

**From:** [Marsh, Matthew](#)  
**To:** [Paul Dean](#)  
**Cc:** [Breckenridge, Bruce](#); [Higho, Toby](#)  
**Subject:** RE: PPC Court of Appeal judgment [SKY-LDM.FID19216]  
**Date:** 24 August 2012 11:18:41

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Dear Paul

Further to Ofcom's request for Sky to consider the Court of Appeal's judgment (British Telecom plc. v Office of Communications (Partial Private Circuits) dated 27 July) and the impact it has on its submissions, Sky provides the following comments, which supplement those made in my email to Neil Buckley of 2 August.

### Each and Every charge

As Ofcom rightly points out in the Draft Determination, the effect of Condition H3.1 is to require BT to secure that "*each and every*" of its charges for BES are reasonably derived from the cost of provision *etc.* In reaching this view, Ofcom stated that it "*should consider BT's charges on a disaggregated basis...*" (paragraph 8.37).

The Court of Appeal adopts the same position and roundly rebuffs BT's arguments on aggregation. For example, Lord Justice Etherton (delivering the leading judgment) states (at paragraphs 68 and 75):

*"I do not accept that the principles of the CRF [Common Regulatory Framework] required Ofcom, in considering whether BT was in breach of Condition H3.1, to take into account the lower charges for the terminating sections of PPCs sold by BT.*

...

*BT's case is that it has complied with Condition H3.1, and so demonstrated, because it is consistent with the regulatory purposes and the objectives of the CRF to have regard to the charges for entire PPCs, both terminating and trunk segments. The effect of that approach, however, is to undermine the whole object of the 2004 regulatory regime..."*

Notwithstanding the Court's rejection of the principle of aggregation, it also states (paragraph 70) that "*as a matter of fact, BT did not have a business strategy of selling the terminating segments at a particularly low price and compensating for that low price by charging more for the trunk segments*". The same 'matter of fact' is true in relation to BT's sale of BES. BT did not sell BES connection "*at a particularly low price*" to compensate for the high price on rental (or vice versa).

The Court notes (paragraph 76) the absurdity of the conclusion that could be reached in the event that BT's argument on aggregation were permitted:

*"in an extreme example, if the trunk market and a terminating market were aggregated, then BT could charge an exploitative charge in one market and an exclusionary charge in the other as long as overall the charges were in an acceptable range. Ofcom observed that that would be inconsistent with its duties and obligations to protect consumers and to promote competition."*

Quite. Finally, Sky notes that the Court describes the approach BT took to aggregating charges as "*fundamentally misconceived since it would undermine the regulatory regime and its objectives applicable during the relevant period...*" (paragraph 80).

The Court's conclusions on aggregation have a direct read-across to the BES dispute and provide further comfort to Ofcom that its (and Sky's) position on aggregation is correct.

### The appropriate cost standard

The Court's judgment lends support to Sky's position that FAC is the appropriate cost standard. As the Court rightly recognises, when interpreting Condition H3.1 it is necessary to consider the "*evidence and fact in the light of regulatory policy*" (paragraph 68). Given the lack of a charge control in respect of BES during the relevant period – there was no concurrent charge control in operation between 2004 and 2009 for the AISBO basket of services – the regulatory regime in respect of BES was materially different to that of PPC.

Had a charge control been in place for BES, it would have ensured the prices across the AISBO basket were at or near to forecast FAC. In the absence of such charge control, the prices for BES were not so constrained and thus BT was able to over-recover its common costs. In the light of this material difference between PPC and BES, and given the fact that the Court makes no statement to the effect that DSAC is the only appropriate cost standard or that FAC is not the appropriate cost standard, Sky again urges Ofcom to apply FAC in its Final Determination.

### Interest

The Court of Appeal states (paragraph 84) that it can "*see no proper basis for reaching a different conclusion from both Ofcom and the Tribunal on the remedy they considered appropriate.*" In the light of this clear and unambiguous statement, it is helpful to recall the conclusion of the CAT, which was to require BT to repay the overpayments as a means of:

*"putting the parties in the position they would have been in had Condition H3.1 been complied with. Failure to do so would undoubtedly signal that compliance with SMP conditions is not rigorously policed and that – we consider – is an inappropriate signal to send"* (paragraph 36 of the CAT's judgment).

Ultimately, all Sky is asking for – consistent with the conclusions of the Court of Appeal and the CAT – is that Ofcom puts Sky back in the position it would have been in had BT complied with Condition H3.1. In order for that to happen, BT must be required to repay to Sky not only the overcharge itself, but also the costs associated with that overcharge – for which interest at Sky's WACC is a reasonable proxy. Collectively, these items comprise the total amount of the excess charge and thus the cost to Sky of the overcharge.

Further support for Sky's position to be repaid the entirety of the excess charge is found in the findings of the Court (paragraphs 83 and 84) on the discretion Ofcom has to resolve the PPC dispute. The Court found that in resolving the PPC dispute Ofcom will:

*"be acting as a regulator giving effect to the statutory regime and, therefore, to the objectives of the CRF...on the particular facts of the case... [And that]:*

*The discretion under section 190 plainly must be exercised in a principled way with a view to achieving those objectives [to determine a dispute by way of requiring the repayment of the proper amount of an overcharge]. 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."*

The starting (and also the end) point that Ofcom should take in exercising its remedial powers should be to order repayment of the excess charge – here, both the overpayment itself and the interest upon such overpayment. On the particular facts (see, in particular Section 8 of Sky's April 2012 submission), such payment is warranted and within Ofcom's discretion. Moreover, such repayment is necessary in order to put Sky back in the position it would have been in had BT complied with Condition H3.1.

### '08' judgment

Sky also considers the recent decision by the Court of Appeal in the '08' appeal ([2012] EWCA Civ 1002) to be relevant to Sky's previous submissions on interest.

In particular, the Court reaches the view (paragraph 74) – consistent with its views on Ofcom’s discretion in its judgment of the PPC case (see above) - that the contractual position between the parties does not bind a regulator when it is determining a dispute:

*“If there is already a contract [which is being examined by an NRA when it is resolving a dispute], the NRA’s powers must enable it to override the contractual rights of one party (or even those of both parties). There is no place for any kind of presumption either way as to the position of one party or the other...So, while the previous position under the contract (if there is one) is no doubt relevant (as the Tribunal said in the TRD case), and while upholding contractual rights, thereby favouring commercial certainty, can be a relevant consideration for the regulator to bear in mind, neither the actual or previous contractual position, nor any right of BT to impose a change, can be of any overriding significance.” (Emphasis added).*

In addition, Lord Justice Etherton, in his short judgment, states that the presence of a particular contractual right was “entirely neutral from a regulatory perspective” (paragraph 101).

In applying the ‘08’ judgment to BES, the inclusion (at BT’s insistence) of a contractual term purporting to exclude the payment of interest is neither determinative nor is it “of any overriding significance”. Ofcom needs to look past the purported effect of the contractual exclusion and instead determine:

- 1) whether the exclusionary clause is “a relevant consideration for the regulator to bear in mind” or whether it should, in the light of the facts, be disregarded; and, only if it decides that the clause should not be disregarded should it then determine,
- 2) whether the exclusionary clause is “fair and reasonable” in the circumstances of the case.

Sky does not consider the clause to be a “relevant consideration” that Ofcom need consider in the resolution of the dispute (see, in particular Section 8 of Sky’s April 2012 submission). Accordingly, the exclusionary clause should be disregarded and Ofcom should, exercising its discretion, award Sky the appropriate amount of interest (the relevant proxy for which is Sky’s WACC).

In the event that Ofcom disagrees with Sky on the relevance of the exclusionary clause, Sky again submits that the clause is neither fair nor reasonable in the light of the facts (see, in particular Section 8 of Sky’s April 2012 submission). Accordingly, the exclusionary clause should be set aside and Ofcom should, exercising its discretion, award Sky the appropriate amount of interest (the relevant proxy for which is Sky’s WACC).

#### Timing of Final Determinations

Sky notes that Ofcom does not anticipate seeking any further comments from the disputing parties before it issues the Final Determinations of the disputes. In the event that the BES Final Determination introduces new points that have not been consulted upon (as opposed to points that flow from previous submissions made by the parties), Sky reserves the right to provide further comments on such new points.

We trust that Ofcom will now move swiftly to issue its Final Determinations.

In the event that any of the above requires any clarification, please could you let me know.

Kind regards

Matthew

**Matthew Marsh**

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**From:** Paul Dean [mailto:Paul.Dean@ofcom.org.uk]  
**Sent:** 06 August 2012 10:54  
**To:** Marsh, Matthew  
**Cc:** Breckenridge, Bruce; Higho, Toby  
**Subject:** PPC Court of Appeal judgment

Matthew,

Please see the attached letter. We note your e-mail of 2 August. However, we are writing to all the parties in the same terms, following the Court of Appeal's judgment.

We shall be in touch again in due course regarding the timing of our final determination, which we are hoping to issue as soon as possible.

Kind regards

Paul

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