

BASIC DETAILS

Consultation title: Draft Determinations to resolve disputes between each of Sky, TalkTalk and Virgin Media and BT regarding BT's charges for Ethernet services

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Name Andrew Wileman

Signed (if hard copy)



Virgin Media's response to Ofcom's Draft Determinations dated 9 February 2012 to resolve disputes between each of Sky, TalkTalk and Virgin Media and BT regarding BT's charges for Ethernet services

20th April 2012

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1. EXECUTIVE SUMMARY

Virgin Media broadly supports Ofcom's approach to resolving these Disputes

1.1 Virgin Media broadly supports and agrees with the approach taken by Ofcom in these Draft Determinations ("the Draft Determinations")¹ and considers that approach to be largely consistent with their legal duties and with the judgment of the Competition Appeal Tribunal ("the CAT") in the PPC case ("the PPC Judgment")². In particular, Virgin Media supports Ofcom's:

- 1.1.1 conclusion that BT has failed to demonstrate that each and every charge for the relevant Ethernet services was cost-oriented;
- 1.1.2 proposal to resolve these Disputes on the basis of a disaggregated assessment of each and every individual charge in dispute. This approach:
 - 1.1.2.1 is consistent with the SMP cost orientation requirement in Condition HH3.1 which relates to *"each and every charge offered"*;
 - 1.1.2.2 is the most apt methodology to ensure compliance by BT with its regulatory obligations;
 - 1.1.2.3 is in line with the findings of the CAT in the PPC Judgment;
- 1.1.3 use of DSAC as the appropriate cost benchmark to assess BT's compliance with its SMP cost orientation obligations;
- 1.1.4 proposal to reject BT's request to use new DSAC data based on a revised methodology for calculating LRIC and DSACs introduced after the publishing of BT's Regulatory Financial Statements (the "RFS"), rather than the published DSACs for the years 2006/07, 2007/08, 2008/09 and 2009/10;
 - 1.1.4.1 Virgin Media considers it would send entirely the wrong message to BT in terms of the need to comply with its regulatory obligations - and would indeed fundamentally dilute the incentive to do so - if BT were permitted to restate its figures using a different methodology;
- 1.1.5 assessment of overcharging and consideration, in assessing whether or not BT has overcharged for the relevant Ethernet services, of:

¹ Draft Determinations to resolve disputes between each of Sky, TalkTalk and Virgin Media and BT regarding BT's charges for Ethernet services, 9 February 2012

² *British Telecommunications Plc v Office of Communications (Partial Private Circuits)* [2011] CAT 5, Judgment of 22 March 2011.

- 1.1.5.1 the magnitude and duration of the amounts by which BT's charges exceeded DSAC;
 - 1.1.5.2 whether, and the extent to which, charges exceeded FAC; and
 - 1.1.5.3 the rate of return on capital employed; and
- 1.1.6 requiring BT to pay to Virgin Media the difference between the amounts paid by it for the various Ethernet services in dispute and the maximum charge under which Ofcom would have considered BT not to have overcharged for those services (DSAC).
- 1.2 However, Virgin Media strongly disagrees with Ofcom's proposal that interest should not be payable:
 - 1.2.1 It is neither appropriate nor consistent with Ofcom's statutory duties for Ofcom to determine the award of interest by reference to the *Backhaul and Wholesale Extension Services* contract whose terms were effectively unilaterally imposed on Virgin Media and the other Disputing CPs by BT and are heavily weighted in BT's favour.
 - 1.2.2 In any event, Ofcom's power to award interest is neither ousted nor limited by what the parties may have agreed between themselves contractually (or in this case been forced to accept). Ofcom would be failing in its Section 3 duties if it simply let the contractual situation dictate whether interest is payable and did not carry out a proper assessment of what is fair as between the parties and reasonable from the point of view of Ofcom's regulatory objectives.
 - 1.2.3 For all the above reasons, Virgin Media therefore strongly urges Ofcom to reconsider its provisional decision not to award interest.
- 1.3 In addition, Virgin Media believes that it is also in dispute with BT regarding BT's charges for various Ethernet services during the additional period 1 April 2009 to 31 March 2011, notwithstanding that the original dispute referral referred to charges between 1 April 2006 and 31 March 2009. It therefore requests that Ofcom, in line with its provisional conclusions in the Verizon dispute over Ethernet charges³, extends the period of Virgin Media's Dispute and awards a repayment in respect of the additional period as well.

³ Dispute between Verizon and BT relating to BT's charges for WES, Provisional Conclusions, 4 April 2012.

2. STRUCTURE

- 2.1 This Response serves as Virgin Media's response to both the Draft Determinations resolving a dispute to which it was a party and to the subsequent Provisional Determination involving Cable & Wireless ("CWW") and BT published on 23 February 2012 ("Ethernet 2")⁴.
- 2.2 This Response follows the structure of Ofcom's Explanatory Statement accompanying the Draft Determinations:
- 2.2.1 Section 3 (Services in dispute);
 - 2.2.2 Section 4 (Which charges should be cost orientated?);
 - 2.2.3 Section 5 (Ofcom's proposed approach to determining whether BT's charges were cost orientated);
 - 2.2.4 Section 6 (Has BT satisfactorily demonstrated that its relevant charges were cost orientated?);
 - 2.2.5 Section 7 (Which is the appropriate DSAC data for assessing cost orientation?);
 - 2.2.6 Section 8 (BT's revenues and costs of providing the BES and WES services in dispute);
 - 2.2.7 Section 9 (Ofcom's assessment of whether BT's charges were cost orientated); and
 - 2.2.8 Section 10 (Repayments).

⁴ Provisional Determination of a Dispute between Cable & Wireless and BT about BT's charges for Ethernet services, 23 February 2012

3. SERVICES IN DISPUTE

- 3.1 Virgin Media confirms that the services which are in dispute with BT are those set out in Tables 1.1 and 7.4 of the Draft Determinations.
- 3.2 However, as regards the time period during which Virgin Media was overcharged by BT for those services, this extends beyond the period currently set out in the Draft Determinations.
- 3.3 Virgin Media submitted its dispute on 10 August 2010 (see paragraph 1.3 of the Draft Determinations) and did not include services in the years ending 31 March 2010 (i.e. 2009/10) and 31 March 2011 (i.e. 2010/11). The original dispute referral therefore referred to charges between 1 April 2006 and 31 March 2009.
- 3.4 BT has published RFS for both of those years (i.e. 2009/10 and 2010/11) and having had sufficient time to analyse those RFS, Virgin Media now believes it has been overcharged for Ethernet services during the additional period 1 April 2009 to 31 March 2011.
- 3.5 Given the identical basis on which Virgin Media believes it has been overcharged by BT during the additional period and given BT's stated position on the overcharging alleged by CWW in Ethernet 2 during that period, Virgin Media believes that BT would not agree that it had overcharged Virgin Media nor agree to make a repayment to Virgin Media in respect of the additional period if repayment was requested.
- 3.6 It would therefore, in our view, be disproportionate for Virgin Media to be required to lodge a subsequent dispute either for the remaining four months in the year ending 31 Mar 2010 that were not included in our original dispute submission (i.e. 1 April 2009 to 31 July 2009 inclusive) or for the period after that (i.e. 1 August 2009 to 31 March 2011). We therefore request that Ofcom extends the period of Virgin Media's Dispute and awards a repayment in respect of the additional period accordingly.
- 3.7 There is precedent in the Verizon Ethernet Dispute⁵ for Ofcom extending the time period of a dispute notwithstanding that the additional period did not form part of the original dispute referral and that, prior to submission, there were no negotiations with BT specifically about services during the additional period.
- 3.8 That dispute concerns some of the same Ethernet services as are dealt with in these Disputes and in fact cross-refers to and relies on large parts of the Draft Determinations in these Disputes.
- 3.9 In the Verizon dispute, and despite the not unexpected objections from BT, Ofcom has provisionally concluded that it is satisfied that the parties are in dispute for the additional period (being 1 August 2009 to 31 March 2011 in that case). Virgin Media

⁵ Dispute between Verizon and BT relating to BT's charges for WES, Provisional Conclusions, 4 April 2012.

would invite Ofcom to come to the same conclusion in this Dispute in relation to the period 1 April 2009 to 31 March 2011.

- 3.10 If necessary, Virgin Media will participate in an all parties meeting with BT and Ofcom to discuss the additional period, during which Virgin Media submits it will become abundantly clear that the parties are indeed in dispute about the additional period as well.
- 3.11 In addition, Ofcom will save resources if it deals with the additional period at the same time as determining these Disputes.
- 3.12 In conclusion, Virgin Media believes that it is also in dispute with BT regarding BT's charges for various Ethernet services during the additional period 1 April 2009 to 31 March 2011, notwithstanding that the original dispute referral referred to charges between 1 April 2006 and 31 March 2009. It therefore requests that Ofcom, in line with its provisional conclusions in the Verizon dispute over Ethernet charges, extends the period of Virgin Media's Dispute and awards a repayment in respect of the additional period as well.

4. WHICH CHARGES SHOULD BE COST ORIENTATED?

Virgin Media supports Ofcom's assessment

- 4.1 Virgin Media agrees with Ofcom's proposal to resolve these Disputes on the basis of a disaggregated assessment of each and every individual charge in dispute (see paragraph 8.90 of the Draft Determinations). This approach:
- 4.1.1 is consistent with the SMP cost orientation requirement in Condition HH3.1 which explicitly requires that *"each and every charge... is reasonably derived from the cost of provision based upon 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"*;
 - 4.1.2 is the most apt methodology to ensure compliance by BT with its regulatory obligations; and
 - 4.1.3 is in line with the findings of the CAT in the PPC Judgment⁶.

Detailed comments

- 4.2 Regarding the level of aggregation in the RFS Virgin Media acknowledges that in practice there are further detailed charges that sit behind the RFS since *"Ofcom has permitted BT to merge some 'low value services' where operating costs are typically less than £10 million per annum"* (see paragraph 8.42 of the Draft Determinations). The level of aggregation in the RFS should not however detract from the fact that SMP Condition HH3.1 explicitly requires *"each and every charge"* to be cost oriented - which implies that a more disaggregated approach may be required to test for compliance with that condition.
- 4.3 Virgin Media agrees with Ofcom (see paragraph 8.44 of the Draft Determinations) that *"BT must be able to demonstrate to our satisfaction that those charges covered by a cost orientation obligation are compliant with that obligation."* Virgin Media also agrees with Ofcom that *"BT cannot infer from the aggregated approach to financial reporting that was permitted, particularly in the early years of the Relevant Period, that an aggregated approach to cost orientation is appropriate."* (see paragraph 8.44 of the Draft Determinations).
- 4.4 BT seeks to argue that the services purchased should be aggregated (for example Rental and Connection charges (see paragraph 8.60) and Main Link and Rental charges (see paragraphs 8.81-8.86 of the Draft Determinations)). Virgin Media believes that notwithstanding any aggregation in the RFS, each and every underlying charge must be cost oriented, in line with Condition HH3.1. Accordingly the

⁶ See paragraphs 227 and 228 in particular.

compliance of each and every service in dispute which is subject to that obligation should be assessed on a disaggregated basis.

- 4.5 Virgin Media concurs with the view (as set out in 8.33 in the Draft Determinations) that *“Ethernet services (main link rental, local end connection and local end rentals) ... are not purchased in fixed proportions”*. Moreover, these individual services are (in some instances) purchased separately, depending on requirements. For example, a local end rental can be purchased either with or without a main link rental
- 4.6 Virgin Media agrees with Ofcom (see paragraph 8.57 of the Draft Determinations) that where CPs purchase services in varying proportions, it is important that each and every charge is individually cost orientated. This interpretation is also consistent with the CAT’s interpretation (as set out in paragraph 228 of PPC Judgment) which states that *“.. the purchaser of 2 Mbit/s trunk will want to know that the particular service he is buying is cost orientated. He will doubtless be rather less concerned with cost orientation of services he is not purchasing”*. Cost orientation should therefore not be judged on or against an aggregated product set.

5. **OFCOM'S PROPOSED APPROACH TO DETERMINING WHETHER BT'S CHARGES WERE COST ORIENTATED**

Virgin Media supports Ofcom's analysis and approach

- 5.1 Virgin Media agrees with Ofcom that the appropriate measure of cost orientation is DSAC (see paragraph 9.18 in the Draft Determinations and Virgin Media's letter to Openreach dated 1 February 2010).

Detailed comments

- 5.2 Virgin Media also agrees with Ofcom that, in line with the PPC Judgment, the DSAC test should not be applied in a mechanistic way and that Ofcom should also consider:

5.2.1 the magnitude and duration of the amounts by which BT's charges for Ethernet services exceeded DSAC;

5.2.2 whether, and the extent to which, charges exceeded FAC;

5.2.3 the rate of return on capital employed (see paragraph 9.68).

- 5.3 As Ofcom notes in paragraph 10.48, the CAT concluded in the PPC Judgment that there was no need to show economic harm of any sort for a finding that the relevant SMP condition had been breached. On that basis, Ofcom has decided not to consider economic harm in these Draft Determinations and Virgin Media strongly supports that decision.

- 5.4 Virgin Media believes that DSAC is the most appropriate measure of cost orientation. Given the similarity of the wording of the SMP cost orientation Condition H3.1 applying to PPCs (see paragraph 9.2 of the Draft Determinations) Virgin Media believes it is appropriate to follow a consistent approach to that taken by the CAT in the PPC Judgment (as set out in 9.20 of the Draft Determinations), which states: "*In this case, DSAC represented the best single measure for assessing whether the condition had been satisfied and so represented the upper limit or ceiling on the permissible mark up of prices*" (paragraph 307(3)).

6. HAS BT SATISFACTORILY DEMONSTRATED THAT ITS RELEVANT CHARGES WERE COST ORIENTED?

Virgin Media supports Ofcom's conclusion

6.1 Virgin Media agrees with Ofcom's conclusion that BT has failed to demonstrate that each and every charge for Ethernet services was cost-oriented.

Detailed comments

6.2 BT has sought to argue that it has difficulty ensuring compliance with its cost orientation obligations because of the fluctuating nature of cost benchmarks, the difficulty in estimating volumes and the time taken before information from its RFS are available.

6.3 Firstly, Virgin Media would submit that BT must maintain some view of price and cost for its own business on a more frequent basis than it publishes its RFS.

6.4 Secondly, we support Ofcom's view that even if BT experienced difficulties in estimating volumes (see 9.39 and 13.25) or did not have a great deal of historic data, this does not detract from the fact that BT has an obligation to ensure compliance with Condition HH3.1 in each and every year in which it applied. BT has not presented credible evidence that it was unable to do this.

6.5 In relation to the evidence that BT was able to provide to Ofcom, this consists of a number of different types of evidence for the most part already considered by Ofcom in the Final Determinations and by the CAT in the PPC Judgment and rejected in relation to those disputes. The evidence includes: a ROCE analysis on an aggregated basis; a comparison of revenues to DSACs, again based on aggregated data; international benchmarking evidence; the fact that there is no economic harm (in BT's view); and circuit analyses (see Section 10 generally).

6.6 Virgin Media agrees with Ofcom's rejection of BT's evidence in the context of these Disputes. Specifically:

6.6.1 BT's analysis of ROCE is on an aggregated basis that fails to demonstrate that the relevant charges were cost orientated.

6.6.2 BT's comparison of revenues to DSAC is at an inappropriate aggregated level that similarly fails to demonstrate that the relevant charges were cost orientated.

6.6.3 As per the PPC Judgment, international benchmarks are not relevant to the assessment of BT's compliance with its cost orientation obligations under condition HH3.1 (see paragraph 266). As Ofcom helpfully puts it in paragraphs 10.27 to 10.35, BT's obligation is to ensure that its prices are

orientated to its costs, not that they are lower than those of its international peers.

- 6.6.4 As per the PPC Judgment, economic harm is not a pre-requisite to concluding whether there has been a breach of the cost orientation condition.

Interaction with Ofcom between 2004 and 2007

- 6.7 Virgin Media also rejects BT's suggestion that any interaction it had with Ofcom in 2006, 2007 and 2008 when it apparently worked closely with Ofcom "*as BT's and Ofcom's respective strategy and policy in respect of AISBO/Ethernet products developed and BT altered its pricing and/or introduced new products*" could have constituted compliance with condition HH3.1 (see 10.4.2(a) and 10.55)
- 6.8 As we set out in our letter of 1 February 2010 to BT, "*it is clearly BT's obligation to ensure that its charges comply with Cost Orientation obligations independently of Market Review assessments undertaken by Ofcom. This is a point emphasised by Ofcom when it stated that price reductions apply 'without prejudice' to the Cost Orientation obligation*".
- 6.9 We agree with Ofcom that none of its actions or omissions (or any actions taken by BT) provide evidence that Ofcom considered, or gave BT grounds to believe it considered, that BT's charges for Ethernet services were cost orientated. We also agree with Ofcom that BT could never have had a legitimate expectation that Ofcom would not resolve a dispute about the cost orientation of BT's charges (in the light of an SMP obligation) in accordance with its statutory functions (see 10.54).

Delays to the introduction of price reductions

- 6.10 In relation to BT's further argument that, had it been able to introduce price reductions sooner in 2008/09, its revenues for Ethernet services (and therefore the amounts by which DSAC was exceeded) would have been lower, Virgin Media notes that BT was forced to withdraw its November 2008 price notification because it was in breach of another SMP obligation (Condition HH6) in failing to give the requisite 90 days advance written notice of price changes (see paragraph 10.89 of the Draft Determinations).
- 6.11 Virgin Media was among the CPs which objected to BT's attempt to introduce price reductions without adhering to its SMP obligation on notice. As Ofcom notes in paragraph 10.95, the obligation to give sufficient prior notice (Condition HH6) is there for the benefit of BT's competitors as well as BT's customers.
- 6.12 As a competitor to Openreach in the market for the supply of Ethernet services, Virgin Media had every right to object to the lack of sufficient notice of BT's price changes on that occasion, which did not give it sufficient time to adjust its own prices and organise its own tariffs.



6.13 Moreover, it is clearly inappropriate for BT to rely on the reduction of notice periods in order to meet its cost orientation obligations.

7. WHICH IS THE APPROPRIATE DSAC DATA FOR ASSESSING COST ORIENTATION?

Virgin Media supports Ofcom's approach in the Draft Determinations

- 7.1 Virgin Media agrees with Ofcom that the appropriate starting point for resolving the Disputes is BT's RFS. Virgin Media strongly supports Ofcom's proposal to reject BT's request to use new DSAC data based on a revised methodology for calculating LRIC and DSACs introduced after the publishing of RFS, rather than the published DSACs for the years 2006/7, 2007/8, 2008/9 and 2009/10.

BTs proposals on revised DSAC data and cost allocation methodology

- 7.2 In relation to BT's proposals to spread an additional £417 million of costs across the DSACs for Ethernet services and to remove £229 million from the DSACs of PPC services (see paragraph 11.27), Virgin Media supports Ofcom's provisional decision to reject those proposals and to rely on BT's published DSACs in the years 2006/7, 2007/8, 2008/9 and 2009/10.
- 7.3 Virgin Media considers it would send entirely the wrong message to BT in terms of the need to comply with its regulatory obligations if BT were permitted to restate its figures using a different methodology every time its compliance with a cost orientation obligation was questioned in order to mitigate the effects of a dispute. Such an approach would allow BT to effectively go back and 'game' its SMP obligations.
- 7.4 BT had the flexibility to change the cost allocation methodology it used in advance of publication of those RFS, but chose not to do so. Where it subsequently did so in the RFS for 2010/11, it clearly did so, we would submit, in order to minimise any repayment Ofcom might order for that year, taking full advantage of the fact that Ofcom had yet to resolve the disputes.
- 7.5 It must be assumed that BT is only proposing to use a new methodology retrospectively at this stage because the effect would be to reduce the potential overcharge for Ethernet services and would overall be significantly to BT's advantage. This has certainly been the effect of introducing it in the 2010/11 RFS.
- 7.6 Given that the methodology used at the time was neither obviously inappropriate nor contained any mathematical, input or software errors (this is conceded by BT – see paragraph 11.58), there is no justification in insisting on the revised methodology.
- 7.7 Clearly if Virgin Media was seeking to force BT retrospectively to replace one potential (but appropriate) cost allocation methodology with another, Ofcom would not sanction that. It can therefore only be right that BT is not permitted retrospectively to use a different cost allocation methodology either.

- 7.8 Virgin Media agrees with Ofcom (see paragraph 11.33) that ordinarily it is important to be able to rely upon BT's RFS to assess whether BT has complied with its obligations at the relevant time.
- 7.9 Virgin Media rejects BT's claim that the calculation of the DSACs in the RFS in the years 2006/7, 2007/8, 2008/9 and 2009/10 is wrong. Out of all the services across all years just one service exhibits a DSAC which is below FAC (i.e. 2006/7 BES 100Mbit/s rental (see Table 11.4 of the Draft Determinations)).
- 7.10 The fundamental point is that two different models are being used by BT to calculate FAC (using Activity Based Costing methodology/model) and DSACs (using its LRIC model outputs) separately, an (in Virgin Media's view inconsistent) approach which does not always produce DSACs that are greater than FAC (see paragraph 11.51 in the Draft Determinations).
- 7.11 Virgin Media endorses Ofcom's point in 11.51, that if BT had derived both FAC and DSAC on the basis of a consistent model you would expect DSACs always to be greater than or equal to FAC.
- 7.12 Virgin Media also supports Ofcom in its conclusion that the one instance in which the DSAC was below FAC (BES 100 MBit/s rental during 2006/7) arose from the "*calculation method not the calculations themselves*" (see Paragraphs 11.58 of the Draft Determinations).

Restated data

- 7.13 Virgin Media can see no inconsistency in Ofcom's position in rejecting these proposals to use revised DSAC data in the years 2006/7, 2007/8, 2008/9 and 2009/10 even though it accepted BT's restated RFSs in the PPC Final Determinations⁷.
- 7.14 The 2006/7 restated data which Ofcom accepted in the original PPC dispute and uses in these Draft Determinations (see 6,15 of the PPC Final Determination) corrected factual errors in volume and revenue information for those services. In contrast, the restated DSACs BT is now proposing are the result of retrospective changes BT wants to make to its underlying DSAC calculation methodology.
- 7.15 It is one thing to correct factual errors in volumes and revenues which, on the basis that they are genuine errors, Virgin Media accepts should be done, but quite another to try to retrospectively introduce a new cost allocation methodology affecting a number of services and not just Ethernet services, and where Ofcom (and BT) have relied on the original data in numerous regulatory decisions, including the setting of

⁷ "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" published 14 October 2009



charge controls and to determine the DSACs used in the Final Determinations and the PPC Judgment.

8. BT'S REVENUES AND COSTS OF PROVIDING THE BES AND WES SERVICES IN DISPUTE

8.1 Virgin Media agrees that it is appropriate to correct for errors and to make the adjustments that Ofcom proposes to make (as set out in paragraphs 12.36 to 12.100 in the Draft Determinations) with the following exception:-

8.1.1 Virgin Media believes that a consistent approach to that used in the PPC Judgment should be applied to holding gains/losses in this dispute (see paragraphs 12.85 to 12.96). This means that the treatment of holding gains/losses should be based upon the "*actual holding gains and losses as reported by BT in its regulatory financial statements*" (see paragraph 12.87 of the Draft Determinations). This approach to the holding gains and losses would also be consistent with the duct valuation reported in BT's 2009/10 RFS (see paragraph 12.94 of the Draft Determinations).

8.1.2 Virgin Media is not able to validate the application of these corrections and adjustments since BT does not publish the underlying LRIC or FAC Cost Accounting models used to generate the RFS.

9. **OFCOM'S ASSESSMENT OF WHETHER BT'S CHARGES WERE COST ORIENTATED**

Virgin Media supports Ofcom's assessment

- 9.1 Virgin Media agrees with Ofcom's assessment of overcharging as set out in Section 13 of the Draft Determinations.
- 9.2 Virgin Media agrees that Ofcom should consider, in assessing whether or not BT has overcharged for the relevant Ethernet services,:
- 9.2.1 the magnitude and duration of the amounts by which BT's Ethernet charges exceeded DSAC;
 - 9.2.2 whether, and the extent to which, charges exceeded FAC; and
 - 9.2.3 the rate of return on capital employed,
- all of which are in line with the PPC Judgment.
- 9.3 In relation to the WES10 Rental services, whilst Ofcom has found DSACs to be exceeded only in relation to one year (2008/09), which is the year in dispute (see 13.55), Virgin Media agrees that Ofcom should conclude that there was nevertheless overcharging in that year by virtue of the magnitude by which BT's charges exceeded DSAC (125%) and since this resulted in a ROCE of 32% in that year.
- 9.4 Duration is just one of the factors which Ofcom has said it will take into account in line with the PPC Judgment. In this instance, the sheer magnitude of the excess should be sufficient to justify a finding of overcharging.
- 9.5 Virgin Media notes that Ofcom is giving BT a further chance to provide evidence that demonstrates that it reasonably expected its charges in 2008/09 to be below unit DSAC. Given the potential impact on Virgin Media if Ofcom decides not to find overcharging for these services in light of any new evidence from BT, Virgin Media would ask for sight of any such evidence and an opportunity to review and comment on it before Ofcom concludes on these Disputes in the Final Determinations.
- 9.6 In any event, BT has already had ample opportunity to demonstrate, in compliance with condition HH3.1, that each and every charge for WES and BES services was cost-orientated. In the context of this investigation alone BT has had since September 2010 to come up with compelling evidence to show that its charges were cost-oriented and that, in relation to any particular services or years in dispute, a finding of overcharging would be inappropriate.
- 9.7 Virgin Media appreciates that Ofcom must, in the interests of procedural fairness, allow BT a further opportunity to explain its Ethernet pricing, but, as in the further PPC disputes currently under investigation, any explanation which BT presents at this



very late stage will be a last ditch attempt to avoid a finding of overcharging and must be viewed in that light. Any truly compelling and likely explanation would have been given a long time ago had it existed.

10. REPAYMENT

- 10.1 Virgin Media supports Ofcom's proposal to require BT to pay to Virgin Media the difference between the amounts paid by it for the various Ethernet services in dispute and the maximum charge under which Ofcom would have considered BT not to have overcharged for those services (DSAC).
- 10.2 However, Virgin Media strongly disagrees with Ofcom's proposal that interest should not be payable.

Detailed comments on repayment

- 10.3 In the context of these Disputes, BT was subject to an SMP obligation requiring it to charge cost oriented prices, which it failed to do, and that SMP obligation was put in place to resolve competition problems in the relevant market.
- 10.4 Requiring BT to make repayments in these Disputes is appropriate in order to provide the correct incentives to BT to comply with its regulatory obligations and to promote competition in the relevant markets.
- 10.5 It is fair as between BT and Virgin Media, reasonable from the point of view of Ofcom's regulatory objectives and consistent with Ofcom's statutory duties, the Community Requirements and the CAT's conclusions in the PPC Judgment (see 14.27).
- 10.6 Virgin Media also agrees with the methodology used to derive the amounts set out in Table 14.3. This has the advantage that it starts from BT's audited RFS and allows a consistent approach to repayments across the Disputing CPs.
- 10.7 Virgin Media would reiterate that the CAT made it clear in the PPC Judgment that the exercise by Ofcom of its discretion under section 190(2)(d) of the Communications Act 2003 to order repayment was not dependent on proof of loss or economic harm⁸.

Detailed comments on interest

- 10.8 It is neither appropriate nor consistent with Ofcom's duties for Ofcom to determine the award of interest by reference to the *Backhaul and Wholesale Extension Services* contract whose terms were effectively imposed on Virgin Media and the other Disputing CPs by BT and are heavily weighted in BT's favour. At present, Openreach has the right to levy interest charges on late payments, but there is no corresponding right to interest on overpayments made to Openreach.
- 10.9 Clause 12.3 dealing with interest on repayments ordered by Ofcom was not individually negotiated at the time the agreement was first entered into, simply

⁸ Paragraph 338(4) of the PPC Judgment.

because BT and the CPs ran out of time – and CPs therefore had no choice but to sign the agreement. It has been disputed by the CPs ever since⁹.

- 10.10 In any event, as the CAT recently confirmed¹⁰, Ofcom's power to award interest is neither ousted nor limited by what the parties may have agreed between themselves contractually (or in this case been forced to accept).
- 10.11 Ofcom would be failing in its Section 3 duties if it simply let the contractual situation dictate whether interest is payable and did not carry out a proper assessment of what is fair as between the parties and reasonable from the point of view of Ofcom's regulatory objectives.
- 10.12 Moreover, unquestioningly following the relevant contractual terms in any given dispute leads to inconsistency in the determination of these kinds of dispute, which runs entirely contrary to the principles with which Ofcom's regulatory activity should be consistent¹¹.
- 10.13 In the PPC Final Determinations and Draft Determinations, for example, interest was awarded on the basis that the PPC Handover Agreement did happen to allow for interest to be payable where charges are adjusted pursuant to an Ofcom direction.
- 10.14 In circumstances where these standard industry contracts are effectively imposed by BT on wholesale customers and their terms are for the most part not individually negotiated, Ofcom should disregard them and consider instead what would be fair as between the parties and reasonable from the point of view of Ofcom's regulatory objectives.
- 10.15 Approaching the exercise of its discretion in this way, it would be clear to Ofcom under that assessment that it would be neither fair as between the parties nor reasonable from the point of view of Ofcom's regulatory objectives if BT was allowed

⁹ The *Backhaul and Wholesale Extension Services* contract was negotiated in 2004 under considerable time pressure in order to allow migration from unregulated LAN Extension Services (LES) to the regulated wholesale product, Wholesale Ethernet Services (WES), within 60 working days of Ofcom's direction that BT must provide a wholesale product⁹. Under the direction, CPs could nominate their existing LES purchases for WES and a paper migration would occur, reclassifying them to WES.

During that brief negotiation, there were more pressing and immediate contract issues that CPs and BT were focusing on and the Ofcom interest clause was not seen as a priority for CPs as the product was new and the relevance of the interest clause was negligible at that time. BT also promised that it would renegotiate the contract to deal with such clauses after launch.

CPs raised concerns about the clause at the subsequent review, but with so many other material issues to resolve it was not taken further. The creation of Openreach in 2006 pushed back the review as Openreach took over the running of the product. Subsequent reviews achieved very little. The Ofcom interest clause issue was raised again in the 2008 review but again was not actively pursued, giving way to more practical/immediate concerns.

As BT's position was by then entrenched, the only way to overturn the clause would have been via a dispute referral. Given the costs involved in doing this and the limited resources available to CPs and indeed to Ofcom the matter was not pursued.

¹⁰ *BT (Termination charges: 080 calls) v OFCOM* [2011] CAT 24 at paragraph 241.

¹¹ Section 3(a) of the Communications Act 2003.

to benefit substantially from failing to comply with its SMP obligations. Fairness (and the PPC Judgment at paragraph 338(2)) dictates that Virgin Media should be put in the position in which it would have been had BT complied with its SMP obligations from the outset, and this requires that BT should have to pay interest on the amounts it has overcharged.

- 10.16 There would be a fundamental dilution of BT's incentive to comply with its regulatory obligations in future if it is not to be required to account for interest in the context of these Disputes and in any future disputes where the relevant contractual terms which it has imposed on its customers happen to be in its favour.
- 10.17 For all the above reasons, Virgin Media therefore strongly urges Ofcom to reconsider its provisional decision not to award interest.