charges used in its pricing paper was [ $\approx$  1.2-1.4] which is consistent with the DSAC/FAC ratio for the component Special Fault Investigations from the 2010/11 RFS.<sup>70</sup>

#### December 2012 pricing paper

- 4.39 BT was unable to locate the precise calculations used to support its FAC estimates for SFIs in the December 2012 pricing paper, although it said this was likely to have been derived in a similar way to that in the February 2012 pricing paper. However, BT said that the DSAC/FAC ratio of [ $\approx$  1.2-1.4] used in the paper was derived from the component Special Fault Investigations from the 2011/12 RFS. This appears consistent with Table 4.6 which shows that the DSAC/FAC ratio for the SFI services reported in the RFS in 2011/12 was [ $\approx$  1.2-1.4].<sup>71</sup>
- 4.40 BT said it had traced the calculations used to derive the unit FAC for TRC hours but had not been able to locate the calculations used for the unit FAC for the visit element of the TRC visit charge.
- 4.41 BT said the TRC hourly unit FAC was derived from the component Time Related Charges in the 2011/12 RFS. BT said that it analysed the FAC from the RFS between 'visit related costs' and 'hourly costs' based on management judgement.<sup>72</sup> BT said it then analysed the hourly cost FAC estimate between time taken on TRC visits, TRC hourly costs and volume deals in order to obtain a FAC estimate for the hourly costs. It divided this hourly cost by the volume of TRC hours to derive the unit FAC.
- 4.42 BT said that the DSAC was estimated by multiplying the unit FAC estimate by a DSAC/FAC ratio of [ $\approx$  1.2-1.4], the same ratio as used for SFI services (and which was derived from the Special Fault Investigation component from the 2011/12 RFS).

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<sup>68</sup> BT response dated 22 July 2016 to question 1 of the 2<sup>nd</sup> section 191 notice dated 15 July 2016.

<sup>69</sup> BT response dated 22 July 2016 to question 1 of the 2<sup>nd</sup> section 191 notice dated 15 July 2016.

<sup>70</sup> BT response dated 22 July 2016 to question 1 of the 2<sup>nd</sup> section 191 notice dated 15 July 2016. Table 4.6 does not show the DSAC/FAC ratio for 2010/11 since we did not ask for RFS information for 2010/11 as it was outside the Relevant Period.

<sup>71</sup> The SFI service in 2011/12 was made up of two cost components: Special Fault Investigation and Openreach Sales Product Management. The Special Fault Investigation component referenced by BT represented almost all of the unit cost of the SFI services reported in the RFS.

<sup>72</sup> BT response dated 22 July 2016 to question 1 of the 2<sup>nd</sup> section 191 notice dated 15 July 2016, page 5.

## Ofcom's provisional view

### Assessment against DSAC

- 4.43 BT relies on the fact that prices for TRCs and SFIs were below its DSAC estimates when it assessed the data for internal pricing decisions in February 2012 and December 2012 to demonstrate that its charges were cost oriented.
- 4.44 As explained above, we agree that DSAC is the appropriate cost standard to use for the purposes of assessing BT's compliance with its cost orientation obligations. However, we note that even on the face of its pricing papers BT has failed to demonstrate that each of its charges for TRCs and SFIs were below DSAC for the whole of the Relevant Period. Both pricing papers show that the prices for [X] were above BT's estimate of DSAC before the introduction of the pricing changes assessed in those papers.<sup>73</sup>
- 4.45 In any event, we do not consider that the DSAC tests set out in the two pricing papers provided by BT (as shown in Tables 4.1 to 4.4 above) are sufficient to satisfactorily demonstrate that BT complied with its cost orientation condition throughout the Relevant Period for the following reasons, which we discuss in more detail below:
- The RFS cost data does not appear robust;
  - The pricing papers do not cover the whole of the Relevant Period; and
  - The pricing papers do not include costs for each and every TRC and SFI charge in dispute.

#### *The RFS cost data does not appear robust*

- 4.46 As set out above, BT told us that the FAC and DSAC information included in the pricing papers was derived from cost data reported in the 2010/11 and 2011/12 RFS, although it was unable to explain in all cases how the calculations were performed. Our starting point for assessing compliance with cost orientation obligations is normally BT's view of its costs as published in its RFS, since we would expect the RFS to contain the best available information for resolving disputes.
- 4.47 However, in the 2014 FAMR Statement we reviewed BT's volume, revenue and FAC data for TRCs and SFIs in the period 2009/10 to 2012/13, which includes data from the 2010/11 and 2011/12 RFS that BT relied on in its pricing papers. Following analysis of the RFS cost information in these years we found "*significant concerns with the reliability of this data*".<sup>74</sup> We said that we had "*identified various (and in some cases counter-intuitive) trends in both BT's cost and revenue data which BT has been unable to fully explain*", which meant that we had "*concerns with both the underlying absolute figures and the reliability of any trends inferred from this data*".<sup>75</sup>
- 4.48 We have revisited the analysis carried out for the purposes of the 2014 FAMR Statement and for the reasons given in the 2014 FAMR Statement, we do not

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<sup>73</sup> £[X] price vs £[X] DSAC in the February 2012 pricing paper and £[X] price vs £[X] DSAC in the December 2012 pricing paper.

<sup>74</sup> 2014 FAMR Statement, paragraph 18.81.

<sup>75</sup> 2014 FAMR Statement, paragraph 18.82.

consider that the underlying RFS FAC data for 2010/11 and 2011/12, on which the FAC estimates in the pricing papers are based, are robust. We therefore consider that it would be inappropriate to rely on these FAC estimates for the purposes of resolving the Dispute.

- 4.49 In addition, we note that the relationship between FAC and DSAC in the RFS for TRC and SFI services, as shown in Table 4.6, appears inconsistent and counterintuitive. BT has told us that the underlying labour costs for TRC and SFI services are the same (see paragraph 4.82) and given this, the significant difference in DSAC/FAC ratios between TRC and SFI services derived from RFS data does not appear credible. We noted above that one reason for the difference in the DSAC/FAC ratios is that SFI services are included within the 'access' increment in BT's LRIC model while TRC services are included in the 'other' increment.
- 4.50 Given that both TRCs and SFIs are network access services, it is not clear to us why they are included in different increments in BT's LRIC model. However, we recognise that in its pricing papers BT applied the DSAC/FAC ratio for SFIs to both TRC and SFI services when estimating DSAC. This would appear reasonable given that the DSAC/FAC ratio for SFIs was derived from the access increment of BT's LRIC model.
- 4.51 As explained further in Step 2 of our analysis below, while we do not consider that the FAC estimates in BT's pricing papers are robust, we consider that the DSAC/FAC ratios which BT has used in those papers to derive DSAC estimates do appear broadly reasonable.

*Pricing papers do not cover the whole Relevant Period*

- 4.52 The pricing papers are dated 27 February 2012 and 17 December 2012 and relate to the price changes made on 8 June 2012 and 1 April 2013. However, they do not enable an assessment to be made as to whether BT's charges in effect from the start of the Relevant Period (1 April 2011) to 27 February 2012 (the date of the February 2012 pricing paper), or from 1 April 2013 to the end of the Relevant Period, were cost oriented. In particular, we note that BT has not provided a pricing paper (or any other evidence) supporting price changes made on 1 April 2014 to, for example, SFI base and Coop modules.
- 4.53 In addition, given that the cost information used in the February 2012 pricing paper relates to 2010/11 and that used in the December 2012 pricing paper relates to 2011/12, the only cost information directly associated with the Relevant Period appears to be the 2011/12 data in the December 2012 pricing paper.
- 4.54 Therefore, even if we considered that the cost estimates included in the two pricing papers were reliable (which for the reasons set out above is not the case), we would not consider that BT had demonstrated that the TRC and SFI charges were cost oriented over the whole of the Relevant Period.

*Pricing papers do not include costs for each and every TRC and SFI charge in dispute*

- 4.55 BT told us that it did not produce RFS information for each TRC and SFI product and service during the Relevant Period although the pricing papers attempt to estimate costs for some individual services, as explained above. The pricing papers appear to include estimates of FAC and DSAC for each SFI charge but not all TRC charges. In particular, they include estimates of FAC and DSAC for TRC hourly and visit charges

for normal working days but do not appear to include cost information for TRC hourly and visit charges outside normal working days (e.g. Sundays and bank holidays), internal and external NTE shifts, or TRC stores charges.<sup>76</sup> The pricing papers therefore do not enable us to assess whether each and every TRC and SFI charge was cost oriented during the Relevant Period.

### EBIT margins

- 4.56 BT said it had “*taken comfort that TRC and SFI prices complied with the basis of charges obligation from Ofcom’s consideration of TRC and SFI prices during the relevant period, (i.e. in the 2012 Charge Control where Ofcom observed that Openreach’s returns were ‘in line with our normal expectation for Openreach services, suggesting that they are not overcharging for TRCs’)*”.<sup>77</sup>
- 4.57 BT argued that it “*was entitled to rely on this [statement] and set prices consistently with the margins that Ofcom has endorsed*” and noted that the EBIT margin assessed in both the February 2012 and December 2012 pricing papers was “*in line with the EBIT margin Ofcom reviewed in the March 2012 statement (~20%)*”.<sup>78</sup>
- 4.58 BT’s submission refers to Ofcom’s 2012 LLU/WLR Statement, in which Ofcom set new charge controls for LLU and WLR services to apply from 1 April 2012.<sup>79</sup> As part of its review, Ofcom considered arguments from CPs, including TalkTalk, that BT’s TRCs and SFIs should be included within the scope of the LLU charge control. In the 2012 LLU/WLR Statement, we set out our reasoning for deciding that regulation of LLU TRCs and SFIs through cost orientation rather than a charge control remained appropriate at that time.<sup>80</sup>
- 4.59 In relation to LLU TRCs, we explained:

“4.334 We note that the cross-market nature of TRCs and the nature of the service itself means that a charge control (by way of a basket or other means) may not be a sufficiently targeted intervention. For example, TRCs can be provided in the Leased Lines and WFAEL markets (in addition to the WLA market), making it difficult to identify robustly all LLU TRC costs (which are reasonably necessary for the use of LLU services). As noted in the March 2011 Consultation, we do not consider that separate reporting arrangements in Openreach’s regulatory accounts would be appropriate or proportionate. Further, the structure of the charges, given the nature of the service, also means that charges can be variable. For example, TRC charges can vary depending on when the work takes place (i.e., on a weekday or during business hours or outside normal business hours).

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<sup>76</sup> The February 2012 pricing paper includes one charge of £ [redacted] for stores, which could relate to the stores item “broadband micro filter” since the price of this item was £ [redacted] from June 2012. The February 2012 pricing paper also includes an ‘incremental cost’ against stores of £ [redacted] but it is not clear what this cost relates to.

<sup>77</sup> BT submission dated 16 June 2016, paragraph 4.

<sup>78</sup> BT submission dated 16 June 2016, paragraphs 48-50.

<sup>79</sup> Charge controls for these services were imposed as a consequence of Ofcom’s 2010 reviews of the WLA and Wholesale Fixed Analogue Exchange Line markets.

<sup>80</sup> 2012 LLU/WLR Statement, paragraphs 4.322-4.369.

4.336 *We recognise that LLU (and WLR) TRCs can represent a significant item of spend for CPs (although we note that 2009/10 industry spend on LLU and WLR TRCs is likely to be approximately at least 30% less than what TTG stated in its March 2011 Consultation response for 2009/2010).*

4.337 *However, we have reviewed Openreach's overall returns (which are commercially confidential) for TRCs. We consider that these are in line with our normal expectations for Openreach services, suggesting that they are not overcharging for TRCs by Openreach.*<sup>81</sup>

- 4.60 Condition FAA4.1 imposes an ongoing obligation on BT to secure and be able to demonstrate that each of its relevant charges for network access is reasonably derived from the costs of provision based on a forward looking long run incremental cost approach and allowing an appropriate mark up for the recovery of common costs including an appropriate return on capital employed.
- 4.61 We do not accept that BT can demonstrate compliance with this requirement by showing that its EBIT margins for TRCs and SFIs during the Relevant Period were at or around a particular level, on the basis of the above statements by Ofcom. The context in which these statements were made was Ofcom's consideration of whether to impose a charge control on BT's TRCs, rather than a review of whether BT's charges for those services were cost oriented. The statements therefore cannot be understood as a finding by Ofcom that BT's charges for TRCs at the time of the 2012 LLU/WLR Statement were consistent with BT's cost orientation obligation (and Ofcom did not even consider BT's returns on SFIs).
- 4.62 Indeed, we note that elsewhere in its submission BT argued that:
- "Ofcom's discussion in various and market review statements since 2010 make it clear that, in relation to TRCs and SFI, the change to a charge control obligation [in the 2014 FAMR Statement] represented a deliberate change in how prices should be set and the level of those prices, with no judgment being made on whether previous prices complied with the basis of charges obligation."<sup>82</sup> (emphasis added)*
- 4.63 Furthermore, Ofcom's statements related to the overall level of returns which Openreach was making for TRCs. We consider that it would have been clear to BT at the time that an assessment of these returns would not be sufficient to establish compliance with the cost orientation condition. As noted above, we set out in the 2010 WLA Statement that we would assess compliance with the cost orientation condition by assessing whether, as a first order test, BT's charges were between DLRIC and DSAC, and the 2012 LLU/WLR Statement was published following the PPC Judgment in which the CAT confirmed that DSAC was an appropriate test for these purposes.<sup>83</sup> It is clear from the 2012 LLU/WLR Statement that Ofcom did not consider whether or not BT's TRC charges were above or below DSAC.
- 4.64 Finally, we note that it is unclear to what extent BT placed reliance on Ofcom's statements in the 2012 LLU/WLR Statement in making pricing decisions. BT states

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<sup>81</sup> Ofcom did not consider BT's returns on SFI services in the 2012 LLU/WLR Statement.

<sup>82</sup> BT submission dated 16 June 2016, paragraph 3(d).

<sup>83</sup> See paragraphs 4.9 and footnote 42 above.

that it 'reasonably relied' on Ofcom's statements in assessing compliance in June 2012 and March 2013.<sup>84</sup> However, it appears that the DSAC test was used as the primary basis for assessing compliance with the cost orientation condition in both the February 2012<sup>85</sup> and December 2012 pricing papers, with an assessment against margins used as a 'further basis' for assessing compliance.<sup>86</sup>

### Provisional conclusion

- 4.65 For the reasons above we do not consider that BT has demonstrated to our satisfaction that its TRC and SFI charges were compliant with SMP Condition FAA4.1 for the Relevant Period.

## **Step 2. If BT has not satisfactorily demonstrated compliance, were BT's relevant charges nonetheless below DSAC?**

### **The Parties' views**

- 4.66 TalkTalk considered that "*the available evidence strongly suggests that prices for all or many TRC/SFI services were significantly above FAC costs throughout or for much of the Relevant Period*".<sup>87</sup>
- 4.67 TalkTalk referred to the 2014 FAMR Statement in which Ofcom found evidence that BT's revenues for TRCs appeared to be above FAC in 2012/13 and 2013/14.<sup>88</sup> TalkTalk submitted that it was very likely that BT's TRC charges were also above FAC before 2012/2013 on the basis that BT's previous twelve months' costs were likely to have been similar to those in the years 2012/13 and 2013/14 which Ofcom had analysed. TalkTalk noted that, for some TRC and SFI services, BT's prices were above or not substantially below those in the years which Ofcom had analysed.<sup>89</sup>
- 4.68 TalkTalk argued further that "*the nature of SFI/TRC services implies that the DSAC cost (properly derived) is very similar to the FAC cost*".<sup>90</sup> TalkTalk stated that:

*"for a particular product there will only be a difference between DSAC and FAC costs if the product's cost stack includes an attribution of fixed and common wholesale network costs. However, SFI/TRC services are essentially engineering labour and as such cause no fixed and common network costs to be incurred and therefore should properly include no allocation of fixed and common wholesale network costs."*<sup>91</sup>

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<sup>84</sup> BT submission dated 16 June 2016, paragraph 51(b).

<sup>85</sup> We note that the February 2012 pricing paper, on the basis of which the June 2012 pricing changes were assessed, pre-dates the 2012 LLU/WLR Statement, although Ofcom had published a draft Statement on 3 February 2012 which contained the same wording as that referred to by BT. The February 2012 pricing paper refers to [3<].

<sup>86</sup> BT submission dated 16 June 2016, paragraph 50(b).

<sup>87</sup> TalkTalk submission, paragraph 3.9.

<sup>88</sup> 2014 FAMR Statement, paragraphs 18.90-18.94.

<sup>89</sup> TalkTalk submission, paragraph 3.8.

<sup>90</sup> TalkTalk submission, paragraph 3.12.

<sup>91</sup> TalkTalk submission, paragraph 3.12.

- 4.69 TalkTalk therefore considered that the available evidence suggested that BT's charges for SFIs and TRCs were above DSAC as well as FAC costs.<sup>92</sup>
- 4.70 BT argued that it had used an appropriate cost standard, DSAC, to set its charges during the Relevant Period. It considered that TalkTalk was incorrectly claiming that BT was required to set prices at FAC, and that this effectively amounted to seeking to have a charge control retroactively applied to a period when BT was only subject to a cost orientation obligation. BT considered that this gave rise to important policy risks.<sup>93</sup>
- 4.71 BT further rejected TalkTalk's claim that FAC costs and DSAC costs are similar for TRCs and SFIs. BT stated that:

*"The analysis in the pricing papers from 2012 and a review of published information for similar services demonstrates that it is always the case that DSAC is clearly higher than FAC for TRCs and SFIs."*<sup>94</sup>

- 4.72 To evidence its view that DSAC costs are higher than FAC costs, BT pointed to its assessment in the February 2012 pricing paper, in which the ratio of DSAC to FAC was approximately [ $\geq$  1.2-1.4]. BT also provided a selection of higher DSAC/FAC ratios which related to copper provision and maintenance services in the three years preceding the 2014 FAMR Statement. BT argued that:

*"TRC services are similar in nature to the maintenance and provision of copper lines and SFI services and related to the maintenance of copper lines. One would expect the fixed and common cost ("FCC") of TRC and SFI services to be the same or similar to those of copper provision and maintenance services."*<sup>95</sup>

### **Ofcom's provisional view**

- 4.73 As explained above, where BT has failed to demonstrate to our satisfaction that its relevant charges were cost oriented, at Step 2 of our analysis we assess whether the charges were nonetheless below DSAC.
- 4.74 We do not consider that prices being above FAC would be sufficient to find that BT had failed to comply with its cost orientation obligation, unless they were also above DSAC. However, we do not understand TalkTalk to be arguing that we should apply a FAC cost standard<sup>96</sup>. Rather, we understand TalkTalk's position to be that DSAC costs for TRCs and SFIs, properly derived, will in fact be very similar to FAC.
- 4.75 In this section we therefore first consider the sources of information available to us in order to establish what the appropriate DSACs for BT's charges were in the Relevant Period, before applying the DSAC test to BT's charges for TRCs and SFIs.

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<sup>92</sup> TalkTalk submission, paragraph 3.1.

<sup>93</sup> BT submission dated 16 June 2016, paragraphs 5 and 6.

<sup>94</sup> BT submission dated 16 June 2016, paragraph 5.

<sup>95</sup> BT submission dated 16 June 2016, paragraphs 44-47.

<sup>96</sup> Subject to TalkTalk's argument that we should apply some form of further test beyond DSAC to ensure that BT does not over-recover its common costs across all services, which we consider above.

## RFS data

- 4.76 We would normally consider that the DSAC figures reported in the RFS are the starting point for assessing BT compliance with the cost orientation obligation.
- 4.77 However, in this case we have concerns that the RFS data underpinning the FAC information in BT's pricing papers, and on which its DSAC estimates in those pricing papers are based, are not reliable.<sup>97</sup> As noted above, BT informed us that there were a number of factors that meant that the RFS unit cost data could not be reliably compared across years and urged caution in using the data. In addition, the RFS data are aggregated which does not allow Ofcom to assess whether each separate charge is cost oriented.
- 4.78 For these reasons, we do not consider that it would be appropriate to use the FAC or DSAC data reported in the RFS (or set out in BT's pricing papers) to assess whether TRC and SFI charges were cost oriented.<sup>98</sup>
- 4.79 While we have adjusted RFS data in previous disputes to address particular concerns, the concerns we have identified in this case relate to the overall robustness and reliability of the data for TRC and SFI services. In the absence of reliable RFS data, we have considered alternative sources of financial information that we can use to inform our view on BT's compliance with cost orientation. We discuss these below.

## Alternative cost information

- 4.80 One alternative source of cost data that we could use is Openreach's management accounts. In the 2014 FAMR Statement we set a charge control for TRC services based on our FAC estimate of the underlying hourly costs using information sourced from Openreach's management accounts uplifted to allow for an estimate of overhead costs.<sup>99</sup>
- 4.81 We also used management accounts data to set the charge control for TRCs in the 2016 BCMR Statement.<sup>100</sup> Since we relied on Openreach's management accounts data in the last two charge control decisions relating to TRCs, we consider it is reasonable to consider management accounts data as the basis for resolving the Dispute.
- 4.82 We asked BT to provide cost information from its management accounts for each TRC and SFI service during the Relevant Period. BT said it is not possible to provide disaggregated cost information for each TRC and SFI product.<sup>101</sup> BT said that "*the vast majority of copper TRCs and SFIs are undertaken by B grade engineers. There is no distinction between the particular products or services and therefore the costs cannot be split by reference to [each TRC and SFI service].*"<sup>102</sup> BT provided a breakdown of the hourly cost stack applicable to both TRC and SFI services, as shown in Table 4.7.

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<sup>97</sup> See paragraphs 4.46 to 4.51 above.

<sup>98</sup> As noted above and explained further below, we consider that the DSAC/FAC ratios reported in the RFS for SFI services may be a reasonable basis on which to estimate DSACs once we have reliable FAC estimates.

<sup>99</sup> 2014 FAMR Statement, paragraph 18.102,

<sup>100</sup> 2016 BCMR Statement, Volume II, paragraph 8.86.

<sup>101</sup> BT response dated 8 July 2016 to question 7d of the 1<sup>st</sup> section 191 notice dated 15 June 2016.

<sup>102</sup> BT response dated 8 July 2016 to question 7 of the 1<sup>st</sup> section 191 notice dated 15 June 2016.

**Table 4.7: Hourly cost stack for TRC and SFI services from management accounts, £ nominal**

	2011/12	2012/13	2013/14	2014/15
Salary	[redacted]	[redacted]	[redacted]	[redacted]
Allowances	[redacted]	[redacted]	[redacted]	[redacted]
Overtime	[redacted]	[redacted]	[redacted]	[redacted]
NI	[redacted]	[redacted]	[redacted]	[redacted]
Pension	[redacted]	[redacted]	[redacted]	[redacted]
<b>Engineering Pay cost B2</b>	[redacted]	[redacted]	[redacted]	[redacted]
Engineering Pay cost C1	[redacted]	[redacted]	[redacted]	[redacted]
<b>Weighted engineering pay cost Pay Cost<sup>1</sup></b>	[redacted]	[redacted]	[redacted]	[redacted]
Vehicle hire cost	[redacted]	[redacted]	[redacted]	[redacted]
Travel & subsistence	[redacted]	[redacted]	[redacted]	[redacted]
Tools	[redacted]	[redacted]	[redacted]	[redacted]
Mobile	[redacted]	[redacted]	[redacted]	[redacted]
Training	[redacted]	[redacted]	[redacted]	[redacted]
<b>Engineering variable cost</b>	[redacted]	[redacted]	[redacted]	[redacted]
Band 1 manager	[redacted]	[redacted]	[redacted]	[redacted]
Band 2 manager	[redacted]	[redacted]	[redacted]	[redacted]
Controls & direct desk support	[redacted]	[redacted]	[redacted]	[redacted]
<b>Total Support costs</b>	[redacted]	[redacted]	[redacted]	[redacted]
<b>Total hourly cost</b>	[redacted]	[redacted]	[redacted]	[redacted]

Source: BT response dated 8 July 2016 to question 7a-c of the 1<sup>st</sup> section 191 notice dated 15 June 2016 and BT response dated 27 July 2016 to question 3 of the 2<sup>nd</sup> section 191 notice dated 15 July 2016.

Note: <sup>1</sup> in its 27 July 2016 response, BT said that its analysis of the engineering split in June 2016 suggested that the majority ([redacted]%) of TRC and SFI work was carried out by B2 engineers with the rest carried out by C1 engineers.

- 4.83 One advantage of using the data shown in Table 4.7 is that the hourly cost is reasonably stable over time, unlike the cost trends derived from the RFS data. The hourly cost in Table 4.7 increases by [redacted]% in 2012/13, [redacted]% in 2013/14 and [redacted]% in 2014/15. We would expect the hourly cost of labour to be relatively stable over time, with annual changes largely reflecting wage inflation and efficiencies.<sup>103</sup>
- 4.84 Given our concerns regarding the reliability of BT's RFS data, we consider that the management accounts data represents the best information available to us to assess whether BT's charges for SFIs and the hourly and visit charges for TRCs were cost oriented in the Relevant Period. As explained below, we used the management accounts data to obtain DSAC estimates for these services by first deriving FAC estimates and then applying DSAC/FAC ratios based on BT's RFS data to derive DSAC estimates. We then used these estimates to apply the DSAC test to BT's charges.
- 4.85 The management accounts data did not include cost information on BT's TRC stores charges. We therefore consider these charges separately at paragraphs 4.130 to 4.133.

<sup>103</sup> The vehicle element of the hourly cost may also reflect changes in fuel costs.

## FAC estimates

4.86 There are some issues with using the management accounts data to derive FAC estimates, but we consider that the data can be adjusted to address many of these issues:

- The data only reflects hourly costs;
- The data does not include all relevant costs;
- The data may include overtime costs associated with charges for work outside normal hours;
- The data reflects billed hours rather than actual hours worked; and
- The data does not reflect the modular cost of SFI services.

### *The data only reflect hourly costs*

4.87 The management accounts data reflects the hourly costs for TRC and SFI services. We therefore considered how best to use this information to estimate the costs of the various services in dispute.

4.88 SFI services are charged on a modular basis but, as described below, module costs are a function of hourly charge multiples. We therefore consider that hourly charges can be adjusted using these multiples and used as a basis for assessing whether SFI services were cost oriented.

4.89 In relation to the TRC hourly charge, we consider that the management accounts data can be used to assess cost orientation since these costs are on an hourly basis.<sup>104</sup>

4.90 The TRC visit charge includes an hour of engineering time but is also intended to cover the costs of the engineer getting to the end customer's premises. In the 2014 FAMR Statement the visit element of the charge was treated as equivalent to an hour of engineering time.<sup>105</sup> As BT has not provided any separate cost information on the visit element of the charge, we have used a consistent approach with that adopted in the 2014 FAMR Statement and assumed that the cost of the visit element of the charge is equivalent to the hourly cost, i.e. that the visit charge effectively represents two hours of engineering time.<sup>106</sup>

4.91 In relation to internal and external NTE shifts, the charges during the Relevant Period were the same as for the visit charge in normal hours and in the 2014 FAMR Statement we noted that BT had told us that these charges were directly linked to TRC rates, although the prices were fixed.<sup>107</sup> On the basis that the charges for these services were the same as for the visit charge in normal hours throughout the

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<sup>104</sup> We describe below some adjustments to the data we have made in order to estimate FAC for hourly charges for (i) normal hours, (ii) other times except Sunday and bank holidays and (iii) Sundays and bank holidays.

<sup>105</sup> 2014 FAMR Statement, paragraph 18.121.

<sup>106</sup> However, as explained further below, the adjustment we make for billed hours only applies to the hourly element of the visit charge, consistent with the approach used in the 2014 FAMR Statement.

<sup>107</sup> 2014 FAMR Statement paragraph 18.159.

Relevant Period, we have assumed that the cost stack for internal and external NTE shifts is the same as for the visit charge in normal hours. We describe our approach to estimating this cost stack below.<sup>108</sup>

*The data does not include all relevant costs*

4.92 The management accounts data does not include the following costs:

- Certain engineering variable costs and support costs;
- General overheads; and
- Return on capital employed.

4.93 We explain the adjustments we propose to make for these costs below in deriving our FAC estimates.

**Certain engineering variable costs and support costs**

4.94 BT said that some variable engineering costs and support costs were either understated or missing in certain years in the management accounts data.

4.95 Under variable engineering costs, BT said that mobile costs are not available for years before 2014/15.<sup>109</sup> However, the cost estimates it provided appear to include a small allowance for mobile costs in years before 2014/15.<sup>110</sup> On this basis we have not made any adjustment for mobile costs.

4.96 BT also said that: (i) training costs could be understated since the costs in the management accounts only related to external training and did not include internal training costs, and (ii) no allowance has been included for Service Management Centre costs. BT said this was consistent with the data it submitted on TRCs for the 2016 BCMR Statement.<sup>111</sup> While these costs may be relevant to the provision of TRC and SFI services during this period, we have not made a specific adjustment for these costs since it is not clear how material these costs could be and we do not have any data with which to make a reasonable adjustment. These costs may also be included in the allowance for general overhead costs that we describe below.

**General overheads**

4.97 BT said that no allocation has been made in the management accounts for general overheads such as Group Finance and Group HR costs.<sup>112</sup> We consider that it would be reasonable to include an allowance for general overhead costs since these would be expected to be common across a number of services and the cost orientation obligation allows for an appropriate mark up for common costs. This would also be consistent with the approach in both the 2014 FAMR Statement and 2016 BCMR

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<sup>108</sup> As explained above, we consider TRC stores separately in paragraphs 4.130 – 4.133 as the management accounts data did not include cost information on these items.

<sup>109</sup> BT response dated 8 July 2016 to question 7b of the 1<sup>st</sup> section 191 notice dated 15 June 2016.

<sup>110</sup> BT response dated 27 July 2016 to question 3 of the 2<sup>nd</sup> section 191 notice dated 15 July 2016.

<sup>111</sup> BT response dated 8 July 2016 to question 7b of the 1<sup>st</sup> section 191 notice dated 15 June 2016. BT's cost estimates provided on 27 July 2016 to question 3 of the 2<sup>nd</sup> section 191 notice dated 15 July 2016 do however appear to include an allowance for internal 'coaching' costs.

<sup>112</sup> BT response dated 8 July 2016 to question 7b of the 1<sup>st</sup> section 191 notice dated 15 June 2016.

Statement where an allowance for general overheads was included when estimating FAC for these services.<sup>113</sup>

- 4.98 We have considered what information is available to us in order to estimate an allowance for general overheads.
- 4.99 For the purposes of the 2016 BCMR Statement, BT provided a breakdown of overheads associated with TRC services provided in relation to BT's WLA and WFAEL services in 2014/15.<sup>114</sup> In the 2016 BCMR Statement we estimated overheads associated with Ethernet TRCs by starting with BT's estimate of WLA/WFAEL TRC overheads and (i) uplifting pay related overheads on the basis of the percentage difference in salary between WLA/WFAEL TRCs and Ethernet TRCs; (ii) removing overheads we thought inappropriate or not relevant for Ethernet TRCs; (iii) accepting those overheads we thought reasonable; and (iv) deflating overheads attributed using pay plus return on assets (Pay and ROA) to reflect the base year adjustment we made to corporate overheads (activity group AG112).<sup>115</sup>
- 4.100 In order to estimate an appropriate uplift for overheads for the purposes of resolving the Dispute, we have also started from BT's breakdown of overheads associated with WLA/WFAEL TRCs that it provided for the 2016 BCMR Statement. We have made the same adjustment to remove inappropriate overheads, but not the other adjustments.<sup>116</sup> As a proportion of 2014/15 SFI and TRC costs for normal working hours (as amended as described in this section), the estimated overheads uplift using this approach is [x<] %.
- 4.101 We have considered whether an overhead uplift of this scale is reasonable for the purposes of determining the Dispute by considering the operating costs reported as being 'General Support' and 'General Management' in the RFS in the Relevant Period. We consider that these categories can give a reasonable estimate of 'general overheads' though they may include some types of costs that may not be considered overheads and exclude others that could be considered as overheads. In the period 2011/12 to 2014/15 the proportion of operating costs that these two categories represented ranged from 27% to 34% (averaging 30%) for the WLA and WFAEL markets, and 30% to 36% (averaging 33%) for Openreach overall.
- 4.102 Given that the hourly cost of TRCs and SFIs using management account data is relatively stable year on year (as shown in Table 4.8 below) we consider that a single annual percentage uplift for general overheads would be appropriate for the purposes of resolving the Dispute. On balance, given the range of figures presented

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<sup>113</sup> 2016 BCMR Statement, Volume II, paragraph 8.96; 2014 FAMR Statement, paragraphs 18.102-18.112.

<sup>114</sup> 2016 BCMR Statement, Volume II, paragraph 8.95.

<sup>115</sup> 2016 BCMR Statement, Volume II, footnote 498.

<sup>116</sup> We have not made any of the adjustments specifically relating to Ethernet TRCs. We have also not made any of the adjustments to overheads attributed using the Pay and ROA methodology to reflect the base year adjustment which we made to corporate overheads. This is because this adjustment was made to reflect Ofcom's 2015 review of BT's cost attribution methodology and we do not consider that it would be appropriate to apply those changes for the purposes of estimating an appropriate overheads uplift to use in deriving FAC estimates for the Relevant Period, which pre-dated Ofcom's cost attribution review.

above, we consider that an annual uplift for general overheads of 30% is appropriate.<sup>117</sup>

### **Return on capital employed**

4.103 The management accounts cost stack does not include an allowance for return on capital employed. From the RFS information provided by BT it appears that the capital employed by TRC and SFI services is minimal and in many cases negative.<sup>118</sup> Given the low levels of capital employed for these services we do not propose to make an adjustment to the management accounts data to include a return on capital employed in our FAC estimate. We do not consider this would materially affect our assessment.

*The data may include overtime costs associated with charges for work outside normal hours*

4.104 The management accounts data includes overtime costs. BT told us that this includes overtime for normal working days as well as bank holidays and weekends.<sup>119</sup> This is relevant because, as shown in Table 3.1, there are different hourly TRC charges for (i) normal working days, (ii) all other times except Sundays and bank holidays and (iii) Sundays and bank holidays. We understand that the overtime costs included in the management accounts data represents all overtime divided by all hours.

4.105 Ideally we would assess each of these three TRC hourly charges against a separate cost stack. However, the management accounts data provided by BT does not identify overtime or other costs related to different days. We understand that overtime can relate to normal hours working where an engineer is required to work outside of their scheduled hours. We consider that it is reasonable to assume that most work relates to normal hours though BT has not been able to provide information on hours worked at different times.<sup>120</sup> [redacted]

4.106 In the absence of further information at this stage we have estimated FAC costs for each type of charge as follows:

- In order to estimate the cost stack for normal working days we have assumed that the hourly overtime cost from the management accounts is a reasonable estimate of the overtime associated with normal working hours.
- In relation to (i) all other times except Sundays and bank holidays and (ii) Sundays and bank holidays, we have assumed that the difference in charges

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<sup>117</sup> We note that we applied an overhead uplift of [redacted]% in the 2014 FAMR Statement. However, such an uplift is not consistent with the evidence we have considered above, which includes evidence on the level of overheads associated with WLA/WFAEL TRCs provided by BT for the purposes of the 2016 BCMR Statement that was not available at the time of the 2014 FAMR Statement.

<sup>118</sup> BT response dated 6 July 2016 to question 5b of the 1<sup>st</sup> section 191 notice dated 15 June 2016. BT's response indicated that return on capital employed represented between ([redacted]%) and [redacted]% of FAC for SFI services and between ([redacted]%) and [redacted]% of FAC for TRC services. In the 2014 FAMR Statement we also noted that these services had low levels of capital employed (see for example paragraph 18.75).

<sup>119</sup> Email from BT to Ofcom dated 14 July 2016.

<sup>120</sup> Page 135 of the 2014/15 RFS has an analysis of TRC hours between normal hours, other hours and Sundays and bank holidays. We note that in this analysis BT says that it is not possible to split TRC hours between these different categories.

for these days reflects differences in labour rates for working outside of normal hours. In order to estimate the cost stack for these charges, we have therefore uplifted our estimate of FAC (after the overheads adjustment described above) by the ratio of the relevant charge to the normal hours charge.<sup>121</sup> However, for this purpose we have excluded the hourly overtime cost from the management accounts. This is because we consider that including an explicit allowance for overtime as well as multiplying FAC by the ratio of charges risks double-counting the additional labour rates associated with work outside of normal hours.

*The data reflect billed hours rather than actual hours worked*

4.107 Our analysis in the 2014 FAMR Statement identified that, on average, BT appeared to be billing for more hours than the actual hours worked by engineers for TRCs.<sup>122</sup> We considered that this risked BT over recovering its costs and applied an 18% reduction to TRC visit and hourly charges.<sup>123</sup> We asked BT to provide us with the ratio of actual engineering time spent working on TRCs to billed time for each year in the Relevant Period. At this stage BT has been unable to provide this analysis.

4.108 Consistent with our analysis in the 2014 FAMR Statement, we have therefore applied an annual 18% reduction to TRC hourly costs, but we have not applied this adjustment to (i) the visit element of the visit charge<sup>124</sup> or (ii) SFI costs.<sup>125</sup>

*Revised FAC data*

4.109 Table 4.8 summarises the revised cost data for standard hourly TRCs and SFIs, applying the adjustments described above. We consider that these cost data represent acceptable estimates for the hourly FAC for TRCs and SFIs.

**Table 4.8: Estimate of TRC and SFI hourly FAC, £ nominal**

	2011/12	2012/13	2013/14	2014/15
Hourly costs per BT	[X]	[X]	[X]	[X]
Add: Overheads (30% uplift)	[X]	[X]	[X]	[X]
Estimated hourly FAC for SFIs and visit element of visit charge	[X]	[X]	[X]	[X]
Subtract: Overbilling adjustment	[X]	[X]	[X]	[X]
Estimated hourly FAC for hourly TRCs	[X]	[X]	[X]	[X]

<sup>121</sup> For example, in 2011/12 the hourly charge for Sunday hours was £100 compared to £50 for normal working hours; a ratio of 2. To estimate the 2011/12 FAC associated with Sunday charges we therefore uplifted our 2011/12 FAC estimate for normal working hours by a multiple of 2.

<sup>122</sup> 2014 FAMR Statement, paragraph 18.132. This analysis was based on a sample of data from January to March 2014.

<sup>123</sup> Paragraph 18.146, 2014 FAMR Statement

<sup>124</sup> Paragraph 18.144 of the 2014 FAMR Statement states that the billing adjustment was made to the hourly charge in the visit charge and to the additional hour charge. Footnote 1362 explains that that visit element of the visit charge was only subject to the cost adjustment and not the billing adjustment.

<sup>125</sup> In paragraph 18.168, footnote 1381 of the 2014 FAMR statement we said that we did not consider that SFIs suffered from the same billing issue.

4.110 Table 4.9 shows the same estimates for the TRC hourly charges for (i) all other times except Sunday and bank holidays (other times charge) and (ii) Sundays and bank holidays (Sunday/BH charge).

**Table 4.9: Estimate of TRC hourly FAC for other times and Sunday/BH, £ nominal**

	2011/12	2012/13	2013/14	2014/15
Hourly costs per BT	[X]	[X]	[X]	[X]
Subtract: overtime	[X]	[X]	[X]	[X]
Add: Overheads (30% uplift)	[X]	[X]	[X]	[X]
Estimated hourly FAC	[X]	[X]	[X]	[X]
Subtract: Overbilling adjustment	[X]	[X]	[X]	[X]
Estimated hourly FAC	[X]	[X]	[X]	[X]
Hourly multiplier for other times	[X]	[X]	[X]	[X]
<b>Estimated other times hourly FAC</b>	[X]	[X]	[X]	[X]
Hourly multiplier for Sunday/BH	[X]	[X]	[X]	[X]
<b>Estimated Sunday/BH hourly FAC</b>	[X]	[X]	[X]	[X]

4.111 Table 4.10 shows the estimated FAC for the TRC visit charge, which, as explained above, consists of one hour of time excluding the billing adjustment and one hour of time including the billing adjustment. For the visit charge in normal hours we have estimated the FAC by adding together the hourly costs with and without the billing adjustment from Table 4.8. For the other times and Sunday/BH visit charges, we have estimated FAC by adding together the hourly costs with and without the billing adjustment from Table 4.9 (before applying the hourly multiplier) and multiplying the result by the ratio of other times and Sunday/BH visit charges to the normal hours visit charge.<sup>126</sup>

4.112 We have also applied our estimate of FAC for the normal hours visit charge to the internal and external NTE shift charge.

**Table 4.10: Estimate of FAC for TRC visit charge, £ nominal**

	2011/12	2012/13	2013/14	2014/15
Normal hours	[X]	[X]	[X]	[X]
Other times	[X]	[X]	[X]	[X]
Sunday/BH	[X]	[X]	[X]	[X]

*The data does not reflect the modular cost of SFI services*

4.113 SFIs are priced by module and we understand that each module is a multiple of hourly costs. BT provided us information on the hourly multiples for the Relevant Period, which are shown in Table 4.11.

<sup>126</sup> For example, in 2011/12 the visit charge in normal hours was £105 and the visit charge for other times was £130, giving a ratio of 1.24.

**Table 4.11: SFI labour hours per module**

Module	2011/12	2012/13	2013/14	2014/15
Base	[X]	[X]	[X]	[X]
Network	[X]	[X]	[X]	[X]
Frame	[X]	[X]	[X]	[X]
Internal Wiring	[X]	[X]	[X]	[X]
Internal Equipment	[X]	[X]	[X]	[X]
Coop	[X]	[X]	[X]	[X]
Frame Direct	[X]	[X]	[X]	[X]

Source: BT response dated 27 July 2016 to question 3 of the 2<sup>nd</sup> section 191 notice dated 15 July 2016

4.114 We applied the relevant multiples to standard hourly FAC from Table 4.8 in each year of the Relevant Period in order to estimate the FAC per SFI module. The resulting FAC estimates are shown in Table 4.12.

**Table 4.12: SFI FAC per module, £ nominal**

Module	2011/12	2012/13	2013/14	2014/15
Base	[X]	[X]	[X]	[X]
Network	[X]	[X]	[X]	[X]
Frame	[X]	[X]	[X]	[X]
Internal Wiring	[X]	[X]	[X]	[X]
Internal Equipment	[X]	[X]	[X]	[X]
Coop	[X]	[X]	[X]	[X]
Frame Direct	[X]	[X]	[X]	[X]

### DSAC estimates

4.115 At this stage we have an estimate of the TRC visit and hourly FAC and SFI modular FAC but in order to assess BT's compliance with the cost orientation obligation we require estimates of DSAC.

4.116 We have considered estimating DSAC by either (i) requiring BT to re-run its LRIC model, or (ii) applying DSAC/FAC ratios to our FAC estimates.<sup>127</sup> Consistent with previous disputes, we do not consider it would be practicable or proportionate to require BT to re-run its LRIC model in order to resolve the Dispute.<sup>128</sup> We have

<sup>127</sup> This is consistent with the approach taken in previous disputes. See, for example, paragraph 4.64 of the Level 3 Determination.

<sup>128</sup> Issues with re-running the LRIC model include (i) mapping our estimates of FAC onto appropriate cost components during the relevant period of the dispute and adjusting the costs of other components accordingly; (ii) re-running the LRIC model for all of BT and not just the services in dispute; (iii) re-running the LRIC model for four separate years; (iv) a timing issue where BT would not be able to re-run the model until we had concluded on the appropriate level of FAC, delaying the final determination and; (v) BT may not have the data or parameter information needed to re-run the model in all years.

therefore have estimated DSAC by applying an appropriate DSAC/FAC ratio to the FAC estimates.

4.117 In order to estimate an appropriate DSAC/FAC ratio we have considered the following:

- Similarity of DSAC to FAC;
- RFS data;
- BT's pricing papers; and
- Other sources of information.

### *Similarity of DSAC to FAC*

4.118 As set out above, TalkTalk argued that DSAC for TRCs and SFIs, properly derived, is very similar to FAC. This was on the basis of its view that SFIs and TRCs are essentially engineering labour and therefore should cause no fixed and common network costs to be incurred. On the other hand, BT argued that DSAC was always clearly higher than FAC for these services.

4.119 In the 2013 FAMR Consultation we recognised that few common costs were likely to be associated with TRC and SFI services. We said that *“the costs of TRCs and SFIs are largely incremental in nature. So, unlike some other access products (for example, those which use duct and copper), we would expect that the allocation of common costs would only have a small impact on TRCs and SFIs.”*<sup>129</sup> We did however recognise that the costs of TRCs and SFIs would include a number of indirect costs such as *“vehicles, service centre costs, training, and general overheads”*<sup>130</sup> and we consider that some of these, in particular general overheads, would be common across a number of services.

4.120 On the basis that there are some common costs associated with TRC and SFI services we would expect DSAC to exceed FAC, but only by a relatively small margin given that there are relatively few common costs compared to other types of access services.<sup>131</sup>

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<sup>129</sup> 2013 FAMR Consultation, paragraph 12.75.

<sup>130</sup> 2013 FAMR Consultation, paragraph 12.74.

<sup>131</sup> DSACs are calculated using BT's LRIC model. At a high level, DSACs are calculated on the basis of distributing the standalone cost of a broad increment (for example the access increment) across the services within that increment. As such, certain common costs that would be allocated to all the services provided by the firm under a FAC methodology are allocated to a smaller set of services under a DSAC methodology. On that basis, we would typically expect the DSAC for an individual service to be greater than the FAC for that service. Where the amount of common cost to be allocated is relatively small, we would expect the difference between DSAC and FAC to be correspondingly smaller than for other services which incur a larger number of common costs. See further Annex 11 of the PPC Determinations and Section 12 of the Ethernet Determinations. Section 3.4 of BT's 2015 LRIC Relationships and Parameters document explains the calculation of DSAC in the LRIC model (available at:

<https://www.btplc.com/Thegroup/RegulatoryandPublicaffairs/Financialstatements/2015/LRICModelRelationshipsandParameters201415.pdf>).

### *Pricing papers*

4.121 BT told us that the DSAC/FAC ratio used for TRCs and SFIs in the February 2012 pricing paper was [§<1.2-1.4] and in the December 2012 pricing paper it was [§<1.2-1.4].<sup>132</sup> BT said that the DSAC/FAC ratios of [§<1.2-1.4] and [§<1.2-1.4] were consistent with the DSAC/FAC ratio of the Special Fault Investigation component (CO989) reported in the 2010/11 and 2011/12 RFS respectively.

### *RFS data*

4.122 As set out in Table 4.6 above, the DSAC/FAC ratio for TRCs was over 3 in most years of the Relevant Period and the ratio for external SFIs was significantly lower at between [§<1.2-1.4] between 2011/12 and 2013/14, before increasing markedly in 2014/15 to [§<1.6-1.8].

4.123 We explained above that one reason for the difference in the DSAC/FAC ratios is that SFI services are included within the 'access' increment in BT's LRIC model while TRC services are included in the 'other' increment. Given that both TRCs and SFIs are network access services, we do not consider that it would be appropriate to rely on the DSAC/FAC ratios for TRCs reported in the RFS since these were not estimated by reference to the access increment and are not consistent with our view that DSAC would only exceed FAC by a relatively small margin.

4.124 On the other hand, we consider that the DSAC/FAC ratios for external SFIs of between [§<1.2-1.4] reported in the RFS between 2011/12 and 2013/14 align with our expectation that DSAC would exceed FAC but only by a relatively small margin.<sup>133</sup> We also consider it relevant that BT used the DSAC/FAC ratios associated with SFIs in its pricing papers for both TRC and SFI services. Therefore for 2010/11 to 2013/14 we have used the DSAC/FAC ratios for SFI services reported in the RFS to derive our DSAC estimates for both TRCs and SFIs.

4.125 For 2014/15, we consider that the DSAC/FAC ratio of [§< 1.6-1.8] for SFIs is somewhat of an outlier compared to the DSAC/FAC ratio in earlier years and it does not align with our expectation that DSAC would exceed FAC by a relatively small margin. For these reasons we do not consider that it would be appropriate to use the SFI DSAC/FAC ratio of [§< 1.6-1.8] for 2014/15, and we have therefore instead used the average DSAC/FAC ratio during the 2010/11 to 2013/14 period of [§< 1.2-1.4].<sup>134</sup> Again we apply this ratio to derive our DSAC estimates for both TRCs and SFIs.

### *Other sources*

4.126 BT said that TRC services are similar in nature to the maintenance and provision of copper lines and SFI services are related to the maintenance of copper lines. Therefore, it said it would expect the fixed and common costs, and the DSAC/FAC

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<sup>132</sup> BT response dated 22 July 2016 to question 1 of the 2<sup>nd</sup> section 191 notice dated 15 July 2016.

<sup>133</sup> We recognise that it is difficult to assess what a 'relatively small margin' may be since DSAC/FAC ratios can vary significantly by service in the reported RFS. However, between 2010/11 and 2013/14 the average DSAC/FAC ratio for WLA and WFAEL services reported in the RFS was between 1.55 and 1.80 and we note that the reported DSAC/FAC ratios for external SFIs of between [§< 1.2-1.4] are below these averages.

<sup>134</sup> This is the average of the DSAC/FAC ratios in 2011/12, 2012/13 and 2013/14 of [§<1.2-1.4], [§<1.2-1.4] and [§<1.2-1.4] respectively.

ratios, of TRC and SFI services to be similar to those of copper provision and maintenance services.<sup>135</sup>

4.127 BT provided DSAC/FAC ratios for the years 2011/12, 2012/13 and 2013/14 for MPF new provides, MPF rental, WLR basic rental and WLR basic connection services. The DSAC/FAC ratios for these services in this period range from 1.37 to 2.16 and average 1.67. We have not placed any weight on these ratios because (i) they do not directly relate to TRCs and SFIs (and we have estimates of the TRC and SFI DSAC/FAC ratios from the RFS), and (ii) while these services may be broadly similar to TRCs and SFIs in that they largely represent engineering labour activities, it is possible that the non-labour activities are dissimilar to TRC and SFIs, affecting the DSAC/FAC ratios.<sup>136</sup>

#### *Provisional conclusion on estimating DSAC*

4.128 Based on the analysis set out above we have used the DSAC/FAC ratios for SFI services from the RFS in 2010/11 to 2013/14 and the average DSAC/FAC ratio for these services over this period in 2014/15 to derive DSAC for each of SFI and TRC services. The relevant ratios are summarised in Table 4.13.

**Table 4.13: Proposed DSAC/FAC ratios**

	2011/12	2012/13	2013/14	2014/15
<b>DSAC/FAC ratio</b>	[<1.2-1.4]	[<1.2-1.4]	[<1.2-1.4]	[<1.2-1.4]

Source: Ofcom, based on information from the RFS for SFI services

4.129 Table 4.14 shows the TRC and SFI unit DSAC estimates which we derive by applying these DSAC/FAC ratios to our FAC estimates.

**Table 4.14: Unit DSACs for TRCs and SFIs, £ nominal**

	2011/12	2012/13	2013/14	2014/15
<b>TRC charges</b>				
Hourly – normal hours	48.07	47.07	48.56	51.11
Hourly - other times	74.07	65.27	67.10	71.61
Hourly - Sunday/BH	87.14	84.94	89.46	95.48
Visit - normal hours	106.68	104.46	107.77	113.43
Visit - other times	119.73	117.45	124.10	132.45
Visit - Sunday/BH	138.14	139.81	148.92	158.94
Internal and external NTE shift	106.68	104.46	107.77	113.43
<b>SFI module charges</b>				
Base	131.30	129.59	140.62	148.01
Network	69.24	54.87	50.63	53.29
Frame	33.15	29.32	20.18	21.24

<sup>135</sup> BT submission dated 16 June 2016, paragraph 45.

<sup>136</sup> In addition, the MPF and WLR rental services include costs associated with access duct which, being a common cost shared across many different services, is likely to mean the DSAC/FAC ratios for such services would be relatively higher than those services which did not use access duct, such as TRCs and SFIs.

Internal Wiring	11.56	11.90	14.80	15.58
Internal Equipment	31.76	31.10	32.08	33.77
Coop	15.35	14.27	15.60	16.42
Frame Direct	92.57	93.62	100.66	105.96

### TRC stores charges

4.130 We noted above that the management accounts data shown in Table 4.7 did not include any costs of TRC stores items. BT said that while it had cost information on TRC stores it was difficult to extract the relevant data from its systems.<sup>137</sup> BT provided the cost data set out in Table 4.15, which it stated was the “*best information it has available at this time*”<sup>138</sup>, noting that:

- [redacted]
- [redacted]<sup>139</sup>
- [redacted]<sup>140</sup>

**Table 4.15: TRC stores costs, £ nominal**

	Cost
Internal pack	[redacted]
External pack	[redacted]
Data ext kit	[redacted]
Broadband front plate	[redacted]
Block terminal 92A	[redacted]

Source: BT emails to Ofcom dated 5 August 2016 and 9 August 2016.

4.131 We note that BT was only able to provide this information close to publication of our Provisional Conclusions and several weeks after our initial request. The cost data is furthermore, not contemporaneous with the Relevant Period as it does not appear from the material available to us that BT undertook an analysis of the costs involved in providing these services during that period.<sup>141</sup> However, in the absence of any

<sup>137</sup> Email from BT to Ofcom dated 5 August 2016.

<sup>138</sup> Ibid.

<sup>139</sup> [redacted]

<sup>140</sup> Email from BT to Ofcom dated 5 August 2016.

<sup>141</sup> We note, for example, that [redacted]

other cost information associated with TRC stores items, we propose to use this data to resolve the dispute.

4.132 To obtain DSAC estimates for TRC stores using this data, we have assumed the following:

- The unit cost information provided by BT applies to the whole Relevant Period. [X]
  
- [X]
  
- [X]

4.133 Table 4.16 sets out our estimate of DSAC for each TRC stores item during the Relevant Period.

**Table 4.16 Unit DSACs for TRC stores, £ nominal**

	2011/12	2012/13	2013/14	2014/15
Internal pack	3.84	3.84	3.84	3.84
External pack	8.06	8.06	8.06	8.06
Data ext kit	3.94	3.94	3.94	3.94
Broadband front plate	5.83	5.83	5.83	5.83
Block terminal 92A	0.80	0.80	0.80	0.80

Application of the DSAC test

4.134 Table 4.17 shows the results of the DSAC test for the TRC visit and additional hourly charge and each SFI modular charge. The DSAC test shows the ratio of price to DSAC so a percentage above 100% indicates that price exceeded DSAC while a percentage below 100% indicates that price was below DSAC. We have assessed each charge against our estimate of DSAC in the corresponding financial year.

**Table 4.17: Results of the DSAC test for TRC charges, £ nominal**

Financial year	2011/12	2012/13	2013/14	2014/15
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Provisional conclusions to resolve a dispute regarding BT's historical charges for SFIs and TRCs

Price periods	1 Apr 2011 – 31 Mar 2012	1 Apr 2012 – 7 Jun 2012	8 Jun 2012 – 31 Mar 2013	1 Apr 2013 – 31 Mar 2014	1 Apr 2014 – 26 Jun 2014
<b>TRC charges</b>					
<b>TRC hourly – normal</b>					
Price	50.00	50.00	57.00	60.00	60.00
DSAC	48.07	47.07	47.07	48.56	51.11
Price / DSAC	104.0%	106.2%	121.1%	123.6%	117.4%
<b>TRC hourly - other times</b>					
Price	85.00	85.00	85.50	90.00	90.00
DSAC	74.07	65.27	65.27	67.10	71.61
Price / DSAC	114.8%	130.2%	131.0%	134.1%	125.7%
<b>TRC hourly - Sunday/BH</b>					
Price	100.00	100.00	114.00	120.00	120.00
DSAC	87.14	84.94	84.94	89.46	95.48
Price / DSAC	114.8%	117.7%	134.2%	134.1%	125.7%
<b>TRC visit - normal</b>					
Price	105.00	105.00	115.00	120.00	120.00
DSAC	106.68	104.46	104.46	107.77	113.43
Price / DSAC	98.4%	100.5%	110.1%	111.3%	105.8%
<b>TRC visit - Other times</b>					
Price	130.00	130.00	143.50	150.00	150.00
DSAC	119.73	117.45	117.45	124.10	132.45
Price / DSAC	108.6%	110.7%	122.2%	120.9%	113.2%
<b>TRC visit - Sunday/BH</b>					
Price	150.00	150.00	172.00	180.00	180.00
DSAC	138.14	139.81	139.81	148.92	158.94
Price / DSAC	108.6%	107.3%	123.0%	120.9%	113.2%
<b>TRC stores - internal pack</b>					
Price	5.88	5.88	6.40	6.70	6.70
DSAC	3.84	3.84	3.84	3.84	3.84
Price / DSAC	153.1%	153.1%	166.7%	174.5%	174.5%
<b>TRC stores - external pack</b>					
Price	13.70	13.70	14.90	15.60	15.60
DSAC	8.06	8.06	8.06	8.06	8.06
Price / DSAC	170.0%	170.0%	184.9%	193.5%	193.5%
<b>TRC stores - data ext kit</b>					
Price	6.61	6.61	7.20	7.60	7.60
DSAC	3.94	3.94	3.94	3.94	3.94
Price / DSAC	167.8%	167.8%	182.7%	192.9%	192.9%
<b>TRC stores - broadband front plate</b>					
Price	5.83	5.83	6.40	6.70	6.70
DSAC	5.83	5.83	5.83	5.83	5.83
Price / DSAC	100.0%	100.0%	109.8%	114.9%	114.9%
<b>TRC stores – block terminal 92A</b>					
Price	1.24	1.24	1.40	1.50	1.50
DSAC	0.80	0.80	0.80	0.80	0.80
Price / DSAC	155.0%	155.0%	175.0%	187.5%	187.5%
<b>Internal and external NTE shift</b>					
Price			115.00	120.00	120.00
DSAC			104.46	107.77	113.43
Price / DSAC			110.1%	111.3%	105.8%
<b>SFI module charges</b>					
<b>Base</b>					

Price	105.00	105.00	125.00	130.00	134.25
DSAC	131.30	129.59	129.59	140.62	148.01
Price / DSAC	80.0%	81.0%	96.5%	92.4%	90.7%
<b>Network</b>					
Price	75.00	75.00	75.00	80.00	80.00
DSAC	69.24	54.87	54.87	50.63	53.29
Price / DSAC	108.3%	136.7%	136.7%	158.0%	150.1%
<b>Frame</b>					
Price	75.00	75.00	70.00	70.00	70.00
DSAC	33.15	29.32	29.32	20.18	21.24
Price / DSAC	226.3%	255.8%	238.7%	346.9%	329.6%
<b>Internal Wiring</b>					
Price	50.00	50.00	40.00	40.00	40.00
DSAC	11.56	11.90	11.90	14.80	15.58
Price / DSAC	432.6%	420.1%	336.1%	270.2%	256.7%
<b>Internal Equipment</b>					
Price	25.00	25.00	20.00	20.00	20.00
DSAC	31.76	31.10	31.10	32.08	33.77
Price / DSAC	78.7%	80.4%	64.3%	62.3%	59.2%
<b>Coop</b>					
Price	25.00	25.00	20.00	15.00	0
DSAC	15.35	14.27	14.27	15.60	16.42
Price / DSAC	162.8%	175.2%	140.2%	96.2%	0.0%
<b>Frame Direct</b>					
Price	105.00	105.00	115.00	120.00	120.00
DSAC	92.57	93.62	93.62	100.66	105.96
Price / DSAC	113.4%	112.2%	122.8%	119.2%	113.3%

4.135 The results of the DSAC test show that:

- For TRC charges:
  - TRC visit charges and hourly charges were above DSAC throughout the Relevant Period with the exception of the TRC visit charge in normal hours in 2011/12;
  - The charge for internal and external NTE shift was above DSAC for the period from 8 June 2012 to 26 June 2014.
  - TRC stores charges for internal pack, external pack, data ext kit and block terminal 92A were above DSAC for the Relevant Period.
  - TRC stores charges for broadband front plate were equal to DSAC between 1 April 2011 and 7 June 2012 but above DSAC from 8 June 2012 to 26 June 2014.
- For SFI charges:
  - Frame Direct charges were above DSAC throughout the Relevant Period;
  - Network, Frame, and Internal Wiring module charges were above DSAC throughout the Relevant Period;

- Coop module charges were above DSAC in 2011/12 and 2012/13 but below DSAC in 2013/14 and 2014/15; and
- Base and Internal Equipment module charges were below DSAC throughout the Relevant Period.

4.136 On the basis of the analysis that we have carried out above, we provisionally conclude that certain of BT's TRC and SFI charges exceeded DSAC during the Relevant Period.<sup>142</sup>

4.137 In Step 3 we consider whether there are any other relevant factors that we need to take into consideration in assessing whether BT's charges were compliant with SMP Condition FAA4.1.

### **Step 3. Are there any other relevant factors that we need to consider in order to determine whether BT's charges were compliant with SMP Condition FAA4.1?**

4.138 For the services and years in which we have found BT's charges have exceeded DSAC, we consider under Step 3 other factors that might indicate these charges were nonetheless cost oriented. We then conclude whether overcharging has occurred.

4.139 The additional factors which we consider are relevant in this case are:

- The magnitude and duration by which charges exceeded DSAC.
- Whether, and the extent to which, charges exceeded FAC.

4.140 We consider these factors for each of the services we have found to be in excess of DSAC for at least part of the Relevant Period under Step 2, namely the TRC visit and hourly charge, the internal and external NTE shift charge, the TRC stores charges and the following SFI modular charges: Frame Direct, Network, Frame, Internal Wiring and Coop.

4.141 We cannot assess the return on capital employed (ROCE) as we often do in such assessments because, as set out above, these services are associated with low levels of capital employed and we have not included an estimate of ROCE in our FAC estimates. Given this, reliable ROCE estimates are not available for the TRC and SFI services in question.

4.142 As noted above, BT argued that its charges were compliant with the cost orientation obligation on the basis that its EBIT margins for TRCs and SFIs were consistent with the level which Ofcom considered as part of the 2012 LLU/WLR Statement. We do not consider that a consideration of BT's EBIT margins is relevant to determining whether BT's charges were cost oriented, and for the reasons set out in paragraphs 4.56 to 4.64 we do not consider that BT could place reliance on the statements made by Ofcom in the 2012 LLU/WLR Statement in relation to Openreach's returns on

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<sup>142</sup> While we find that BT's charges for certain services exceeded DSAC throughout the Relevant Period, as explained in Section 2 BT's TRC and SFI services ceased to be subject to a cost orientation obligation from 26 June 2014, shortly before the end of the Relevant Period. We take this into account when we reach our provisional conclusion on whether and for what period BT has overcharged for these services below.

TRCs and SFIs. We therefore have not considered BT's EBIT margins further at Step 3 of our analysis.

## **Magnitude and duration by which charges exceeded DSAC**

### TRC hourly charges

- 4.143 TRC hourly charges for normal working hours exceeded DSAC by between 4% and 24% during the period, with the excess generally increasing over the Relevant Period. BT increased charges twice during this period; by 14% on 8 June 2012 and by 5% on 1 April 2013.
- 4.144 Although the charges between 1 April 2011 and 7 June 2012 were above DSAC by a relatively small margin (4% to 6%), we note that DSAC was relatively stable during this period and BT has not provided evidence that it reviewed prices against DSAC during this period except for the February 2012 pricing paper, which it used to support a subsequent increase in prices on 8 June 2012. This price increase expanded the difference between prices and DSAC to over 20%. On this basis we consider that BT's hourly TRC charges for normal hours were not cost oriented throughout the Relevant Period.
- 4.145 TRC hourly charges for other times exceeded DSAC by between 15% and 34% during the period. BT reviewed these charges twice during the period, increasing the charges by 1% on 8 June 2012 and by 5% on 1 April 2013. On the basis that charges were persistently and significantly above DSAC we consider that BT's hourly TRC charges for other times were not cost oriented throughout the Relevant Period.
- 4.146 TRC hourly charges for Sunday/BH exceeded DSAC by between 15% and 34% during the period. BT reviewed these charges twice during the period, increasing the charges by 14% on 8 June 2012 and by 5% on 1 April 2013. On the basis that charges were persistently and significantly above DSAC we consider that BT's hourly TRC charges for Sunday/BH were not cost oriented throughout the Relevant Period.

### TRC visit charges

- 4.147 TRC visit charges for normal working hours were below DSAC in 2011/12 but exceeded DSAC by 0.5% between 1 April 2012 and 7 June 2012 and by 6% to 11% between 8 June 2012 and 26 June 2014. BT increased its visit charges twice during the period; by 10% on 8 June 2012 and by 4% on 1 April 2013.
- 4.148 The excess of price over DSAC in the two-month period between 1 April 2012 and 7 June 2012 was only 0.5%. During this period price was unchanged from the previous period at £105 but DSAC reduced marginally, resulting in a small excess. Given the short period of the excess and the fact that it was caused by a reduction in DSAC rather than an increase in price, we do consider that BT's charges were cost oriented during this period.
- 4.149 However, for the rest of the Relevant Period, between 8 June 2012 and 26 June 2014, BT's charges were persistently in excess of DSAC by 6% to 11% and BT increased prices twice, expanding the difference between price and DSAC. Therefore, we consider that BT's TRC visit charges for normal hours were not cost oriented for the period 8 June 2012 to 26 June 2014.
- 4.150 TRC visit charges for other times exceeded DSAC by between 9% and 22% during the Relevant Period and TRC visit charges for Sunday/BH exceeded DSAC by

between 7% and 23%. BT increased the other times charges by 10% on 8 June 2012 and by 5% on 1 April 2013, and it increased the Sunday/BH charges by 15% and 5% on the same dates. The charges for these services were above DSAC by 7% to 10% between 1 April 2011 and 7 June 2012. However, we note that DSAC was relatively stable during this period and BT has not provided evidence that it reviewed prices against DSAC during this period except for the February 2012 pricing paper, which it used to support subsequent increases in prices for these charges on 8 June 2012. These price increases expanded the difference between prices and DSAC to over 20%. On this basis we consider that BT's TRC visit charges for other times and Sunday/BH were not cost oriented throughout the Relevant Period.

#### Internal and external NTE shift

4.151 Internal and external NTE shift charges exceeded DSAC by 10% to 11% between 8 June 2012 and 31 April 2014, and by just under 6% between 1 April 2014 and 26 June 2014. BT increased the charge by 4% on 1 April 2013. Whilst the excess over DSAC was slightly lower in the last three months of the Relevant Period, we note that this was not as a result of a reduction in price by BT but rather a slight increase in the DSAC. On the basis that charges were persistently above DSAC we consider that BT's internal and external NTE shift charges were not cost oriented in the period from 8 June 2012 to 26 June 2014.

#### TRC stores charges

4.152 BT's charges for internal pack, external pack, data ext kit and block terminal 92A were all persistently and significantly above DSAC throughout the Relevant Period, by 53% to 94%. On this basis we consider that these charges were not cost oriented throughout the Relevant Period.

4.153 BT's charges for broadband front plate were equal to DSAC between 1 April 2011 and 7 June 2012. However, BT's price increases on 8 June 2012 and 1 April 2013 put prices above DSAC by 10% to 15%. We note that it does not appear that BT considered any cost information relating to TRC stores charges when it increased these prices, and on the basis that charges were significantly above DSAC, we consider that BT's charges were not cost oriented in the period 8 June 2012 to 26 June 2014.

#### SFI charges

4.154 SFI modular charges for Frame Direct, Network, Frame and Internal Wiring exceeded DSAC throughout the Relevant Period, by 108% to 432%. BT reviewed these charges twice during this period, although in some cases (for example Network and Frame) BT only changed prices once during the period. On the basis that charges were persistently and significantly above DSAC we consider that BT's SFI module charges for Network, Frame, Internal Wiring and Frame Direct were not cost oriented during the Relevant Period.

4.155 The Coop module charge was significantly above DSAC in 2011/12 and 2012/13, by between 40% and 75%, but below DSAC in 2013/14 and in 2014/15 (although the price appears to have been set at zero from 1 April 2014). BT reduced the price of the Coop module three times during the period. The price change on 1 April 2013 reduced the charge from £20 to £15, putting it below our estimate of DSAC in 2013/14 (£15.60). On this basis, we consider that BT's SFI Coop module charges were not cost oriented for the period 1 April 2011 to 31 March 2013, i.e. the period when charges were above DSAC.

## **The extent to which charges exceed FAC**

4.156 As a cross check, we also considered the extent to which charges exceeded FAC for those services where prices were above DSAC for part of the Relevant Period. In each case, TRC and SFI charges that were above DSAC were also significantly above FAC in the Relevant Period.

4.157 However, we do not place any weight on this assessment in this case, given that our estimates of DSAC are based on DSAC/FAC ratios which are greater than 1 and therefore charges which we find to be above DSAC will automatically also exceed FAC.

## **Ofcom's provisional conclusion on whether BT's historical TRCs and charges for SFIs were cost oriented in line with the requirements of FAA4.1**

4.158 Based on the evidence available to us our provisional conclusions are that:

- For SFI services:
  - Frame Direct: BT's charges were not cost oriented for the period 1 April 2011 to 26 June 2014.
  - Base and Internal Equipment modules: BT's charges were cost oriented throughout the Relevant Period.
  - Network, Frame and Internal Wiring modules: BT's charges were not cost oriented for the period 1 April 2011 to 26 June 2014.
  - Coop module: BT's charges were not cost oriented for the period 1 April 2011 to 31 March 2013.
- For TRC services:
  - BT's visit charges for normal hours were not cost oriented for the period 8 June 2012 to 26 June 2014.
  - BT's visit charges for other times and Sunday/BH were not cost oriented for the period 1 April 2011 to 26 June 2014.
  - BT's hourly charges were not cost oriented for the period 1 April 2011 to 26 June 2014.<sup>143</sup>
  - BT's charges for internal and external NTE shift were not cost oriented for the period 8 June 2012 to 26 June 2014.
  - BT's charges for TRC stores items internal pack, external pack, data ext kit and block terminal 92A were not cost oriented for the period 1 April 2011 to 26 June 2014.

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<sup>143</sup> Note, as explained above we provisionally conclude that the overcharge for each relevant service ended on 26 June 2014 as Condition FAA4.1 ceased to apply with effect from that date (see Section 2 above).

- BT's charges for TRC store item broadband front plate were not cost oriented for the period 8 June 2012 to 26 June 2014.

4.159 It is our provisional view that TalkTalk was overcharged for TRC and SFI services for those periods over which we have found the above charges were not cost oriented, to the extent that those services were reasonably necessary for the use of BT's network access services in the WLA market.<sup>144</sup>

#### **Step 4: Should we require BT to make repayments and if so what level should the repayments be?**

4.160 In Step 3, we provisionally concluded that BT has overcharged for certain of its TRCs and SFI services in the Relevant Period.

4.161 Where Ofcom has made a determination of the proper amount of a charge in respect of which amounts have been paid by one of the Parties to the other, section 190(2)(d) of the 2003 Act gives us the power to give a direction, enforceable by the party to whom the sums are to be paid, requiring the payment of sums by way of an adjustment of an underpayment or an overpayment.

4.162 In the remainder of this section we consider whether we should exercise our discretion to require BT to make a repayment to TalkTalk, and if so, what the level of any such repayment should be.

4.163 In reaching our provisional conclusion, we have been guided by our duties and Community obligations under sections 3, 4 and 4A of the 2003 Act (as amended). We have also taken account of submissions from the Parties and the findings of the CAT and the Court of Appeal in relation to Ofcom's power under section 190(2)(d) to require repayments in previous judgments.

#### **Parties' views**

4.164 TalkTalk is seeking a repayment of £[<] for overpayment for TRCs and SFIs purchased from BT between 1 April 2011 and 30 June 2014.

4.165 TalkTalk calculated its estimated overpayment by calculating for each of the years between April 2011 to June 2014, the total amount of TRCs and SFIs paid by TalkTalk (excluding VAT) less an estimated FAC/DSAC. TalkTalk notes that it has assumed that the FAC and DSAC levels are similar and that the FAC level can be derived from the size of the step reduction in TRC and SFI charges at the beginning of the charge controls imposed by Ofcom from 1 July 2014 under the 2014 FAMR Statement.<sup>145</sup>

4.166 BT argued that Ofcom "*does not have...the power to order retroactive payments in dispute resolution proceedings. This is because the CRF does not permit the NRAs to order administrative payments as a remedy for past breaches.*"<sup>146</sup> BT referred to the pending Ethernet appeals before the Court of Appeal (see Section 2 above).

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<sup>144</sup> We consider that any charges between DLRIC and DSAC would be compliant with the cost orientation obligation and on this basis, any charges that exceed DSAC will have resulted in an overcharge,

<sup>145</sup> TalkTalk submission, paragraph 3.14.

<sup>146</sup> BT submission dated 16 June 2016, paragraph 7.

- 4.167 In relation to TalkTalk's proposed methodology for calculating the amount of the repayment, BT argued that it was fundamentally flawed. This is because TalkTalk's methodology uses FAC as one of the cost standards (which BT argues is inappropriate), alongside DSAC and further, TalkTalk assumes FAC and DSAC are similar which is contrary to BT's arguments that DSAC and FAC are not at all similar. BT argued that TalkTalk's approach effectively amounted to asking Ofcom to retroactively apply the charge control condition applied by Ofcom under the 2014 FAMR Statement.

### **Provisional view on whether BT should make repayments to TalkTalk**

- 4.168 Ofcom has the power pursuant to section 190(2)(d) of the 2003 Act to direct that one party to a dispute should pay a sum to another party by way of an adjustment of an overpayment. In assessing whether it is appropriate for us to order BT to make repayments to TalkTalk in this case we have given consideration to the impact of BT's overcharging for TRC and SFI services on competition and the impact that allowing BT to retain profits realised from overcharging might have on incentives for future compliance with SMP obligations.
- 4.169 We do not agree with BT's argument that Ofcom does not have the power to order repayments in this case. In fact, Ofcom's powers to order repayment in circumstances where overcharging in breach of an SMP condition has occurred has been explicitly addressed in previous cases. For example, in the PPC Court of Appeal Judgment, the Court of Appeal considered Ofcom's power under section 190(2) to require repayments and stated that:

*"The starting point must be, in a case of overcharging in breach of an SMP condition, to order repayment of the amount of the excess charge. If, however, the payee can show some good reason why a lesser repayment or no repayment at all would better achieve the objectives of the Act and the CRF then that would provide a principled basis for Ofcom to give a direction for only a partial repayment or to make no direction for repayment at all."*<sup>147</sup>

- 4.170 The Court of Appeal Judgment concluded that Ofcom's discretion under section 190 of the 2003 Act was:

*"a discretion to make such order for repayment as will best achieve the objectives of the [2003] Act and the CRF on the particular facts of the case."*<sup>148</sup>

- 4.171 The Court held that the discretion under section 190 "*must be exercised in a principled way with a view to achieving those objectives*".<sup>149</sup>
- 4.172 Overcharging for WLA services, including TRCs and SFIs, distorts competition between BT and its competitors, which is ultimately detrimental to consumers. We therefore believe it would be appropriate, in light of our duties to further the interests of consumers, where appropriate by promoting competition, in the Dispute to require repayments.

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<sup>147</sup> PPC Court of Appeal Judgment, paragraph 85.

<sup>148</sup> PPC Court of Appeal Judgment, paragraph 83.

<sup>149</sup> PPC Court of Appeal Judgment, paragraph 84.

- 4.173 Further, if we were not to require repayments, BT would be able to unfairly retain the gains from overcharging, and this could provide a disincentive for it to comply with its regulatory obligations. The incentives and regulatory signals that determinations in disputes send to CPs as to how we interpret regulatory obligations and are likely to assess future conduct are important.
- 4.174 We consider that to require BT to repay TalkTalk promotes the interests of consumers and competition, by ensuring that the SMP obligations imposed on BT are enforced. The enforcement of BT's SMP obligations protects consumers, enables other providers to compete with BT and helps to level the playing field for BT's competitors, leading to downward pressure on prices, availability of a wider range of services and improved quality of service.
- 4.175 In light of our assessment, we provisionally conclude that it is appropriate and proportionate for Ofcom to exercise its powers under section 190(2)(d) of the 2003 Act to direct BT to make repayments.

### Provisional view on amount of repayment

- 4.176 Although we agree with TalkTalk that repayment of BT's overcharge for TRCs and SFIs during the Relevant Period would be appropriate in this case, we do not consider that TalkTalk's proposed methodology for calculating repayments is appropriate.
- 4.177 We consider that any charges between DLRIC and DSAC would be compliant with the cost orientation obligation. We therefore propose to apply the same approach to the level of repayments in the Dispute as we have applied in previous disputes relating to BT's cost orientation obligations, which is to base the level of repayments on the difference between the level of each charge and the relevant DSAC.
- 4.178 Neither BT nor TalkTalk has provided evidence to suggest that a lesser repayment or no repayment would better achieve the objectives of the 2003 Act. We therefore consider it appropriate for us to direct BT to make repayments to TalkTalk reflecting the full amount of the overcharge.

### Assessment of the amount of repayments

- 4.179 In order to estimate the amount of the required repayments we have calculated the difference between price and DSAC for each of the TRC and SFI services for which we provisionally concluded BT had overcharged in paragraph 4.158. Table 4.18 sets out the overcharge for each relevant TRC and SFI charge in each year.

**Table 4.18: Overcharge for each TRC and SFI charge, £ nominal**

Financial year	2011/12	2012/13		2013/14	2014/15
Price periods	1 Apr 2011 – 31 Mar 2012	1 Apr 2012 – 7 Jun 2012	8 Jun 2012 – 31 Mar 2013	1 Apr 2013 – 31 Mar 2014	1 Apr 2014 – 26 Jun 2014
<b>TRC charges</b>					
TRC hourly – normal	1.93	2.93	9.93	11.44	8.89
TRC hourly - other times	10.93	19.73	20.23	22.90	18.39
TRC hourly - Sunday/BH	12.86	15.06	29.06	30.54	24.52
TRC visit - normal			10.54	12.23	6.57
TRC visit - Other times	10.27	12.55	26.05	25.90	17.55
TRC visit - Sunday/BH	11.86	10.19	32.19	31.08	21.06
TRC stores - internal pack	2.04	2.04	2.56	2.86	2.86

TRC stores - external pack	5.64	5.64	6.84	7.54	7.54
TRC stores -data ext kit	2.67	2.67	3.26	3.66	3.66
TRC stores - broadband front plate			0.57	0.87	0.87
TRC stores – block terminal 92A	0.44	0.44	0.60	0.70	0.70
Internal and external NTE shift			10.54	12.23	6.57
<b>SFI module charges</b>					
Network	5.76	20.13	20.13	29.37	26.71
Frame	41.85	45.68	40.68	49.82	48.76
Internal Wiring	38.44	38.10	28.10	25.20	24.42
Coop	9.65	10.73	5.73		
Frame Direct	12.43	11.38	21.38	19.34	14.04

Source: Ofcom.

4.180 We have identified the amount by which BT has overcharged for each service in each year and consider it appropriate to direct BT to repay TalkTalk a level of repayment reflecting the full amount of the overcharge for each of these services.

4.181 However, we do not have information required to calculate the amount of the overcharge by BT. In particular:

4.181.1 We do not have information on the volumes of each service purchased by TalkTalk in the Relevant Period.

4.181.2 TalkTalk's dispute submission indicates that the Parties have "*previously reached agreement on a partially overlapping claim for TRCs and SFIs*",<sup>150</sup> which may affect the amount which BT is required to repay TalkTalk.

4.181.3 As set out in Section 2, BT's charges for TRCs and SFIs were subject to the cost orientation obligation under Condition FAA4.1 where they were purchased in relation to network access services falling within Conditions FAA1, FAA9 or FAA10 and were reasonably necessary for the use of those services. The obligation on BT to repay TalkTalk therefore only applies to TRCs and SFIs purchased by TalkTalk during the relevant periods of overcharge set out above to the extent that these services were reasonably necessary for the use of BT's WLA network access services, including its LLU services.<sup>151</sup> This is a question of fact, although we note that we concluded in the 2014 FAMR Statement that:

*"we would expect a large majority of TRC and SFI services to be reasonably necessary in order for CPs to provide downstream services based on LLU and WLR and, therefore, any such services would fall within the network access requirement we are imposing on BT."*<sup>152</sup>

4.182 We therefore propose to leave it to the Parties to agree the exact level of repayment due, based on our calculations of the difference between price and DSAC set out in Table 4.18.

<sup>150</sup> TalkTalk submission, footnote 32.

<sup>151</sup> As set out in Section 3, BT and TalkTalk disagreed over the extent to which BT's TRC stores charges for block terminal 92A were relevant to BT's WLA services.

<sup>152</sup> 2014 FAMR Statement, paragraph 18.46.

## Interest

- 4.183 We have also considered whether it would be appropriate for us to award interest on the repayment amount. In considering whether it would be appropriate for us to award interest on the repayment amount, we had regard to the Parties' views as well as the Interest Guidance<sup>153</sup> set out in the Gamma Determination.<sup>154</sup>
- 4.184 TalkTalk requested repayment with interest without any further submission on how interest should be calculated. BT argued that Ofcom does not have the power to order retrospective payments, however made no specific submissions on interest.
- 4.185 The Interest Guidance contained guidance about our approach to interest in the context of resolving a dispute involving charges payable under BT's Standard Interconnection Agreement (SIA). Although we noted that the scope of the dispute in the Gamma Determination related specifically to repayments directed by Ofcom in relation to charges payable under BT's SIA, we considered that, in principle, the Interest Guidance may also be relevant more generally to repayments directed by Ofcom relating to other products and services.<sup>155</sup>
- 4.186 The Interest Guidance explains that in deciding whether interest should be payable and, if so, at what rate, Ofcom will take account of all relevant considerations, with a view to setting an amount of principal plus interest which would best meet our statutory duties and regulatory objectives, in particular, with a main objective of avoiding CPs having incentives to set unduly high charges.<sup>156</sup>
- 4.187 However the Interest Guidance also explains that although we could seek to assess on a case-by-case basis the actual benefit to the overcharging firm as a result of the overcharge in that case, such an in-depth assessment would be complex and is unlikely to be practical. In the Interest Guidance we noted that it is important to adopt an approach which would foster commercial and regulatory certainty and that an appropriate interest rate should be readily calculable using available data.<sup>157</sup>
- 4.188 As set out in the Interest Guidance, we consider that the Bank of England base rate plus 1% (BoE+1%)<sup>158</sup> is likely to be an appropriate rate to reflect the benefit derived by the overcharging firm from the overcharge in most cases.<sup>159</sup> However, we recognise that, depending on the facts of the case and taking into account any evidence provided by the parties, it may be appropriate to adopt a different rate in order to ensure that our objectives are met.<sup>160</sup>

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<sup>153</sup> On 25 October 2013, Ofcom issued a determination to resolve a dispute between Gamma and BT concerning the interest rate set out in BT's Standard Interconnect Agreement. As part of this determination, Ofcom issued guidance setting out Ofcom's approach to interest (the Interest Guidance).

<sup>154</sup> Dispute between Gamma and BT relating to the 'Ofcom Interest Rate' contained within BT's Standard Interconnect Agreement (SIA), Final Determination, 25 October 2013:

[http://stakeholders.ofcom.org.uk/binaries/enforcement/competition-bulletins/closed-cases/all-closed-cases/cw\\_01108/CW\\_011080613.pdf](http://stakeholders.ofcom.org.uk/binaries/enforcement/competition-bulletins/closed-cases/all-closed-cases/cw_01108/CW_011080613.pdf).

<sup>155</sup> Gamma Determination, paragraph 4.14.

<sup>156</sup> Gamma Determination, paragraph A2.1.

<sup>157</sup> Gamma Determination, paragraphs A2.9 and A2.10.

<sup>158</sup> We noted that this is the rate which has conventionally been adopted by the High Court in commercial cases and by the CAT when awarding interest on penalties on appeal.

<sup>159</sup> Gamma Determination, paragraph A2.12.

<sup>160</sup> Gamma Determination, paragraph A2.13.

4.189 At this stage, the parties to the Disputes have not put forward arguments as to why we should not follow this approach in this case.

4.190 There do not appear to be any distinguishing features of this Dispute which might justify a departure from the Interest Guidance. We therefore provisionally conclude that BT should be required to repay TalkTalk the repayment amount with interest at BoE+1%.

### Timing of payments

4.191 As set out above, BT is currently appealing the CAT's Ethernet Judgment. One of BT's grounds of appeal relates to whether Ofcom has the power to order retrospective payments in dispute resolution proceedings under section 190 of the 2003 Act. A separate ground of appeal relates to whether Ofcom has the power to award interest when resolving disputes. In its response to TalkTalk's dispute submission, BT again set out its position that Ofcom does not have the power to order retrospective payments.

4.192 We do not agree with BT's view of Ofcom's dispute resolution powers for the reasons set out above. However, in light of the Ethernet appeals, in resolving recent disputes in relation to BT's average porting conveyance charges we determined that BT's repayment of overpayments made by Gamma and Vodafone before the dates on which the disputes were brought to Ofcom, as well as the interest on these repayments, would only have to be paid after the Court of Appeal hands down a judgment in the Ethernet appeals which is unfavourable to BT in relation to these issues.<sup>161</sup>

4.193 For consistency, we propose to adopt the same approach in relation to this Dispute. Therefore we provisionally conclude that repayment of the overpayments made by TalkTalk for TRCs and SFIs, and the interest on that repayment, shall only be payable if the Court of Appeal hands down a judgment in the Ethernet appeals which confirms Ofcom's powers to direct such repayments.

### Provisional Conclusions and next steps

4.194 For the reasons set out above, we provisionally conclude that BT has overcharged TalkTalk for TRCs and SFIs during the Relevant Period and that it would be appropriate in this case to order BT to repay the overcharge to TalkTalk, with interest. We consider an appropriate repayment level to be the difference between the level of the charge and DSAC.

4.195 We have identified the amount by which BT has overcharged for each service in each year. We do not have accurate information as to the volumes of each service purchased by TalkTalk and therefore propose to leave it to the Parties to agree the exact levels of repayment that are due, based on our calculated unit charges. We note repayment is dependent on the outcome of the Ethernet appeals.

4.196 In line with our Dispute Resolution Guidelines, we are allowing two weeks for the Parties and other interested parties to provide any comments on our provisional

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<sup>161</sup> 'Disputes between BT and each of Gamma and Vodafone in relation to BT's average porting conveyance charges', 11 November 2015. Available at: [http://stakeholders.ofcom.org.uk/binaries/enforcement/competition-bulletins/open-cases/all-open-cases/cw\\_01161/Final\\_Determination.pdf](http://stakeholders.ofcom.org.uk/binaries/enforcement/competition-bulletins/open-cases/all-open-cases/cw_01161/Final_Determination.pdf).

conclusions. The deadline for comments is 5pm on 26 August 2016. Details of how to respond to these provisional conclusions are set out in Annexes 1 and 2 below. Our proposed Determination is set out at Annex 3.

## **Assessment of consistency of Ofcom's provisional conclusions with our statutory duties and Community obligations**

4.197 In conducting our provisional assessment, we have considered our general duties in section 3 of the 2003 Act and also the six 'Community requirements' set out in section 4 of the 2003 Act, which give effect, among other things, to the requirements of Article 8 of the Framework Directive.

4.198 In particular, we have had regard to:

4.198.1 our duty to further the interests of citizens (i.e. all members of the public in the United Kingdom) in relation to communications matters and to further the interests of consumers in relevant markets, where appropriate by promoting competition (section 3(1)); and

4.198.2 our duty to promote competition (section 4(3)) and to encourage, to the extent Ofcom considers it appropriate, the provision of network access and service interoperability for the purposes of securing efficiency and sustainable competition in communications markets, efficient investment and innovation and the maximum benefit for the customers of communications network and services providers (sections 4(7) and 4(8)).

4.199 We consider that our Provisional Conclusions are consistent with these duties. Ensuring that charges are capped at a cost oriented level and that BT's SMP obligations are enforced serves to promote effective competition, and through this furthers the interests of consumers.

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

## Annex 1

# Responding to these Provisional Conclusions

## How to respond

Ofcom invites written views and comments on the issues raised in this document, to be made **by 5pm on 26 August 2016**.

We would be grateful if you could assist us by completing a response cover sheet (see Annex 2), to indicate whether or not there are confidentiality issues.

For larger responses - particularly those with supporting charts, tables or other data - please email [tarnya.wilkins@ofcom.org.uk](mailto:tarnya.wilkins@ofcom.org.uk) attaching your response in Microsoft Word format, together with a provisional conclusions response coversheet.

Responses may alternatively be posted to the address below, marked with the title of these provisional conclusions.

Tarnya Wilkins  
Competition Group  
Ofcom  
Riverside House  
2A Southwark Bridge Road  
London SE1 9HA

Note that we do not need a hard copy in addition to an electronic version. It would be helpful if you could explain why you hold your views and how Ofcom's proposals would impact on you.

## Further information

If you want to discuss the issues and questions raised in this document, or need advice on the appropriate form of response, please contact Tarnya Wilkins on 020 7783 4283.

## Confidentiality

In line with our Dispute Resolution Guidelines, as a part of publishing a final determination, Ofcom may publish non-confidential versions of responses. If you think your response should be kept confidential, can you please specify what part or whether all of your response should be kept confidential, and specify why. Please also place such parts in a separate annex.

If someone asks us to keep part or all of a response confidential, we will treat this request seriously and will try to respect this. However, sometimes we will need to publish all responses, including those that are marked as confidential, in order to meet legal obligations.

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

## **Next steps**

Ofcom intends to publish a determination by 30 September 2016.

Please note that you can register to receive free mail Updates alerting you to the publications of relevant Ofcom documents. For more details please see:

[http://www.ofcom.org.uk/static/subscribe/select\\_list.htm](http://www.ofcom.org.uk/static/subscribe/select_list.htm)

## Annex 2

# Consultation response cover sheet

We have produced a coversheet for responses (see below) and would be very grateful if you could send one with your response. This will speed up our processing of responses, and help to maintain confidentiality where appropriate.

Please put any parts of your response you consider should be kept confidential in a separate annex to your response and include your reasons why this part of your response should not be published. This can include information such as your personal background and experience. If you want your name, address, other contact details, or job title to remain confidential, please provide them in your cover sheet only, so that we don't have to edit your response.

## Cover sheet for response to an Ofcom consultation

### BASIC DETAILS

Consultation title:

To (Ofcom contact):

Name of respondent:

Representing (self or organisation/s):

Address (if not received by email):

### CONFIDENTIALITY

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

Nothing

Name/contact details/job title

Whole response

Organisation

Part of the response

If there is no separate annex, which parts?

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

### DECLARATION

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

Ofcom may publish responses on receipt. If your response is non-confidential (in whole or in part), and you would prefer us to publish your response only once the consultation has ended, please tick here.

Name

Signed (if hard copy)

## Annex 3

# [Provisional] Determination to resolve a dispute between BT and TalkTalk

**[Provisional] Determination under sections 188 and 190 of the Communications Act 2003 (“2003 Act”) for resolving a dispute between TalkTalk Telecom Group Plc (“TalkTalk”) and British Telecommunications Plc (“BT”) concerning BT’s charges for special fault investigation services and time related charges.**

### **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 a 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. Ofcom must publish so much of its determination as (having regard, in particular, to the need to preserve commercial confidentiality) it considers 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 on resolving a dispute which may include, in accordance with section 190(2) of the 2003 Act:

- a) making a declaration setting out the rights and obligations of the parties to the dispute;
- b) giving a direction fixing the terms or conditions of transactions between the parties to the dispute;
- c) 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
- d) 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 7 October 2010, Ofcom published a statement called “*Review of the wholesale local access market*”<sup>162</sup> (the “2010 WLA Statement”) which found that BT held significant market power (“SMP”) in the market for wholesale local access services within the United Kingdom but not including the Hull Area (“WLA market”);

**(D)** In the 2010 WLA Statement, Ofcom imposed a series of SMP conditions on BT in the WLA market under section 45 of the Act, including a basis of charges obligation which

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<sup>162</sup> [http://stakeholders.ofcom.org.uk/binaries/consultations/wla/statement/WLA\\_statement.pdf](http://stakeholders.ofcom.org.uk/binaries/consultations/wla/statement/WLA_statement.pdf).

requires: *“Unless Ofcom directs otherwise from time to time, the Dominant Provider shall secure, and shall be able to demonstrate to the satisfaction of Ofcom, that each and every charge offered, payable or proposed for Network Access covered by Condition FAA1 and/or Conditions FAA9, FAA10 and FAA12 is reasonably derived from the costs of provision based on a forward looking long run incremental cost approach and allowing an appropriate mark up for the recovery of common costs including an appropriate return on capital employed. FAA1 requires BT to provide network access on reasonable request from a third party, and also to provide such network access as Ofcom may from time to time direct.”;*

**(E)** On 10 May 2016, TalkTalk referred a dispute with BT to Ofcom for dispute resolution requesting a determination that BT has overcharged them for certain services, known as special fault investigation services (“SFIs”) and time related charges (“TRCs”), provided to them between 1 April 2011 and 30 June 2014 (which depends on whether or not BT’s charges for those services were cost oriented during that time) and, if so, by how much they have been overcharged and should therefore be reimbursed;

**(F)** Having considered the submissions TalkTalk and BT, Ofcom set the scope of the issues in dispute to be resolved as follows-

*“1) Whether the amount that BT charged TalkTalk for TRCs and SFIs in the relevant period was compliant with SMP Condition FAA4.1; and*

*2) If not, in order to resolve the dispute between the parties, what amount BT should have charged TalkTalk for TRCs and SFIs in the relevant period and whether any repayments should be made.”;*

The relevant period was defined as being between 1 April 2011 and 30 June 2014.

**(G)** 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 and the Community requirements set out in sections 4 and 4A of the 2003 Act;

**(H)** A fuller explanation of the background to the dispute and Ofcom’s reasons for making this [Provisional] Determination is set out in the explanatory statement accompanying this [Provisional] Determination; and

**NOW, THEREFORE, OFCOM MAKES, FOR THE REASONS SET OUT IN THE ACCOMPANYING EXPLANATORY STATEMENT, THE FOLLOWING [PROVISIONAL] DETERMINATION FOR RESOLVING THE DISPUTE:**

**I Declaration of rights and obligations, etc.**

1. BT has overcharged TalkTalk for the following services (which shall each be construed as having the same meaning as provided by BT on its website for definitions and explanations of its products):

- (a) Standard Chargeable Visit (Visit plus up to 1 hours work)
- (b) Additional Hours (or Part thereof)
- (c) MPF Special Fault Investigation 2 ( SF12) - Network module
- (d) MPF Special Fault Investigation 2 ( SF12) - Frame module
- (e) MPF Special Fault Investigation 2 ( SF12) - Internal Wiring module
- (f) MPF Special Fault Investigation 2 ( SF12) - Coop module
- (g) MPF Special Fault Investigation 2 ( SF12) - Frame direct module

- (h) SMPF Special Fault Investigation 2 ( SF12) - Network module
- (i) SMPF Special Fault Investigation 2 ( SF12) - Frame module
- (j) SMPF Special Fault Investigation 2 ( SF12) - Internal Wiring module
- (k) SMPF Special Fault Investigation 2 ( SF12) - Coop module
- (l) SMPF Special Fault Investigation 2 ( SF12) - Frame direct module
- (m) Internal and External Shifts
- (n) Internal pack (For internal work at a normal premises)
- (o) External pack (For external work at a normal premises)
- (p) Data ext kit (Associated with Broadband Health check)
- (q) SSFP NTE2000 (Broadband front plate)
- (r) Block Terminal 92A (for Redcare use)

in the Relevant Period for the periods specified in the explanatory statement, where those services were reasonably necessary for the use of BT's local-loop unbundling services or sub-loop unbundling services provided pursuant to Condition FAA9 or FAA10 imposed under the 2010 WLA Statement, or otherwise for the provision of network access by BT pursuant to Condition FAA1.

2. Ofcom gives a direction to BT to pay to TalkTalk, by way of adjustment of an overpayment for those services, a sum to be calculated by BT and TalkTalk in accordance with the methodology set out in the explanatory statement. Unless otherwise already paid by BT to TalkTalk, this sum shall be payable within five working days after the Court of Appeal hands down its judgment in the Ethernet Determination provided that judgment does not find that Ofcom has no jurisdiction under section 190(2) of the 2003 Act to make a direction as set out above.

3. Finally, interest at a rate of the Bank of England base rate plus 1% compounded annually shall be payable by BT to TalkTalk on the amount to be calculated by the parties in paragraph 2 above. Unless otherwise already paid by BT to TalkTalk, this sum shall be payable within five working days after the Court of Appeal hands down its judgment in the Ethernet Determination provided that judgment does not find that Ofcom has no jurisdiction under section 190(2) of the 2003 Act to direct BT to pay interest as set out above.

## **II Binding nature and effective date**

4. This Determination is binding on BT and TalkTalk in accordance with section 190(8) of the 2003 Act.

5. This Determination shall take effect on the day it is published.

## **III Interpretation**

6. For the purpose of interpreting this Determination—

a) except as otherwise defined in this Determination, words or expressions used in this Determination (and in the recitals hereto) shall have the same meaning as they have been ascribed in the 2003 Act;

b) headings and titles shall be disregarded; and

c) the Interpretation Act 1978 shall apply as if this Determination were an Act of Parliament.

7. In this Determination—

- a) "2003 Act" means the Communications Act 2003 (c.21);
- b) "BT" means British Telecommunications plc, whose registered company number is 01800000, and any of its subsidiaries or holding companies, or any subsidiary of such holding companies, as defined by section 1159 of the Companies Act 2006;
- c) "Ethernet Determination" means British Telecommunications PLC v Office of Communications & Ors (Case No 1205-7/3/3/13);
- d) "Ofcom" means the Office of Communications;
- e) "SFIs" means special fault investigation services;
- f) "TalkTalk" means TalkTalk Telecoms Group Plc whose registered company number is 7105891, and any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 1159 of the Companies Act 2006; and
- g) "TRCs" means time related charges.

**[x]**

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

[Date]

## Annex 4

# SMP Conditions

## Introduction

This annex sets out, for ease of reference, the SMP Conditions that are most relevant to this Dispute. The full set of SMP Conditions, along with the accompanying explanatory statement, was published as the 2010 WLA Statement.<sup>163</sup>

## SMP Conditions

### Condition FAA1 - Requirement to provide Network Access on reasonable request

**FAA1.1** Where a Third Party reasonably requests in writing Network Access, the Dominant Provider shall provide that Network Access. The Dominant Provider shall also provide such Network Access as Ofcom may from time to time direct.

**FAA1.2** The provision of Network Access in accordance with paragraph FAA1.1 above shall occur as soon as it is reasonably practicable and shall be provided on fair and reasonable terms, conditions and charges and on such terms, conditions and charges as Ofcom may from time to time direct.

**FAA1.3** The Dominant Provider shall comply with any direction Ofcom may make from time to time under this Condition.

**FAA1.4** The Direction dated 20 March 2008 concerning service level agreements, as published on the same day at Annex 2 of the statement entitled '*Service level guarantees: incentivising performance*', given by Ofcom under Condition FA1.2 shall continue to have force, until such time it is modified or withdrawn, as if it has been given under Condition FAA1.2 from the date that this Condition enters into force and that Direction shall be read accordingly.

### Condition FAA4 – Basis of charges

**FAA4.1** Unless Ofcom directs otherwise from time to time, the Dominant Provider shall secure, and shall be able to demonstrate to the satisfaction of Ofcom, that each and every charge offered, payable or proposed for Network Access covered by Condition FAA1 and/or Conditions FAA9, FAA10 and FAA12 is reasonably derived from the costs of provision based on a forward looking long run incremental cost approach and allowing an appropriate mark up for the recovery of common costs including an appropriate return on capital employed.

**FAA4.2** For the avoidance of any doubt:

(a) this Condition FAA4 shall not apply to the requirement on the Dominant Provider to provide Virtual Unbundled Local Access under Condition FAA11; and

(b) except for the charge for MPF Rental, where the charge offered, payable or proposed for Network Access covered by Condition FAA1 and/or Condition FAA9 is

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<sup>163</sup> [http://stakeholders.ofcom.org.uk/binaries/consultations/wla/statement/WLA\\_statement.pdf](http://stakeholders.ofcom.org.uk/binaries/consultations/wla/statement/WLA_statement.pdf).

for a service which is subject to a charge control under Condition FA3(A), the Dominant Provider shall secure, and shall be able to demonstrate to the satisfaction of Ofcom, that such a charge satisfies the requirements of paragraph FAA4.1 above.

### **Condition FAA9 – Requirement to provide Local Loop Unbundling Services (LLU)**

**FAA9.1** Where a Third Party reasonably requests in writing Local Loop Unbundling Services, the Dominant Provider shall provide those Services, which shall include, where also so requested by the Third Party, such Ancillary Services as may be reasonably necessary for the use of those Services. The Dominant Provider shall also provide such Ancillary Services or other Network Access as Ofcom may from time to time direct to ensure the provision of Local Loop Unbundling Services.

**FAA9.2** The provision of Local Loop Unbundling Services, together with any Ancillary Services, in accordance with paragraph FAA9.1 shall occur as soon as reasonably practicable and shall be provided on fair and reasonable terms, conditions and charges and on such terms, conditions and charges as Ofcom may direct from time to time.

**FAA9.3** The Dominant Provider shall comply with any direction Ofcom may make from time to time under this Condition.

**FAA9.4** In this Condition:

**(a) “Ancillary Services”** mean an Associated Facility or services associated with an Electronic Communications Network and/or an Electronic Communications Service which enable and/or support the provision of services via that Network and/or Service or have the potential to do so, which include at a minimum (but without limitation) the following:

- (i) power;
- (ii) Co-Location;
- (iii) Co-Mingling;
- (iv) Site Access;
- (v) Internal Tie Circuits;
- (vi) External Tie Circuits.

**(b) “Co-Location”** means the provision of space permitting a Third Party to occupy part of an MDF Site reasonably sufficient to permit the use of Local Loop Unbundling Services, and in particular to permit the connection of the Dominant Provider's Electronic Communications Network with the Electronic Communications Network of a Third Party at that location;

**(c) “Co-Mingling”** means the provision of Co-Location having the following characteristics:

(i) the Third Party's Electronic Communications Network is situated in an area of the MDF Site which:

- (A) is a single undivided space;

(B) after proper performance by the Dominant Provider of its obligation to provide Local Loop Unbundling Services pursuant to Condition FAA10.1, would permit the normal operation of the Third Party's Electronic Communications Network (or would permit if the Dominant Provider removed any object or substance whether toxic or not, which might reasonably prevent or hinder the occupation of the MDF Site for such use); and

(C) if so requested by the Third Party, is not unreasonably distant from the Dominant Provider's Electronic Communications Network within the MDF site;

(ii) no permanent physical partition is erected in the space between the Third Party's Electronic Communications Network and the Dominant Provider's Electronic Communications Network; and

(iii) the Third Party's Electronic Communications Network is neither owned nor run by the Dominant Provider or by any person acting on the Dominant Provider's behalf;

**(d) "External Tie Circuit"** means a link that connects Local Loop Unbundling Services to the Electronic Communications Network of a Third Party at a location outside the MDF Site;

**(e) "Internal Tie Circuit"** means a link, the whole of which is contained within an MDF Site, that connects Local Loop Unbundling Services to the Electronic Communications Network of a Third Party;

**(f) "Local Loop Unbundling Services"** mean Network Access to Metallic Path Facilities or Shared Access;

**(g) "MDF Site"** means the site of an operational building of the Dominant Provider that houses a main distribution frame;

**(h) "Metallic Path Facilities"** means a circuit comprising a pair of twisted metal wires employing electric, magnetic, electro-magnetic, electro-chemical or electro-mechanical energy to convey Signals when connected to an Electronic Communications Network;

**(i) "Shared Access"** means the non-voice band frequency of Metallic Path Facilities;

**(j) "Site Access"** means access (including the right of entry) to the Dominant Provider's MDF Sites in order to install and operate an Electronic Communications Network to provide Electronic Communications Services over Local Loop Unbundling Services; and

**(k)** references to the expression Electronic Communications Network for the purposes of the expressions Co-Location, Co-Mingling and Site Access in this Condition shall be limited to those matters set out at section 32(1)(b)(i)-(iii) of the Act.

## **Condition FAA10 – Requirement to provide Sub-Loop Unbundling Services (SLU)**

**FAA10.1** Where a Third Party reasonably requests in writing Sub-Loop Unbundling Services, the Dominant Provider shall provide those Services, which shall include, where also so requested by the Third Party, such Ancillary Services as may be reasonably necessary for the use of those Services. The Dominant Provider shall also provide such Ancillary Services or other Network Access as Ofcom may from time to time direct to ensure the provision of Sub-Loop Unbundling Services.

**FAA10.2** The provision of Sub-Loop Unbundling Services, together with any Ancillary Services, in accordance with paragraph FAA10.1 shall occur as soon as reasonably practicable and shall be provided on fair and reasonable terms, conditions and charges and on such terms, conditions and charges as Ofcom may direct from time to time.

**FAA10.3** The Dominant Provider shall comply with any direction Ofcom may make from time to time under this Condition.

**FAA10.4** In this Condition:

(a) **“Ancillary Services”** mean an Associated Facility or services associated with an Electronic Communications Network and/or an Electronic Communications Service which enable and/or support the provision of services via that Network and/or Service or have the potential to do so, which include at a minimum (but without limitation) Tie Circuit.

(b) **“Shared Access”** has the meaning given to it in Condition FAA9;

(c) **“Sub-Loop Unbundling Services”** means access to Metallic Path Facilities or Shared Access at an intermediate point prior to the main distribution frame;

(d) **“Tie Circuit”** means a link that connects Sub-Loop Unbundling Services to the Electronic Communications Network of a Third Party; and

(e) references to the expression Electronic Communications Network for the purposes of the expression Ancillary Services in this Condition shall be limited to those matters set out at section 32(1)(b)(i)-(iii) of the Act.