



Dispute about per-customer line transaction charges for Carrier Pre-Selection

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Further statement

Publication date:

6 July 2009

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Section 1

Summary

- 1.1 Carrier Pre-Selection (CPS) is a mechanism that allows consumers who have a BT line to select, in advance, alternative communications providers to carry some or all of their telephone calls without having to dial a prefix.
- 1.2 This dispute is about the charge that British Telecommunications plc (BT) makes to CPS operators (CPSOs) when it applies CPS to a line (except where CPS is provided in combination with Wholesale Line Rental (WLR), when a different charge applies). This charge is listed in BT's Carrier Price List as "Set-Up – Switch change effected" and referred to in this document as the "CPS set-up charge".¹
- 1.3 Ofcom has determined that BT has significant market power (SMP) in various narrowband wholesale markets and imposed a number of SMP conditions on BT including a requirement to provide CPS under SMP Condition AA8.² This SMP condition, among other things, entitles BT to recover from other communications providers the reasonable costs it incurs in providing CPS.
- 1.4 On 1 November 2007, BT announced new charges for various CPS and WLR transactions including the CPS set-up charge.
- 1.5 On 23 September 2008 Cable & Wireless (C&W), on behalf of itself, THUS plc (THUS), Gamma Telecom Ltd (Gamma) and Opal Telecom Ltd (Opal), together "the CPSOs", referred a dispute between the CPSOs and BT to Ofcom for resolution.
- 1.6 C&W argued that the CPS set-up charge was, and had been, set at a level that enabled BT to recover certain retail costs. C&W argued that BT is not entitled to recover its retail costs from CPSOs and asked Ofcom:
 - to determine the proper amount of the CPS set-up charge from 28 November 2003 to the date of the determination of this dispute;
 - to determine the proper amount of the CPS set-up charge going forward; and
 - to require BT to make any necessary repayments to the CPSOs in dispute.
- 1.7 The scope of this dispute, as published on Ofcom's website, has been to determine:
 - i) whether it is appropriate for BT to recover through the CPS set-up charge the costs it incurs in sending the notification of transfer letter and handling the resulting inbound customer calls (referred to in this document as "the disputed costs"); and, if not,

¹ The section of the BT Carrier Price list that includes the CPS set-up charge is published at: http://www.btwholesale.com/pages/downloads/service_and_support/pricing_information/carrier_price_list_browsable/b7_01.rtf

² See *Review of the fixed narrowband wholesale exchange line, call origination, conveyance and transit markets*, 28 November 2003 (referred to in this document as "the Market Review"). Note that prior to 29 December 2003, the Director General of Telecommunications ("the Director") exercised the powers under the 2003 Act. Therefore, any reference in this draft determination and explanatory statement to Ofcom exercising powers prior to this date should be read as meaning they were exercised by the Director. Also, any references to the Director in the SMP conditions should be read as references to Ofcom.

- ii) the amount by which the CPS set-up charge should be reduced to remove the recovery of the costs BT incurs in sending the notification of transfer letter and handling the resulting inbound customer calls; and
 - iii) the date from which Ofcom's determination of points (i) and (ii) above should apply.³
- 1.8 On 13 February 2009, after consulting on its 30 December 2008 draft determination ("the Draft Determination") Ofcom made a determination ("the Determination")⁴ that BT is not entitled to recover the costs associated with sending the notification of transfer letter and handling the resulting inbound customer calls through the CPS set-up charge and is required to reduce the CPS set-up charge by 78p.
- 1.9 On 20 February 2009, following the Determination, BT notified the industry of a new CPS set-up charge of £1.69, implementing the Determination, with effect from 16 February 2009.⁵
- 1.10 In the explanatory statement accompanying the Determination, Ofcom invited further submissions from all parties on issue (iii), the date from which Ofcom's determination of points (i) and (ii) above should apply (referred to in this document as "the Timing Consultation"). In the Timing Consultation, Ofcom proposed to conclude that its determination of the dispute would be forward-looking only based on a consideration of stakeholders' responses and an analysis of relevant statements made by Ofcom on whether the disputed costs should be removed.
- 1.11 In summary, Ofcom's position is that SMP Condition AA8.4, imposed on 28 November 2003, defines what BT, as the dominant provider, has to do to ensure that its charges for CPS are cost oriented. The specific requirement in SMP Condition AA8.4 is that the charges for CPS shall be based on the long-run incremental costs of providing CPS facilities. As we found in the Determination, the disputed costs are not costs of providing CPS facilities, and BT is not therefore entitled to recover the disputed costs from CPSOs.
- 1.12 BT has a duty to ensure its compliance with its SMP conditions, including SMP Condition AA8.4.
- 1.13 In this case, Ofcom has examined whether it was reasonable for BT to include the disputed costs in the charges for CPS under SMP condition AA8 in the light of its own compliance monitoring and guidance from Ofcom. When looking at the facts of this particular case, Ofcom believes for the following reasons, that it was reasonable for BT to include the disputed costs in the charges for CPS under SMP Condition AA8 up and until the Determination which stated that the disputed costs are not costs of providing CPS facilities, and BT is not therefore entitled to recover the disputed costs from CPSOs.
- 1.14 When SMP Condition AA8 was introduced in 2003, BT took the view that in complying with SMP Condition AA8 it was reasonable to include the disputed costs in the cost stack for CPS.

³ http://www.ofcom.org.uk/bulletins/comp_bull_index/comp_bull_ocases/open_all/cw_999/

⁴ *Dispute about per-customer line transaction charges for Carrier Pre-Selection*, 13 February 2009, published at: http://www.ofcom.org.uk/consult/condocs/deter_repayment/dispute130209.pdf

⁵ http://www.btwholesale.com/pages/downloads/service_and_support/interconnect_pricing/nccn/nccn_601_650/accn_928.rtf

- 1.15 On 18 August 2005, Ofcom set BT's charges for CPS in a direction entitled *Per-provider and per customer line costs and charges for Carrier Pre-selection* ("the August 2005 Direction").⁶ The disputed costs were included in the cost stack that Ofcom used to set the charges. The August 2005 Direction was binding on BT and had ongoing effect.
- 1.16 Some respondents to the consultation issued prior to the final August 2005 Direction, expressed concern about the cost basis of some of BT's CPS charges – in particular, the fact that BT appeared to be recovering some of its retail costs, namely "postage costs for losing letters and related inbound call costs". In the August 2005 Direction, Ofcom stated that it was appropriate for it to consider stakeholders' concerns in relation to the disputed costs and that Ofcom would examine this in a planned 2006 review of CPS charges, which would have been in consultation with all stakeholders (including the parties to this dispute). Ofcom did not, in the August 2005 Direction, provide further specific guidance as to how it would interpret SMP Condition AA8 in relation to the recovery of the disputed costs.
- 1.17 Ofcom did not carry out its planned 2006 review of CPS charges.
- 1.18 In January 2006, Ofcom published a statement setting charge ceilings for a number of WLR services.⁷ The cost stack that Ofcom used for this exercise expressly did not include "sales and marketing costs" (which would have included costs analogous to the disputed costs in this case).⁸ However, Ofcom made no reference to CPS in that statement, and did not state that BT should similarly remove the equivalent costs from the CPS cost stack. The August 2005 Direction therefore remained unchanged and continued to be binding on BT.
- 1.19 In May 2006 Ofcom considered and resolved a separate dispute about repayments in relation to CPS charges (the "Opal dispute"). In that dispute determination, Ofcom required BT to make repayments by way of an adjustment for the overpayment of certain other CPS charges. The level of CPS charges which Ofcom set as a result of that determination continued to enable BT to recover the disputed costs (in line with the August 2005 Direction).⁹
- 1.20 Ofcom did not therefore, prior to the Draft Determination, indicate that (contrary to the August 2005 Direction) it was no longer reasonable for BT to include the disputed costs in the CPS cost stack or that these costs were not costs of providing CPS facilities under SMP Condition AA8.
- 1.21 Ofcom has a duty to resolve certain disputes. When Ofcom decides that it is appropriate for it to handle a dispute, it must consider the dispute and make a determination resolving it. The Determination of 13 February was made in line with this duty.
- 1.22 Ofcom's powers in resolving disputes are set out at section 190 of the 2003 Act. Ofcom has a discretion to use these powers to resolve disputes in a way that supports its statutory duties and regulatory obligations.

⁶ *Per-provider and per customer line costs and charges for Carrier Pre-selection* ("the August 2005 Direction"), 18 August 2005, published at <http://www.ofcom.org.uk/consult/condocs/carrier/statement>.

⁷ *Reviewing and setting the charge ceilings for WLR services*, 24 January 2006 ("the WLR Statement") <http://www.ofcom.org.uk/consult/condocs/wlrcharge/statement/statement.pdf>

⁸ Paragraph 3.64 of the WLR Statement.

⁹ *Determination to resolve a dispute regarding the retrospective application of CPS charges* ("the Opal dispute"), 16 May 2006, published at: http://www.ofcom.org.uk/consult/condocs/cps_charges/determination.pdf

- 1.23 The CPSOs have argued that since 2003, BT has failed to comply with SMP Condition AA8, by recovering the disputed costs through the CPS set-up charge. They further consider that Ofcom should require BT to reimburse CPSOs for the amounts which they claim BT has overcharged since 2003. BT contests that position.
- 1.24 In the Timing Consultation, we gave stakeholders the opportunity to comment on Ofcom's view on the date from which Ofcom's determination of the first two points at issue in this dispute should apply. Ofcom received five responses. None of the respondents has submitted anything that suggests to us that what BT did, prior to this dispute, to comply with SMP Condition AA8 was unreasonable.
- 1.25 On the facts of this dispute, Ofcom has concluded that it was reasonable for BT to include the disputed costs in its cost stack for CPS charges under SMP Condition AA8 from November 2003 to 13 February 2009, when Ofcom determined that those costs should no longer be included for the purposes of that condition. Ofcom does not therefore need to go on to consider whether it would be appropriate to require BT to make any repayments to CPSOs as a result of Ofcom's determination of the first two issues in this dispute.
- 1.26 The CPSOs' responses concerning repayments would only be relevant to our decision if we had found that it had not been reasonable for BT to include the disputed costs in its CPS cost stack at any time prior to the date of the Determination, such that BT had at some point since 2003 overcharged the CPSOs for the provision of CPS services. As a result of our conclusion at paragraph 1.25 above, there is no need for Ofcom to consider the issue of repayments. However, as the parties have made extensive submissions on this issue, we have for completeness addressed those submissions in full in this document.
- 1.27 Ofcom considers that, for the reasons set out at paragraphs 4.85-4.102 below, its decision not to require BT to make repayments is consistent with its statutory duties and regulatory obligations, in particular its principal duty to further the interests of consumers in relevant markets, where appropriate by protecting competition. As noted above, Ofcom does not consider that it would be fair as between the parties to the dispute to order BT to make repayments to the CPSOs from a date at which it could not have known what view Ofcom would take on the recovery of the disputed costs.
- 1.28 This statement addresses stakeholders' comments on the Timing Consultation and sets out Ofcom's conclusions on this element of the dispute. The background to Ofcom's consideration of the date for repayments is set out at section 2. Stakeholders' responses to the Timing Consultation are summarised at section 3. Ofcom's responses to stakeholders' comments and conclusion are set out at section 4.

Section 2

Background and arguments of the parties

- 2.1 This dispute is about the charge BT makes to CPSOs when it applies CPS to a line (except where CPS is provided in combination with WLR, when a different charge applies). This charge is listed in BT's Carrier Price List as "Set-Up – Switch change effected" and referred to in this decision as the "CPS set-up charge".¹⁰
- 2.2 CPS is a mechanism that allows consumers who have a BT line to select, in advance, alternative communications providers to carry some or all of their calls without having to dial a prefix.¹¹
- 2.3 The scope of this dispute, as published on Ofcom's website, has been to determine:
- i) whether it is appropriate for BT to recover through the CPS set-up charge the costs it incurs in sending the notification of transfer letter and handling the resulting inbound customer calls (referred to in this document as "the disputed costs"); and, if not,
 - ii) the amount by which the CPS set-up charge should be reduced to remove the recovery of the costs BT incurs in sending the notification of transfer letter and handling the resulting inbound customer calls; and
 - iii) the date from which Ofcom's determination of points (i) and (ii) above should apply.¹²
- 2.4 Ofcom has determined that BT has significant market power (SMP) in various narrowband wholesale markets and imposed a number of SMP conditions on BT including a requirement to provide CPS under SMP Condition AA8.¹³ This SMP condition, among other things, requires BT to provide CPS and entitles BT to recover from other communications providers the reasonable costs it incurs in providing CPS facilities.
- 2.5 Since the introduction of CPS in 2000, BT has included the disputed costs within the CPS set-up charge as it believed it was entitled to do so in compliance with its SMP obligations.
- 2.6 C&W argued in its submission that BT is not entitled to recover the disputed costs from CPSOs and has not been compliant with its SMP obligations for the following reasons:
- a) The disputed costs are not part of the cost of providing CPS facilities;
 - b) the disputed costs are anomalous compared with those for other BT transferable products;

¹⁰ See footnote 1 above.

¹² http://www.ofcom.org.uk/bulletins/comp_bull_index/comp_bull_ocases/open_all/cw_999/

¹³ See *Review of the fixed narrowband wholesale exchange line, call origination, conveyance and transit markets*, 28 November 2003. Note that prior to 29 December 2003, the Director General of Telecommunications ("the Director") exercised the powers under the 2003 Act.

- c) the disputed costs put CPS providers at an unfair competitive disadvantage relative to BT;
 - d) the disputed costs are levied on transactions where they are not incurred;
 - e) BT is the main beneficiary from the inbound calls;
 - f) the charges do not provide an effective or fair disincentive to mis-selling; and
 - g) the recovery of the disputed costs by BT is contrary to Ofcom's cost recovery principles.
- 2.7 On 13 February 2009, Ofcom made a determination ("the Determination") in relation to the first two elements of the matters falling within the scope of the dispute, as set out above at paragraph 2.3 (i) and (ii). Ofcom concluded that BT is not entitled to recover the disputed costs and is required to reduce the CPS set-up charge by 78p.
- 2.8 On 20 February 2009, following the Determination, BT notified the industry of a new CPS set-up charge of £1.69, implementing the Determination, with effect from 16 February 2009.¹⁴
- 2.9 Ofcom did not come to a final decision in the Determination on the third of the issues in dispute (as set out at paragraph 2.3 (iii) above), namely the date for any repayments. In the Timing Consultation (published alongside the Determination), Ofcom proposed to conclude that its determination of the dispute would be forward looking only. This was based on consideration by Ofcom of stakeholders' responses to a draft determination ("the Draft Determination") published on 6 January 2009 (in which Ofcom had provisionally proposed to require BT to make repayments for the disputes costs from 1 November 2007), and a further analysis of relevant public statements made by Ofcom on whether the disputed costs should be removed.
- 2.10 Ofcom received five responses to its Timing Consultation of 13 February 2009. It now therefore has to consider, in light of those responses and its statutory duties, from what date its determination on the first two issues in dispute should apply, and therefore whether it is fair and reasonable as between the parties to the dispute to require BT to make any repayments to CPSOs.

Arguments on the repayment date: C&W's submission

- 2.11 C&W's submission of 23 September 2008 set out a number of arguments for C&W's request to Ofcom to determine the appropriate CPS set-up charge from 28 November 2003 to date.¹⁵
- 2.12 C&W noted that Section 190(d) of the 2003 Act gives Ofcom specific powers to direct the repayment of overpayments in resolving disputes.
- 2.13 C&W argued that it would be fair as between the parties to the dispute, and reasonable from the point of view of the regulatory Framework objectives, for Ofcom

¹⁴ http://www.btwholesale.com/pages/downloads/service_and_support/interconnect_pricing/nccn/nccn_601_650/accn_928.rtf

¹⁵ Paragraph 2.56 of C&W's submission.

to require BT to reimburse the CPSOs in dispute for any adjustment in the CPS set-up charge from 28 November 2003.¹⁶

2.14 C&W argued that requiring BT to make payments to CPSOs for overpayments since 28 November 2003 would:

- a) promote competition in the provision of retail fixed line telephone calls (in line with Ofcom's duty set out in section 4(3)(a) of the 2003 Act;
- b) promote competition in the provision of electronic communications services; and
- c) encourage the provision of network access and service interoperability (in line with sections 4(7) and 4(8)(a) of the 2003 Act).

2.15 C&W noted, referring to two recent disputes, that:

“There is also precedent for Ofcom ordering reimbursement where BT's charges have not been cost-oriented.”¹⁷

2.16 C&W noted that Ofcom argued in its resolution of the 2006 WLR ISDN2 charges dispute that requiring BT to repay overpayments, in that case, encouraged BT to comply with SMP obligations imposed under the Market Review to promote competition.

2.17 C&W submitted that given the representations made by stakeholders at the time of Ofcom's August 2005 Direction and Ofcom's commitment to consider this issue in the review of charges originally planned for 2006:

“it would be unreasonable for BT to claim to have any expectation that a retrospective adjustment would not at some point be made to rectify its overcharging and to reimburse CPS customers.”¹⁸

2.18 C&W noted that “CPSOs met with Ofcom during the review [that led to the August 2005 Direction] and both during those meetings and in written submissions challenged the inclusion of BT Retail costs in the cost stack.”¹⁹

2.19 C&W stated that it did not challenge Ofcom's decision not to address the issue of retail cost recovery in the August 2005 Direction “given Ofcom's commitment to address the issue via its proposed 2006 review of CPS charges”.

2.20 C&W asked Ofcom to order BT to pay interest on any repayments to CPSOs.²⁰

Arguments on the repayment date: BT's comments on C&W's submission

2.21 In its initial comments on C&W's submission, BT argued that Ofcom should consider the CPS set-up charge from 1 November 2007 only:

¹⁶ This reference is taken from paragraph 178 of the CAT's TRD core issues judgment which states that “Ofcom must have regard to what is fair as between the parties and what is reasonable from the point of view of the regulatory objectives set out in the Common Regulatory Framework Directives and in the 2003 Act.” See section 5 below.

¹⁷ Paragraph 2.62 of C&W's submission.

¹⁸ Paragraph 2.61 of C&W's submission.

¹⁹ Paragraph 2.17 of C&W's submission.

²⁰ Paragraph 2.56 of C&W's submission and letter from Claire Robinson (C&W) to Louise Marriage (Ofcom), 23 October 2008.

“BT [...] does not agree that the scope of the dispute should cover the recovery of the costs related to sending out a [notification] of transfer letter and to inbound customer calls from 28 November 2003. The CPS per-customer line transaction charges, together with the other CPS charges, were set by Ofcom in August 2005 by means of [the 2005 statement] following an extensive review. Having set those charges as of the date of publication of the Determination, Ofcom deferred future consideration of the charges for a further review in 2006. This review never happened, so the CPS per customer line transaction charges remained effective as set by Ofcom in its [August 2005 Direction]. No CPS Operator questioned this decision, or exercised their right to raise an appeal against the charges set by Ofcom. As such the prices set by Ofcom were legally binding until BT carried out a review in 2007. The revised charges for CPS transactions became effective on 1 November 2007. It was after this date that discussions between the named parties and BT began. As a result it is only from this date that CPS charges can be subject to an investigation of the type requested by the CPSOs in dispute. Therefore the scope of the dispute should only examine whether BT’s CPS transaction charges effective from 1 November 2007 onwards should cover these two cost components.”²¹

2.22 BT went on to note that:

“the fact that by means of further regulatory intervention the August 2005 charges became applicable as of an earlier date does not have any bearing on whether the complainants or Ofcom can lawfully open an investigation into the August 2005 charges today.”²²

2.23 Ofcom asked BT to set out in more detail its position as set out in paragraphs 2.21-2.22 above, notably its statement (see paragraph 2.21 above) that the charges set by Ofcom were legally binding until BT’s review. BT set out its position as requested in its letter to Ofcom of 20 November 2008. Referring to the Competition Appeal Tribunal Rules, BT concluded that:

“a decision that has not been appealed, cannot subsequently be reversed by either the parties or Ofcom in relation to the period, the parties and the matter it has decided upon...

“No-one appealed the [August 2005 Direction] and as a result the [August 2005 Direction] binds the parties and Ofcom for the period and on the matter it has decided upon.”²³

2.24 BT went on to note Ofcom’s statement in the statement accompanying the August 2005 Direction that it intended to review charges again in 2006, and argued that setting charges in the context of such a review could be forward looking only:

“Ofcom said that the reason for [its decision not to address the retail cost recovery issue in 2005] was that it found more appropriate to consider the inclusion of these costs only in the future as part of a Market Review, which is by virtue of the Act forward looking only,

²¹ Letter from BT to Ofcom 2 November 2008.

²² *Ibid.*

²³ Letter from BT to Ofcom, 20 November 2008.

and not as part of the dispute resolution at hand that looked into the past.”²⁴

The Draft Determination: Ofcom’s proposals on the repayment date

- 2.25 Having assessed the submissions of the parties and the evidence it gathered in considering the dispute, Ofcom’s provisional conclusion on the date from which its determination on the first two issues in dispute should apply and the issue of repayments was that its determination of the first two issues in dispute should apply from 1 November 2007 and that it would be proportionate and reasonable as between the parties to require BT to pay to the CPSOs a sum by way of an adjustment for the overpayment of the CPS set-up charge from 1 November 2007 to the date of Ofcom’s final determination, to include interest at standard contract rates.
- 2.26 On 30 December 2008 Ofcom issued to each of the parties in dispute and to a party that asked to be considered as an interested party a non-confidential version of the Draft Determination.
- 2.27 On 6 January 2009 Ofcom published the Draft Determination on its website.²⁵ Ofcom asked for comments from all stakeholders by close of business on 16 January 2009. Ofcom received six responses.

Responses to the Draft Determination: BT’s comments on the repayment date

- 2.28 BT stated that it “has been recovering these costs in good faith” and that:

“BT had no reason to foresee Ofcom’s present decision and we therefore disagree that Ofcom’s reasoning on regulatory certainty is persuasive for the period from 28 November 2003 to 31 October 2007 but it is less persuasive for the period from 1 November 2007 to the publication date of this determination”.

The August 2005 Direction

- 2.29 BT suggested that:

“we do not agree that Ofcom’s statement in the August 2005 Direction that it would review the issue of retail cost-recovery should have signalled to BT that the outcome of this review would not favour the inclusion of the disputed costs”.

- 2.30 BT stated that:

“If a further review of the CPS costs had indeed taken place in 2006 as Ofcom planned, then there was no indication in the 2005 Direction as to which way the decision would have been made”

- 2.31 In response to Ofcom’s comment (see paragraph 5.98 of the Draft Determination) that in light of stakeholders’ responses to the consultation that led to the August 2005 Direction, BT should have reconsidered the assumptions used when it came to review its charges in 2008, BT stated that:

²⁴ Letter from BT to Ofcom, 20 November 2008.

²⁵ http://www.ofcom.org.uk/bulletins/comp_bull_index/comp_bull_ocases/open_all/cw_999/.

“Whilst we always consider customers’ feedback, [...] we firmly believe the charges were to be valid, so there was no reason to change this opinion when reviewing the costs in 2007”.

- 2.32 BT noted that “Ofcom acknowledges [...] that the issue of retail cost recovery was not discussed by CPSOs and BT between August 2005 and early 2008, so it was hardly a burning issue with industry. This reinforces in our mind that the stakeholders’ responses in August 2005 should not be relied upon to justify a direction to BT to make refund payments since November 2007.”

The WLR Statement

- 2.33 BT stated that:

“In fact Ofcom said in the WLR January 2006 decision that it had removed sales and marketing costs from the WLR costs stack. The disputed CPS costs are not related to sales and marketing activities”.

- 2.34 BT concluded that it “had no reason to interpret the WLR January 2006 decision as a signal that Ofcom took a particular view on the recovery of the retail costs”.

Responses to the Draft Determination: the CPSOs’ comments

- 2.35 C&W questioned Ofcom’s statement at paragraph 5.88 of the Draft Determination that:

“Ofcom has not identified any specific ‘step change’ in the market on or since 28 November 2003 [...] which would have necessitated or justified a change in cost recovery arrangements.”

- 2.36 C&W argued that:

“there are at least three points between (and including) 28 November 2003 which could be considered ‘step changes’ to the same or greater extent that 1 November 2007 can be considered such a change:

- 28 November 2003: date from which revised CPS charges, as determined by Ofcom’s August 2005 review, were applied
- 26 May 2005: Application of GC14.5
- 18 August 2005: Ofcom Direction on CPS charges”

28 November 2003

- 2.37 C&W considered that 28 November 2003 is the “most relevant” of the dates it proposes as “step changes” in the market. C&W noted that Ofcom’s August 2005 Direction was “at least as significant a change as the price changes that came into effect on 1 November 2003” and that Ofcom subsequently required BT to apply the changes set in the August 2005 Direction to 28 November 2003. C&W concluded that “as such, this must be the logical date from which Ofcom’s current determination is applied”.

2.38 Another respondent argued that 23 November 2003 has always been “the rather logical focal point in the negotiations between CPSOs and BT” as it is the date on which Ofcom introduced the SMP conditions on BT as a result of the Market Review.

2.39 UKCTA considered that:

“as Ofcom (through the dispute [...] brought by Opal) required BT to backdate the CPS charges set out in the August 2005 Direction to 28 November 2003, it must be a fair and reasonable outcome to backdate the revised CPS set-up charge in this dispute to the same date”.

2.40 Another respondent suggested that “Using the same logic as in [the Opal determination], if one strips out the retail costs from the CPS cost stack, the break-even date would also be 28 November 2003”.

2.41 C&W questioned Ofcom’s suggestion²⁶ that “had it considered the issue of retail costs at the time of the August 2005 review, it may have reached a different conclusion”, on the basis that “all the reasons that justify why BT is not entitled to recover these costs were as true in 2005 as they are today.” C&W also suggests that:

“it is reasonable to assume therefore that had Ofcom considered the issue of retail costs at that time [2005] and concluded that BT was not entitled to recover these costs, CPSOs would have benefited from repayment back to 28 November 2003 without recourse to a (further) formal dispute”.

25 May 2005

2.42 C&W noted that the introduction of GC14.5 (on 25 May 2005) might also be considered a step change, as it placed all providers of retail telecommunications services to consumers on the same footing. C&W states however that it considers the arguments for 28 November 2003 to be “more persuasive” than those for the date that GC14.5 was introduced.

Developments following the August 2005 Direction

2.43 C&W stated that CPSOs “believed their concerns would be addressed without the need to challenge the [August 2005] Direction”, as a result of Ofcom’s statement that it would undertake a further review of CPS charges in 2006.

2.44 C&W stated that “It is inappropriate for Ofcom to infer that the lack of any challenge by CPSOs [in 2005] suggest an acceptance of the status quo”. Verizon Business made a similar comment that “This does not mean that the CPSOs accepted the practice of retail recovery by BT, just that the anticipated mechanism to address the issue never materialised”.

2.45 UKCTA considered that the fact no-one challenged the 2005 Direction is “irrelevant” since BT is still required to comply with its regulatory obligations. Global Crossing states that the absence of any challenge to the August 2005 Direction (particularly since Ofcom did not go ahead with its planned 2006 review) was “not in our view sufficient reason to determine that a date of November 2007 would be reasonable”.

²⁶ See for example paragraph 5.91 of the Draft Determination.

2.46 Another respondent argued that it should be obvious to Ofcom that the reason the 2005 Direction was not challenged was because Ofcom had committed to carry out a review of CPS charges (and specifically to address the issue of retail cost recovery) in 2006.

2.47 C&W stated that:

“it is not clear that Ofcom ever formally advised industry that it was not going to conduct a further review of CPS charges, making it difficult for CPSOs to challenge this change in 'administrative priorities'.”

2.48 C&W stated that “further discussion with BT would have been inappropriate” in light of Ofcom’s assurance that the issue would be dealt with as part of the review originally planned for 2006.

2.49 C&W stated that BT’s indication to CPSOs in the summer of 2007 that it was going to conduct its own review “again left CPSOs in limbo on the issue of challenging the charges”. Another respondent states that, after the 2005 Direction, the next opportunity for CPSOs to raise the issue was BT’s introduction of new charges from 1 November 2007.

1 November 2007

2.50 C&W questioned Ofcom’s statement at paragraph 5.92 of the Draft Determination that:

“Given that Ofcom set the CPS charges in its 2005 Direction, Ofcom considers that it was reasonable for BT to continue to recover retail costs, subject always to its ongoing obligation to comply with its SMP Conditions.

2.51 C&W considered that Ofcom’s statements elsewhere in the Draft Determination contradict this statement:

- paragraph 5.92, where Ofcom states that BT was not entitled to assume that the charges set in 2005 would apply until Ofcom made a further Direction
- paragraph 5.96, where Ofcom states that BT could not assume that the 2006 review, had it taken place, would have determined that BT was entitled to recover the retail costs;
- paragraph 5.98, where Ofcom states that in light of clear signals that the issue of cost recovery would be addressed at some point, BT should have taken this into account in setting new charges; and
- paragraph 5.101, where Ofcom notes that, contrary to statements made by BT, the 2005 Direction did not expressly state that it was reasonable for BT to recover the retail costs.

Effect of Ofcom’s proposal to require repayments to 1 November 2007

2.52 C&W questioned Ofcom’s proposal:

“that BT can retain this significant over-recovery for four of the five years in dispute, on the basis of ‘what is fair and reasonable as between the parties’.”

2.53 Verizon Business echoed these comments, stating that:

“As Ofcom have determined that BT is not entitled to recover the referenced costs, then surely the over recovery should be repaid in full”.

2.54 C&W considered that Ofcom’s proposed determination would “[send] clear signals to BT that it is acceptable – and indeed, commercially prudent – as the likelihood is that they will get to ‘keep the cash’”. This view is echoed by another respondent, who considers that Ofcom’s proposed determination “in effect allows BT to “keep the proceeds of the crime” – hardly any incentive to discourage them in future”, and that:

“by failing to require BT to remedy the consequences of its breach Ofcom would leave CPS operators to bear the financial loss of BT’s illegal actions and effectively set a future policy which says it is acceptable to breach regulatory obligations unless or until challenged.”

2.55 C&W did not accept that requiring BT to make repayments from 1 November 2007 is in line with Ofcom’s statutory objectives, which “can only be met if any non-compliance issue is rectified in full”.

2.56 UKCTA and Verizon Business make similar comments, Verizon Business suggesting that:

“..surely Ofcom’s prime duty is to uphold the regulatory framework and ensure compliance is maintained by all operators; this to promote competition and benefit consumers. If the draft decision stands, then Ofcom will have undermined the regulatory certainty they strive to create, which can only have a detrimental effect on competition and ultimately consumers.”

2.57 UKCTA stated that, by contrast, requiring BT to make repayments from 28 November 2003 “would provide a strong incentive on BT to actively seek to comply with its regulatory obligations at all times. Unlike Ofcom’s proposal, such an outcome would thereby promote effective competition in this market”. Global Crossing states that it fully supports UKCTA’s submission on this point and states that it considers the “most equitable” outcome would be “one which restored in full the financial equilibrium since the date of the breach”.

2.58 C&W considered that contrary to Ofcom’s statement that its draft determination promotes regulatory certainty (paragraph 5.92 of the Draft Determination), “allowing BT to ignore its SMP obligations creates massive uncertainty for the rest of industry”.

Ofcom's analysis and proposed determination on the repayment date

- 2.59 In the Timing Consultation, Ofcom responded to the comments made by stakeholders in their responses to the Draft Determination on the issue of the date from which its determination should apply, and the question of repayments (if any) as follows²⁷.
- 2.60 Ofcom highlighted that in the Draft Determination, it had considered a number of possible dates and proposed that BT should be required to make repayments from 1 November 2007.
- 2.61 Ofcom noted that:
- a) BT had argued that Ofcom's position on recovery of the retail costs had not been made clear to it or to industry previously;
 - b) C&W had argued that it should always have been clear to BT that it was not entitled to recover retail costs through the CPS set-up charge. C&W had not identified any clear statement by Ofcom (to BT or industry) on this matter. Rather, it recognised, as does Ofcom, that Ofcom had proposed to carry out a review of CPS charges that would address the issue of the retail costs. Ofcom did not carry out its planned review, as a result of an internal review of its administrative priorities.
- 2.62 In light of stakeholders' responses to the Draft Determination and previous Ofcom statements relevant to recovery of the retail costs, Ofcom proposed that its determination of the dispute would apply on a forward-looking basis only.
- 2.63 Ofcom set out its reasoning for this proposal at paragraphs 7.33--7.42 of the Timing Consultation which are repeated at paragraphs 2.64-2.73 below:
- 2.64 BT is subject to SMP Condition AA8 (which implements the requirements of the Universal Service Directive, specifically, the requirement that pricing for the provision of CPS is cost oriented).
- 2.65 SMP Condition AA8.4 defines what BT, as the dominant provider, has to do to ensure that its charges for CPS are cost oriented. The specific requirement in SMP Condition AA8.4 is that the charges for CPS shall be based on the long-run incremental costs of providing CPS facilities.
- 2.66 The first element of this dispute was to determine whether it was appropriate for BT to recover the retail costs. While Ofcom's analysis of this point drew on the provisions in SMP Condition AA8, it was not necessary, in reaching a view, to establish whether or not the retail costs were reflective of BT's long run incremental cost – Ofcom's focus in resolving the first element of this dispute was on whether the disputed costs constituted a cost of providing CPS facilities (such that they should be included in the CPS cost stack).
- 2.67 In considering the date from which the CPS charge should be reduced (having found that the disputed costs were not costs of providing CPS facilities), Ofcom examined at what point BT could reasonably be expected to know that the retail costs in its cost stack were not costs of providing CPS facilities.

²⁷ The text that follows is taken directly from the Timing Consultation and references are to paragraphs and tables in the Timing Consultation not this document.

- 2.68 When SMP Condition AA8 was introduced in 2003, Ofcom did not give any guidance (in the Market Review) as to how it would interpret SMP Condition AA8 in relation to the recovery of the retail costs. It is therefore Ofcom's view that, at this time, BT could not reasonably be expected to know that the retail costs were not costs of providing CPS facilities under SMP Condition AA8.
- 2.69 In the August 2005 Direction, Ofcom set BT's charges for CPS. The disputed retail costs were included in the cost stack used to set those charges. Although Ofcom stated that it was appropriate for it to consider stakeholders' concerns in relation to the retail costs in its planned 2006 review of CPS charges, it did not indicate what the result of this review might be. In Ofcom's view, the August 2005 Direction did not indicate to BT that the retail costs were not costs of providing CPS under SMP Condition AA8.
- 2.70 On 24 January 2006, Ofcom published the statement *Reviewing and setting the charge ceilings for WLR services* ("the WLR Statement")²⁸. The cost stack that Ofcom used to calculate the charges set out in the WLR Statement did not include any end user costs. In particular, it did not include the equivalent of the disputed retail costs that are the subject of this dispute, which are incurred by BT and other providers for WLR transfers in the same way that they are for CPS transfers (the consumer protection mechanism for WLR and CPS is the same). However, Ofcom did not expressly state in the WLR Statement that BT should similarly remove end user costs, including the disputed retail costs in this case, from the CPS cost stack. While the WLR Statement may have suggested to BT that Ofcom would at some point adopt a similar decision in relation to CPS, Ofcom does not consider that the WLR Statement alone was sufficient to move the burden of reassessing the CPS cost stack (and removing the retail costs) from Ofcom onto BT.
- 2.71 Further, Ofcom's determination of the Opal dispute on 16 May 2006 was based on the charges set by Ofcom in the August 2005 Direction, and Ofcom did not make any statement at this time to suggest that the retail costs should be removed from the CPS charges, in line with the position taken by Ofcom in the WLR Statement. At the end of 2006, Ofcom had not carried out its planned review of CPS charges due to an internal review of its administrative priorities. Therefore, by the end of 2006, Ofcom had not made any statement that would have indicated to BT that the retail costs were not costs of providing CPS facilities under SMP Condition AA8 and that BT should therefore remove them from the CPS cost stack.
- 2.72 Based on a review of statements made by Ofcom between 28 November 2003 and the date of the Timing Consultation, Ofcom found that by 1 November 2007, when BT changed its CPS charges, Ofcom had not indicated with sufficient clarity to BT that it was not reasonable for it to include the disputed retail costs in the CPS cost stack. While the WLR Statement, and Ofcom's commitment to review the inclusion of the retail costs in its planned 2006 review, could be interpreted as suggesting that Ofcom would at some point conclude that BT was not entitled to recover the retail costs from CPSOs, Ofcom's view set out in the Timing Consultation was that these statements together were insufficient for us to conclude that it would have been reasonable to expect BT proactively to remove the retail costs from the CPS cost stack when it came to review its CPS charges in November 2007. Further, Ofcom has not made any statements between 1 November 2007 and the date of the Draft Determination that would have given BT any further clarification regarding this issue.

²⁸ *Wholesale Line Rental: Reviewing and setting charge ceilings for WLR services*, <http://www.ofcom.org.uk/consult/condocs/wlrcharge/statement/statement.pdf>

- 2.73 Based on the analysis above, Ofcom proposed in the Timing Consultation to conclude that its determination of this dispute would apply on a forward-looking basis only. Ofcom invited any further comments on its proposal by 5pm, Friday 27 February 2009.

Date of application of Ofcom's Determination – stakeholders' comments

- 2.74 Ofcom went on (at paragraphs 7.44 -7.64 of the Timing Consultation) to consider the dates suggested by the respondents, their comments on Ofcom's proposal as set out in the Draft Determination, and Ofcom's views on those comments. This is set out below:

Alternative dates proposed by C&W

- 2.75 Ofcom acknowledged (see paragraph 5.89 of the Draft Determination) that it stated that in resolving this dispute one option would be to order repayments from 28 November 2003. One respondent noted that 28 November 2003 is the "logical starting point", being the date that SMP Condition AA8 came into effect (as also noted by C&W in its original submission).
- 2.76 Ofcom considered that the fact that the relevant SMP Condition came into effect on this date was in itself insufficient to establish that it is appropriate to require BT to make repayments from this date. The Market Review did not include any guidance as to how Ofcom would interpret SMP Condition AA8 in relation to the recovery of the retail costs. In the absence of any indication from Ofcom that it was not reasonable for BT to recover the retail costs as at 28 November 2003, it would not therefore be fair to BT to require it to make repayments to the CPSOs from this date. This is supported by the fact that Ofcom's binding August 2005 Direction set charges at a level that enabled BT to recover the retail costs.
- 2.77 C&W, UKCTA and another respondent argued for 28 November 2003 on the basis that the charges set in the August 2005 Direction were subsequently backdated to 28 November 2003 as a result of Ofcom's determination of the Opal dispute, and that Ofcom should therefore apply the same logic in this case as it did in resolving the Opal dispute.
- 2.78 As set out at paragraphs 5.74-5.77 of the Draft Determination, the methodology used in determining the appropriate repayment date in the Opal dispute is not appropriate in this case. In the Opal dispute, Ofcom was concerned with identifying a point at which BT "broke even" and recovered its costs (calculated on the basis of underlying transaction volumes). Here, there is no "break even" point, and the same logic cannot therefore be applied in this dispute. Ofcom did not provide any guidance in the Market Review as to how it would interpret SMP Condition AA8 in relation to the recovery of the retail costs, and so it is not appropriate to require BT to make repayments to 28 November 2003. Ofcom did not, in the Opal dispute, require BT to remove the retail costs from the CPS cost stack.
- 2.79 Ofcom further set out its view that it did not agree with C&W's suggestion that it is "reasonable to assume" that, had Ofcom considered the issue of retail cost recovery in 2005 and reached the conclusion that BT was not entitled to recover the retail costs, it would have required BT to make repayments to 28 November 2003. Ofcom did not consider the issue in 2005, and had it done so it may well have reached the same view that it has in this dispute, i.e. that it is not reasonable to require BT to make repayments to 28 November 2003 because at that time Ofcom had not

provided guidance as to how it would interpret SMP Condition AA8 in relation to the recovery of the retail costs.

- 2.80 C&W further mentioned 25 May 2005, which was when GC14.5 came into effect, as a possible date for repayments. Ofcom set out its view that it does not consider that it is appropriate to require BT to make repayments from 25 May 2005, as Ofcom did not provide any guidance at this time as to how it expected BT to apply SMP Condition AA8 in relation to the recovery of the retail costs.

The August 2005 Direction

- 2.81 While C&W mentioned 18 August 2005, the date of the August 2005 Direction, as one “step change” in the period under consideration, it does not appear to be arguing that Ofcom should consider requiring BT to make repayments from this date. However, the August 2005 Direction did not indicate to BT that the retail costs were not costs of providing CPS facilities under SMP Condition AA8. Ofcom therefore set out its view that it is not appropriate to require BT to make repayments from 18 August 2005.
- 2.82 BT argued that Ofcom’s comments in the August 2005 Direction on recovery of the retail costs, and Ofcom’s commitment to review CPS charges in 2006, did not suggest to BT that, had such a review taken place, Ofcom would have determined in 2006 that BT was not entitled to recover the retail costs from CPSOs.
- 2.83 Ofcom acknowledged that it did not, in the August 2005 Direction, take a view on whether or not BT was entitled to recover the retail costs from CPSOs. In light of the fact that the August 2005 Direction set BT’s CPS charges at a level that enabled BT to recover the retail costs through the CPS set-up charge, Ofcom considered (as argued at paragraph 5.92 of the Draft Determination) it was reasonable for BT to continue to recover the retail costs through the CPS set-up charge following the 2005 Direction.
- 2.84 While C&W questioned this interpretation, Ofcom set out its view that it does not consider that the other statements in the Draft Determination that C&W has highlighted (see C&W’s comments at paragraph 2.51 above) suggest that BT should have been expected to foresee the conclusions that Ofcom has reached in considering this dispute.
- 2.85 Ofcom’s statements in the 2005 Direction put BT on notice that Ofcom intended to consider this issue at some point in the future, and that Ofcom might at some point change the approach it had adopted in the August 2005 Direction. As set out at paragraph 5.92 of the Draft Determination, BT could not assume that the charges set in 2005 would apply until Ofcom made a further Direction. Ofcom therefore considered that it was consistent with BT’s SMP obligations for it to review its CPS charges. However, the comments made by Ofcom in the August 2005 Direction, on their own, were insufficient to have indicated that BT should have changed its approach to cost recovery and excluded the retail costs from the CPS cost stack when it came to review its charges in 2007.

The January 2006 WLR statement

- 2.86 BT noted that in the WLR Statement Ofcom removed BT’s sales and marketing costs from the WLR cost stack. BT submitted that since the retail costs are not sales and marketing costs, it could not have inferred from the WLR Statement that it was not entitled to recover the retail costs through the CPS set-up charge.

- 2.87 At paragraphs 3.64-3.66 of the WLR Statement, Ofcom stated that it had used the costs of BT's PSTN takeover activity as a starting point for estimating the reasonable cost of analogue WLR migrations, as the two activities were similar. As part of this exercise, Ofcom considered that it was not appropriate to include all of BT's costs in the cost stack for WLR charges, and excluded all costs associated with serving end users – not only sales and marketing costs, but also the costs of the notification of transfer letter and inbound calls. The fact that the retail costs are not sales and marketing costs is therefore irrelevant.
- 2.88 Ofcom set out its view that while it considers that the WLR Statement acted as a signal to BT that Ofcom would take the same approach to the retail costs when it came to review CPS charges, it did not expressly state that Ofcom would take a similar approach to the retail costs in the CPS cost stack. Ofcom did not therefore consider that the WLR Statement alone was sufficient to move the burden of reassessing the CPS cost stack (and removing the retail costs) from Ofcom onto BT.

Developments following the August 2005 Direction

- 2.89 C&W questioned Ofcom's statement that, had it considered the issue of retail cost recovery in 2005, it might have reached a different view, as "all the reasons that justify why BT is not entitled to recover these costs were as true in 2005 as they are today." Ofcom set out its view that while this may be true, the fact remained that Ofcom had not until this dispute, reviewed the inclusion of the retail costs in the CPS cost stack or made any clear statement as to whether BT is entitled under SMP Condition AA8 to recover the retail costs from CPSOs.
- 2.90 Ofcom did not dispute C&W's explanation that it did not challenge the August 2005 Direction because Ofcom had committed to carrying out a review of CPS charges in 2006. In response to a comment by Global Crossing, Ofcom clarified that it was not arguing in the Draft Determination that the absence of a challenge to the August 2005 Direction was, in itself "sufficient reason to determine that a date of November 2007 would be reasonable".
- 2.91 Nevertheless, Ofcom set out its view that none of the parties to this dispute could infer from the August 2005 Direction that Ofcom's planned 2006 review of CPS charges would conclude that BT was not entitled to recover the retail costs. It was still open to C&W and the other parties to the dispute to exercise their right to challenge the August 2005 Direction.
- 2.92 Ofcom acknowledged that it did not formally notify the parties of the review of its administrative priorities that led to the cancellation of the planned 2006 review of CPS charges. However, Ofcom set out its view that it does not agree with C&W and others that CPSOs had no further opportunity to raise the issue until BT introduced new charges and were therefore "in limbo" until BT announced those new charges on 10 December 2007. C&W or any other party could have brought the issue to Ofcom formally at any time.

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- 2.93 Ofcom went on to set out that in the absence of any challenge to the August 2005 Direction or further discussion between the parties of recovery of the retail costs, the next step change after the WLR Statement that is relevant for resolving this dispute was on 1 November 2007, when the revised CPS set-up charge (announced by BT on 10 December 2007 but applied with retrospective effect) came into effect. Ofcom explained that the Opal dispute (which concluded in May 2006) is not a relevant

precedent for Ofcom's consideration of this dispute, and the date at which Ofcom resolved the Opal dispute is not therefore a relevant benchmark.

- 2.94 By this time, BT was aware that stakeholders had concerns with BT's recovery of the retail costs and that Ofcom had acknowledged those concerns and undertaken to review CPS charges. In the meantime, Ofcom had also set new charges for WLR that did not enable BT to recover the retail costs through WLR charges. Ofcom explained that it therefore remained of the view, as set out at paragraph 5.98 of the Draft Determination, that BT should have reconsidered the assumptions it used in setting new CPS charges in 2007.
- 2.95 However, Ofcom went on to explain that it accepted that the statements made in the August 2005 Direction and the WLR Statement were insufficient to have suggested to BT, in the absence of any further discussion with the industry and Ofcom, that it should have removed the retail costs from the CPS cost stack.

Section 3

Responses to the Timing Consultation

- 3.1 Ofcom received five responses to the Timing Consultation, from:
- BT;
 - C&W;
 - UKCTA;
 - Verizon Business; and
 - another respondent who asked not to be named.
- 3.2 In addition, Ofcom's case team met C&W and other parties to the dispute on 24 February 2009 to discuss their views in advance of written submissions.
- 3.3 Comments from respondents other than BT are set out at paragraphs 3.4-3.45 below. BT's comments are set out at paragraphs 3.46-3.49 below.

Comments from respondents other than BT

- 3.4 With the exception of BT, none of the respondents to the Timing Consultation supported Ofcom's proposal that BT is not required to make repayments to CPSOs. C&W, Verizon Business and the respondent who asked not to be named all submit that BT should be required to make repayments to CPSOs from 28 November 2003.
- 3.5 Respondents' comments can be separated into three broad areas. First, they argue, Ofcom has used an inappropriate test to determine that BT is not required to make repayments. In any case, BT should have been aware that it was not entitled to recover the disputed costs. BT is also subject to a no undue discrimination obligation that is relevant to Ofcom's consideration of this dispute.
- 3.6 Second, they argue that Ofcom's approach is inconsistent with the approach taken in other disputes. Two respondents provide details of specific disputes that, they submit, suggest Ofcom's proposed approach here is inappropriate.
- 3.7 Third, they suggest that Ofcom's proposal not to require repayments has wider implications, and that Ofcom's Determination is inconsistent with Ofcom's statutory obligations and regulatory principles.
- 3.8 These three broad issues are discussed in turn in the following paragraphs.

Ofcom has used an inappropriate test to determine that BT is not required to make repayments

- 3.9 C&W states that it does not consider Ofcom's approach to be "legitimate":

"BT has a positive obligation to comply with its SMP Conditions... This obligation cannot be set-aside on the excuse that Ofcom hadn't provided any clear guidance on the treatment of the

retail costs in question. It exists as a positive obligation on BT regardless”.

3.10 UKCTA comments that:

“BT has a positive obligation to comply with all its SMP Conditions, which is not reliant on it having regulatory clarity on how those Conditions should be discharged [...] Where there is ambiguity, it must be incumbent on BT to either seek clarification from the regulator, or accept the risk that its approach may be successfully challenged at a later date.”

3.11 Another respondent, who asked not to be named, submits that “Ofcom has misconstrued or misinterpreted BT’s regulatory obligation to offer CPS at cost-oriented prices” and that:

“it is inaccurate to interpret the SMP Conditions, as Ofcom appears to do, to only require BT to adjust its CPS charges as and when Ofcom explicitly requires it to do so”.

3.12 The respondent notes that SMP Condition AA3.1 provides that BT shall:

“secure, and shall be able to demonstrate to the satisfaction of the Director, that each and every charge offered, payable or proposed 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.”

3.13 The respondent concludes that:

“[the SMP Conditions] impose on BT a specific responsibility to ensure that its charges are reasonably derived from cost. In other words, the burden of proof lies firmly with BT to show that its CPS charges are duly cost-oriented”.

3.14 The respondent suggests that:

“where BT becomes sufficiently aware that there is a concern that one of its charges is not so cost-oriented, it must take reasonable steps to achieve clarity for instance by seeking views from Ofcom”.

In any case, BT should have been aware that it was not entitled to recover the disputed costs

3.15 C&W submits that, even if Ofcom’s approach did have merit:

“we don’t accept Ofcom’s assertion that BT couldn’t have known it was breaching its SMP Conditions before this current dispute”.

3.16 C&W notes that Ofcom made a number of decisions on charges for other products “that should have flagged the CPS anomaly” as early as 2002, when Ofcom first set charges for WLR that, C&W submits, “clearly did not include any element for the retail costs that arise from the provision of WLR”, although the same transfer process applies to both products. C&W submits that:

“even if the linkage to the CPS situation wasn’t explicit, a prudent operator would have recognised the link and sought to clarify the implications for other products”.

- 3.17 C&W adds that BT’s SMP obligations to provide CPS and WLR arise from the same Market Review and there is a “clear association” between CPS and WLR.
- 3.18 C&W argues that in any case Ofcom did not give BT “positive signalling in the [August 2005 Direction] that they could continue to recover these costs”, as Ofcom “clearly signalled [in the August 2005 Direction] that it **hadn’t** reached a definitive view on the inclusion of retail costs in the wholesale charges” (C&W’s emphasis).²⁹
- 3.19 The respondent who asked not to be named submits that “there can be little doubt that BT was aware of the concerns expressed by CPS operators over the inappropriateness of including BT retail costs in the charge” and like C&W, argues that Ofcom’s August 2005 Direction “did not say that retail costs could be included in the CPS set-up charge”. The respondent also notes that in 2006 (in the WLR statement) Ofcom “explicitly ruled that retail costs could not be included in the directly related WLR set-up charge”.³⁰ The respondent argues that BT should therefore have “remove[d] the retail costs and then [sought] urgent clarification from Ofcom as to whether retail costs could be lawfully included”.

BT is also subject to a no undue discrimination obligation

- 3.20 C&W notes that BT is subject to a requirement not to unduly discriminate (SMP Condition AA2) as well as an SMP Condition setting the basis of its CPS charges (SMP Condition AA8). C&W argues that BT:

“has always been aware that it was the only operator recovering the costs of its retail activities from other operators. By definition this must be considered discrimination and given the magnitude of this element of its recovery [...] BT should have recognised that this would constitute undue discrimination”.

- 3.21 C&W argues that:

“This situation has existed since before the 2003 Market Review that set the current SMP Conditions, so BT should have been cognisant of this breach from Day 1 of the new Conditions, i.e. 28 November 2003. Should Ofcom continue to rely on its proposed ‘test’ in concluding this dispute, then that must lead it to conclude that BT should repay the overcharges back to 28 November 2003 on this basis.”

- 3.22 C&W states that:

“we believe that the undue discrimination point highlighted above is of itself sufficient evidence to change Ofcom’s position.”

- 3.23 UKCTA also notes that BT is subject to a requirement not to unduly discriminate in relation to CPS, as well as a cost orientation obligation.

²⁹ *Per-provider and per customer line costs and charges for Carrier Pre-selection* (“the August 2005 Direction”), 18 August 2005, published at <http://www.ofcom.org.uk/consult/condocs/carrier/statement>.

³⁰ See *Reviewing and setting the charge ceilings for WLR services* (“the WLR Statement”) 24 January 2006, published at <http://www.ofcom.org.uk/consult/condocs/wlrcharge/statement/statement.pdf>.

3.24 [X]

Ofcom's approach is inconsistent with the approach taken in other disputes

3.25 UKCTA submits that Ofcom's approach in this dispute:

"changes a fundamental principle on which regulation is based, that where an SMP operator has breached its SMP obligations, it will be required to remedy that breach in full".

3.26 UKCTA notes other respondents' submissions on previous disputes that "demonstrate how Ofcom's current approach differs from that adopted in previous cases".

3.27 One respondent, who asked not to be named, argues that "Ofcom's proposal contradicts current regulatory practice around retrospection" in relation to repayments. The same respondent submits that:

"There is in our view an established practice [...] according to which any revised regulated charges can be backdated to a previous period regardless of whether the regulated operator, at the time the charge was originally set, would have known that a particular cost item could not be included.

"This practice has been established through several disputes over the years in which the regulated operator has been required to revise its charges downwards to comply with new requirements around cost-orientation, new methodologies to assess appropriate cost recovery and new approaches to cost calculation whereby specific cost items have been excluded from calculations."

3.28 The respondent refers to a number of cases it suggests are "examples of where Ofcom/Oftel/Competition Appeal Tribunal have backdated determined interconnection charges without any previous indication to the regulated operator that the original charges were too high or otherwise included inappropriate cost items":

- the Director's determination of a dispute about the NTS retail uplift (referred to below as "the NTS retail uplift dispute");³¹
- the Director's determination of a dispute between BT and C&W concerning the level of the Premium Rate Services (PRS) bad debt surcharge within the NTS formula (referred to below as "the PRS bad debt surcharge dispute");³²
- Ofcom's determination of a dispute between BT and others about payments to terminating communications providers (TCPs) for the termination of NTS calls NTS outpayments (referred to below as "the first NTS dispute");³³

³¹ *Direction under the provisions of regulation 6(6) of the Telecommunications (Interconnection) Regulations 1997 resolving a dispute between Energis and BT concerning BT's method of calculating its NTS retail uplift charge since April 1997*, 19 September 2002, published at:

<http://www.ofcom.org.uk/static/archive/oftel/publications/pricing/2002/ener0902.htm>

³² *Direction under the provisions of regulation 6(6) of the Telecommunications (Interconnection) Regulations 1997 resolving a dispute between Cable & Wireless UK ('C&W') and British Telecommunications plc ('BT') over a bad debt surcharge relating to calls to Premium Rate Services*, 28 March 2003, published at:

http://www.ofcom.org.uk/static/archive/oftel/publications/licensing/2003/nts0303_1.htm

- Ofcom's determination of a dispute between BT and Energis about BT's charges for WLR ISDN2 (referred to below as "the WLR ISDN2 charges dispute");³⁴
- Ofcom's determination of a dispute between Opal and BT about the retrospective application of CPS charges (referred to below as "the Opal dispute");³⁵
- Ofcom's determination of a dispute between BT and others about payments to TCPs for the termination of NTS calls (referred to below as "the second NTS dispute");³⁶ and
- Ofcom's determination of various disputes between BT and mobile providers about termination rates (referred to below as "the mobile termination rates disputes") and subsequent redetermination of those disputes following appeal to the Competition Appeals Tribunal (CAT).³⁷

3.29 The same respondent goes on to submit that:

"What Ofcom is now proposing with regard to the CPS set-up charge is completely at odds with past practice. In previous disputes, it has never been suggested by Ofcom that the regulated operator would have had to be explicitly told beforehand that a particular cost item should not be included in a regulated charge in order for backdating to be a possible remedy"

3.30 The respondent suggests that:

"if anything it should be even clearer in the current dispute that retrospection should apply given that BT [...] was aware over many years that the inclusion of retail costs was an issue of significant concern to CPS operators and something Ofcom was planning to review".

3.31 C&W submits that there are "many examples" of disputes where Ofcom has adopted a different approach to repayments, and gives three examples:

³³ *Resolution of a dispute between BT and various providers about NTS outpayments*, 27 May 2004, published at: http://www.ofcom.org.uk/consult/condocs/nts_dispute/bt_dispute/nts_outpayments.pdf.

³⁴ *Resolution of a dispute between Energis and BT relating to BT's charges for WLR ISDN2 from 28 November 2003 until 1 October 2004*, 9 March 2005, published at: <http://www.ofcom.org.uk/consult/condocs/energis-bt/resolution/resolution.pdf>

³⁵ *Determination to resolve a dispute regarding the retrospective application of CPS charges*, 16 May 2006, published at: http://www.ofcom.org.uk/consult/condocs/cps_charges/determination.pdf

³⁶ *Determination to resolve a dispute between BT and various communications providers about NTS outpayments*, 4 June 2007, published at: http://www.ofcom.org.uk/consult/condocs/deter_nts/bt_nts.pdf

³⁷ *Determinations to resolve mobile call termination rate disputes between T-Mobile and BT, O2 and BT, Hutchison 3G and BT and BT and each of Hutchison 3G, Orange and Vodafone*, 19 July 2007, published at:

http://www.ofcom.org.uk/bulletins/comp_bull_index/comp_bull_ccases/closed_all/cw_942/deter.pdf.

See also the CAT's judgment of 20 May 2008 in relation to Ofcom's determination of disputes between T-Mobile and BT, O2 and BT, Hutchison 3G and BT and BT and each of Hutchison 3G, Orange Personal Communications Services and Vodafone relating to fixed to mobile and mobile to mobile termination (the "TRD core issues judgement"), [2008] CAT 12 and Ofcom's subsequent redeterminations of the same disputes, 16 January 2009, published at: http://www.ofcom.org.uk/bulletins/comp_bull_index/comp_bull_ccases/closed_all/cw_1008/.

- in the mobile termination rates disputes, “Ofcom originally concluded that the MNOs could recover their 3G costs, but, following appeal to the CAT, have now amended that position and determined that these costs cannot be recovered and have ordered repayment of these charges, with interest”;
- in its determination of the NTS retail uplift dispute on 19 September 2002, Ofcom “recalculated BT’s NTS retail uplift factor with retrospective effect from 1 April 1999 until 31 March 2000”; and
- in the second NTS dispute, Ofcom:

“backdated adjustments to NTS outpayments (by changing the way in which they were calculated) to 1 October 2006 (the date of BT’s original pricing letter). [This] case is directly analogous with the current dispute; BT couldn’t have known that Ofcom would require them to calculate the charges differently at the time, yet Ofcom still considered retrospection to be appropriate, irrespective of any earlier ‘signalling’ to the contrary”.

Wider implications of Ofcom’s proposal not to require repayments

3.32 C&W argues that the Determination:

“sends a signal to BT (and other SMP operators) that it is commercially prudent to include spurious costs in charges for SMP products as, even if subsequently challenged, Ofcom will not require it to repay these charges”.

3.33 C&W argues that the Determination:

“incentivises BT (and other SMP operators) to review every public Ofcom decision or statement and every private meeting note to find evidence that they can use to exploit their SMP obligations and increase their charges. Wherever Ofcom hasn’t made a decision on a particular cost element, there will be opportunity for this exploitation”.

3.34 Another respondent submits that:

“in essence, Ofcom is suggesting that there is no obligation on BT to review its regulated charges until such time that Ofcom specifically and explicitly instructs BT as to what costs can and cannot be included in the charges”

3.35 The respondent considers that this:

“would significantly reduce BT’s incentive in the future to engage in constructive and meaningful negotiations with other operators [...and] to prevaricate and delay any interconnection negotiations for as long as possible.”

3.36 The same respondent suggests that Ofcom’s proposal means that:

“an SMP operator would be required to adjust its regulated charges only if and when specifically required by Ofcom and then only on a

forward-looking basis. This would provide the strongest incentive possible on an SMP operator to include new cost items in its charges and then, as much as possible, limit transparency and delay any negotiations with other operators wanting to challenge the charges on reasonable grounds”.

3.37 C&W argues that “the whole process of a dispute can take many months”, including the negotiation with BT as well as Ofcom’s dispute resolution process, and that this could mean C&W would find itself “overpaying on any number of products for periods of a year or more before Ofcom issues a determination”.

3.38 UKCTA echoes C&W’s comments, stating that:

“Given that disputes take many months to crystallise and up to six months to resolve once they are accepted by Ofcom, any over-recovery could continue for a year or more before it is rectified. By resolving this current dispute in the way proposed, Ofcom will set an incentive on SMP operators to exploit this opportunity, safe in the knowledge that they will be able to retain the windfall gains made by their overcharging for 12 months or more”.

3.39 Another respondent notes that it usually takes around four and a half months from the date of submission for Ofcom to make a final determination and suggests that:

“Ofcom’s position would leave competitors with no option but to start challenging every single BT charge as soon as possible to avoid losing too much money in case a charge is subsequently held by Ofcom to include unlawful cost items”.

Ofcom’s Determination is inconsistent with Ofcom’s statutory obligations and regulatory principles

3.40 C&W notes that Ofcom has a duty under Section 3(3)(a) of the 2003 Act to have regard, in all cases, to “the principles under which regulatory activities should be transparent, accountable, proportionate, **consistent**...” (emphasis added), and notes that Ofcom’s proposal not to require repayments in this dispute contradicts this duty to have regard to consistency.

3.41 C&W argues that Ofcom’s proposal not to require BT to make repayments in this dispute “create[s] uncertainty in the market as to how Ofcom will view similar situations, which is not only in conflict with this duty, but ultimately will harm competition”.

3.42 C&W argues that Ofcom’s proposals impact on the ability of C&W and others “to manage our cost base and accurately forecast changes to that base in line with known variables (eg RPI)”. C&W submits that:

“at any time BT could increase its charges on any number of products and we’d have no ability to predict that increase, nor comfort that Ofcom would order BT to repay the increase should they be found to be unallowable following a dispute”.

3.43 Verizon Business submits that:

“to allow BT to levy unjustified charges for SMP products in the knowledge that if ultimately those charges are deemed inappropriate they will not be required to repay those charges risks skewing the regulatory arena, lessening competition and ultimately damaging consumers”.

- 3.44 One respondent states that it has suffered a loss as a result of BT’s recovery of the disputed costs from CPSOs, as it has not been able to recover the charges from its own consumers “because it had to follow and preferably undercut [BT] who did not face the same cost”. The respondent suggests that this led to “a competitive distortion between [the respondent] and [BT]”.
- 3.45 The same respondent suggests that Ofcom’s proposals contradict its duty “to act in a proportionate and transparent manner”.

BT’s comments

- 3.46 BT supports Ofcom’s proposal not to require repayments, and submits that:
- “This not only falls in line with [BT’s] legitimate expectations of the outcome, but also allows for regulatory certainty to be maintained, a benefit for operators and Ofcom itself.”
- 3.47 BT submits that it
- “had absolutely no reason to foresee Ofcom’s present decision to exclude these costs from the retail cost stack going forward [...] We are pleased that Ofcom has now agreed that there was no reason that [the various statements considered in the Draft Determination] should have indicated to BT that it should have removed the disputed costs at the time of the cost review in November 2007”.
- 3.48 BT states that while it still believes it is entitled to recover the disputed costs, it will comply with Ofcom’s determination of 13 February 2009, and states that it has issued an ACCN (Access Charge Change Notice) to the industry notifying “the rate as directed by Ofcom” for the CPS set-up charge from 16 February 2009.
- 3.49 BT reiterates comments made in its letter of 20 November 2008 to Ofcom on Ofcom’s power to require repayments:
- “A decision that has not been appealed, cannot subsequently be reversed either by the parties or Ofcom in relation to the period, the parties and the matter it has decided upon. [...] No-one appealed the [2005 Direction], and as a result [it] binds the parties and Ofcom for the period and on the matter it has decided upon. It cannot therefore be subsequently reversed; either directly via the route of an appeal, or indirectly by taking a subsequent decision that makes a different ruling on the same matter, period and parties that were the subject of that decision”.

Section 4

Consideration of responses and conclusion

- 4.1 This section addresses stakeholders' responses, in the same order that they are set out in section 3 above.

Ofcom has used an inappropriate test to determine that BT is not required to make repayments

- 4.2 As set out at paragraphs 3.9-3.14 above, several respondents argue that BT has a "positive obligation" to comply with its SMP obligations proactively, and should not need to rely on explicit guidance from Ofcom as to what costs it is entitled to recover through its charges. They suggest (see for example paragraph 3.14 above) that, where there is any uncertainty as to the way in which BT is expected to meet its various obligations, it should seek guidance from Ofcom.
- 4.3 Ofcom agrees that BT is required to comply with its SMP obligations proactively, as discussed at paragraphs 1.11-1.23 above. As discussed at paragraph 5.97 of the Draft Determination, it is entirely appropriate for BT to review its charges on a regular basis (as it did in this case) to ensure that they are, and continue to be, in compliance with its SMP obligations.
- 4.4 When SMP Condition AA8 was introduced in 2003, BT took the view that in complying with SMP Condition AA8 it was reasonable to include the disputed costs in the cost stack for CPS.
- 4.5 As set out at paragraphs 7.30-7.42 of the Timing Consultation, by 1 November 2007, when BT changed its CPS charges, Ofcom had not indicated with sufficient clarity to BT, that it was not reasonable for it to include the retail costs in the CPS cost stack or that these costs were not costs of providing CPS facilities under SMP Condition AA8. Ofcom's August 2005 Direction set charges at a level that enabled BT to recover the disputed costs. The August 2005 Direction was binding on BT and had ongoing effect. While in January 2006, Ofcom determined in the WLR Statement that the equivalent costs should be removed from BT's WLR cost stack, it made no reference to the treatment of the equivalent costs in the context of CPS. Ofcom's subsequent determination of the Opal dispute in May 2006 was based on the CPS charges set by Ofcom in the August 2005 Direction, and Ofcom did not make any statement at this time to suggest that the disputed costs should be removed from the CPS charges, in line with the position taken by Ofcom in the WLR Statement. The August 2005 Direction, therefore remained unchanged and continued to be binding on BT.
- 4.6 Ofcom agrees that, as suggested by one respondent, "the burden of proof lies firmly with BT to show that its CPS charges are duly cost-oriented". In this case, however, Ofcom accepts that BT reasonably considered its CPS charges **were** compliant with its obligations under SMP Condition AA8. Ofcom had not, prior to the Draft Determination, indicated that it was no longer reasonable for BT to include the disputed costs in the CPS cost stack or that these costs were not costs of providing CPS facilities under SMP Condition AA8.
- 4.7 Respondents argue that, where there is any "ambiguity" or "uncertainty" as to the interpretation of BT's SMP obligations, BT should seek clarification from Ofcom.

Respondents suggest that Ofcom's statement in the August 2005 Direction that it intended to consider further stakeholders' concerns about BT's recovery of certain retail costs created "uncertainty" as to how BT's SMP obligations would be interpreted in the future.

- 4.8 Ofcom does not agree that the August 2005 Direction created "uncertainty" about BT's SMP obligations. Ofcom noted stakeholders' concerns about BT's recovery of retail costs, and undertook to consider them further. Ofcom gave no indication what the outcome of Ofcom's planned 2006 review would be. The August 2005 Direction set charges at a level that enabled BT to recover the disputed costs, while Ofcom's determination of the Opal dispute was based on the charges set by Ofcom in the August 2005 Direction, and Ofcom did not make any statement at this time to suggest that the disputed costs should be removed from the CPS charges, in line with the position taken by Ofcom in the WLR Statement.
- 4.9 C&W argues (see paragraph 3.16 above) that "a prudent operator would have [...] sought to clarify the implications [of Ofcom's policy on WLR] for other products". BT could have sought guidance from Ofcom. However, as discussed in the preceding paragraphs, Ofcom does not agree that the August 2005 Direction created "uncertainty" around BT's SMP obligations, and we do not consider that BT acted unreasonably in not seeking further guidance from Ofcom on this occasion on the interpretation of SMP Condition AA8 in relation to recovery of the disputed costs.

In any case, BT should have been aware that it was not entitled to recover the disputed costs

- 4.10 Ofcom does not agree with C&W's suggestion (see paragraph 3.16 above) that BT should have known that its approach was not consistent with its SMP obligations before the current dispute as a result of Ofcom's approach to WLR (the "CPS anomaly" that C&W refers to). As another respondent (who asked not to be named) notes, Ofcom excluded all retail costs from the WLR cost stack (see paragraphs 5.43-44 of the Draft Determination), and we acknowledge that there is a "clear association" between CPS and WLR. However, Ofcom has never made any explicit statement, in its consideration of WLR, that suggested BT should make changes to the way it dealt with the equivalent costs in its treatment of CPS.
- 4.11 Nor does Ofcom accept C&W's statement (see paragraph 3.18 above) that Ofcom did not give BT "positive signalling in the [August 2005 Direction] that they could continue to recover these costs". As noted above, in its August 2005 Direction Ofcom acknowledged stakeholders' concerns about BT's recovery of the disputed costs but decided at the same time to set charges at a level that enabled BT to recover the disputed costs. The August 2005 Direction was binding on BT. Ofcom's determination of the Opal dispute was based on the charges set by Ofcom in the August 2005 Direction, and Ofcom did not make any statement at this time to suggest that the disputed costs should be removed from the CPS charges, in line with the position taken by Ofcom in the WLR Statement.

BT is also subject to a no undue discrimination obligation

- 4.12 Ofcom does not agree with C&W that the fact BT was able to recover the cost of its retail activities from CPSOs (but not vice versa) must "by definition" (see paragraph 3.20 above) be considered discrimination.
- 4.13 We acknowledge (as noted at paragraph 5.60 of the Draft Determination) that it could be argued that allowing BT to recover its retail costs from CPSOs, when CPSOs

cannot recover their retail costs from BT or anyone else, would be discriminatory. However, it is not within the scope of this dispute to assess whether BT's recovery of the disputed costs did in fact constitute discrimination and if so over what period. As stated in the Draft Determination in response to C&W's arguments on this point (see footnote 102 of the Draft Determination), Ofcom has not assessed whether this alleged discrimination has any impact on competition such that it would be contrary to SMP Condition AA2.

4.14 [X]

Ofcom's approach is inconsistent with the approach taken in other disputes

4.15 Respondents have argued that the approach Ofcom has taken in this dispute is inconsistent with its approach to repayments in a number of previous disputes and contrary to "established practice" (see paragraph 3.27 above).

4.16 Some of these disputes were determined before 2003 and were therefore resolved by the Director under section 6(6) of the Telecommunications (Interconnection) Regulations 1997. The Director had powers to impose "retrospective" determination of terms and conditions (including charges).³⁸ In the following discussion, we therefore refer to retrospective decisions (rather than repayments) in disputes that were resolved by the Director.

The NTS retail uplift dispute

4.17 The NTS retail uplift is the amount that BT retains from the price of a retail NTS (Number Translation Services) call (eg a call to an 0845 number) to cover its retail costs. An increase in the NTS retail uplift results in a corresponding reduction in the payment that BT makes to TCPs for termination of NTS calls. The NTS retail uplift is subject to a cost orientation requirement.³⁹ BT had reviewed the NTS retail uplift on an annual basis, but in 1999, following a change in its accounting methodology which meant the approach it had been using was no longer appropriate, froze the retail uplift at its 1999 level. Energis asked the Director to resolve a dispute about the appropriate level of the NTS retail uplift. In his determination of 19 September 2002, the Director required BT to calculate the NTS retail uplift for the period between 1 April 1999 and 31 March 2000.

4.18 The Director's reasons for requiring BT to calculate the NTS retail uplift with retrospective effect is set out at paragraphs 5.13 and 6.5 of his determination:

"5.13 As BT states itself, the 61.5 per cent figure was an output of a calculation. The Director therefore does not see the rationale behind using this as an input to calculate the following year's charge. Moreover, the freezing of the percentage figure at 61.5 percent does not reflect the change that should have occurred over time to the ratio of retail to network costs. Accordingly, the Director believes that it is reasonable to apply a retrospective charge back to 1 April 1999.

³⁸ Article 7(3), fourth paragraph, of the Interconnection Directive, in force at that time, stated: "When an organisation makes changes to the published reference interconnection offer, adjustments required by the national regulatory authority may be retrospective in effect, from the date of introduction of the change."

³⁹ SMP Services Condition AA11 and Network Charge Control.

“6.5 The Director believes that, in not reviewing the charge from 1 April 1999 BT acted unreasonably. BT could have sought the advice of Oftel but instead chose to freeze the uplift at 61.5 per cent pending Oftel’s impending review of the methodology for which, at the time (late 1998), no date had been agreed.”

4.19 BT had argued (see paragraph 5.23 of the NTS retail uplift dispute):

“that it was wholly inappropriate to use the methodology proposed by the Director to resolve a dispute for a period earlier than the one for which that specific methodology was intended. BT could not have formed the basis of a calculation that was required in applying the NTS formula before that methodology was developed. BT added that it had also been agreed by Oftel and operators that the new method would only be applied from 1 April 2000.”

4.20 In response to that argument the Director stated at paragraph 5.24 that:

“The Director accepts that notice had been given that the new method would apply from April 2000. However, this was in the context of an impending review of the NTS retail uplift which has now been completed. At that time, the Director and other operators had not been aware that BT had ceased to review the retail uplift after August 1998. The Director was then referred this dispute which he is required to resolve under Regulation 6(6) of the Interconnection Regulations. In these exceptional circumstances he remains convinced that it is reasonable to use the new methodology to set the disputed charge.”

4.21 At paragraph 6.9 the Director:

“stresses that this decision to apply retrospection in this instance should not be viewed as setting any general precedent in the event of future reviews of disputes concerning BT’s charges. This decision is based upon the merits and circumstances of this particular case.”

Ofcom’s response

4.22 In his consideration of the NTS retail uplift dispute, the Director found that the parties to the dispute other than BT had a “reasonable expectation” that BT would regularly review the NTS retail uplift, and that BT had “acted unreasonably” in not reviewing the charge from 1 April 1999.⁴⁰

4.23 In the current dispute, however, Ofcom does not believe that BT acted unreasonably in not removing the disputed costs from the CPS cost stack when it came to review its CPS charges in November 2007, in light of the August 2005 Direction, which set charges at a level that enabled BT to recover the disputed costs, and Ofcom’s determination of the Opal dispute, which was based on the charges set by Ofcom in the August 2005 Direction. Neither statement suggested that the disputed costs should be removed from the CPS charges, in line with the position taken by Ofcom in the WLR Statement. Prior to the Consultation, Ofcom had not provided any specific guidance as to how it would interpret SMP Condition AA8 in relation to the recovery of the disputed costs.

⁴⁰ See paragraph 6.5 of the NTS retail uplift dispute determination.

- 4.24 The Director required BT to calculate the NTS retail uplift for a period in the past, using a new methodology, but, as noted above, made it clear that this decision was based on the “exceptional circumstances” of that case and should not be viewed as a precedent in future disputes. We consider that there are no exceptional circumstances in the current dispute that would lead us to adopt the same approach.
- 4.25 We also note that the current dispute is factually different to the NTS retail uplift dispute. In this dispute we have focused on determining whether BT is entitled to recover the disputed costs through the CPS set-up charge (and if so, how much the charge needs to fall and whether BT is required to make repayments to CPSOs as a result). The level of the CPS set-up charge is not (as discussed at paragraph 3.24 of the Draft Determination) within the scope of this dispute.
- 4.26 On the basis of the reasoning at paragraphs 4.22-4.25 above, Ofcom concludes that its proposal that BT is not required to make repayments to the CPSOs is not inconsistent with the Director’s determination of the NTS retail uplift dispute.

The PRS bad debt surcharge dispute

- 4.27 The PRS bad debt surcharge is the amount that BT retains from the net retail price of an NTS call to cover the extra bad debt costs and financing of working capital associated with PRS calls compared to other NTS calls. On 5 April 2002, C&W issued an Operator Charge Change Notice (OCCN) seeking a reduction in the PRS bad debt surcharge from 4.4 per cent to zero, to take effect from 28 June 2002, according to the industry convention of providing 56 working days’ notice of such a price change.
- 4.28 In his determination of the resulting dispute, the Director required BT to reduce the PRS bad debt surcharge from 4.4 per cent to 2 per cent.
- 4.29 C&W asked the Director to recalculate the PRS bad debt surcharge for the period since the start of the Network Charge Control (NCC), 1 October 1997, “or at least be consistent with NTS retail uplift directions in requiring BT to retrospectively apply a charge for the period in which the PRS bad debt surcharge was not cost-oriented.”⁴¹
- 4.30 The Director’s determination of 28 March 2003 took effect from 28 June 2002, the date initially proposed by C&W when it issued BT with a price change notice.
- 4.31 The Director set out his reasoning for his proposals on “retrospective adjustment” at paragraphs 4.30-4.32 of his draft direction of 2 January 2003:

“4.30 The Director is of the view that retrospection should not be applied in the absence of strong evidence or argument to support its application. The Director’s initial view is that there are no compelling reasons to support the request for retrospective adjustment in this dispute, prior to the date that C&W proposed the change come into effect when it submitted its OCCN to BT, which was 28 June 2002.

4.31 Whilst the Director accepts that BT has an obligation to ensure that its charges are cost-oriented, a prime consideration for the Director in this particular dispute is the fact that the level of the PRS bad debt surcharge was determined by previous directions and not set by BT itself. BT has been complying with these directions and

⁴¹ Paragraph 3.4 of the PRS bad debt surcharge dispute.

the Director notes that until now no operator has referred a dispute to the Director.

4.32 The Director has also considered whether the parties have a legitimate expectation that retrospection would apply in this case. In its referral C&W requested that the Director be consistent with his decisions to set BT's NTS retail uplift retrospectively from 1 April 1999 and from 1 April 2000 in requiring BT to retrospectively adjust the PRS bad debt surcharge, were the Director to determine any change in the figure from the current level of 4.4 per cent. However, the Director's decision in relation to the retail uplift was based on the exceptional circumstances particular to that case as outlined in the explanatory memoranda. The Director's initial opinion is that no such exceptional circumstances exist in relation to this dispute."⁴²

Ofcom's response

- 4.32 As set out above, in the PRS bad debt surcharge dispute, the Director's view was that there were no compelling reasons to support C&W's request for retrospective adjustment, prior to the date that C&W proposed the change come into effect when it submitted its OCCN to BT, which was 28 June 2002. The respondents have not submitted arguments as to why they think this case supports their argument that we should require BT to make repayments to 28 November 2003. In the absence of such arguments, it is Ofcom's view that the PRS bad debt surcharge dispute clearly does not support a determination that BT should be required to make repayments for the disputed charges to 28 November 2003.
- 4.33 Ofcom accepts that it could be argued that in the present dispute, 1 November 2007, the date at which BT's new charges came into effect, could be considered the equivalent of the pricing letter date in the PRS bad debt surcharge dispute. However, Ofcom does not believe that we should take a similar approach to that taken in that dispute on the facts here.
- 4.34 As discussed above and at paragraph 7.41 of the Timing Consultation, at the time BT's new charges came into effect Ofcom had not indicated with sufficient clarity to BT, that it was not reasonable for it to include the retail costs in the CPS cost stack or that these costs were not costs of providing CPS facilities under SMP Condition AA8, while Ofcom's determination of the Opal dispute was based on the charges set by Ofcom in the August 2005 Direction, and Ofcom did not make any statement at this time to suggest that the disputed costs should be removed from the CPS charges, in line with the position taken by Ofcom in the WLR Statement.
- 4.35 While the WLR Statement, and Ofcom's commitment to review the inclusion of the disputed costs in its planned 2006 review, may have suggested that Ofcom would at some point conclude that BT was not entitled to recover the disputed costs from CPSOs, prior to the Consultation, Ofcom did not provide any specific guidance as to how it would interpret SMP Condition AA8 in relation to the recovery of the disputed costs. The WLR Statement and Ofcom's commitment to the planned 2006 review are together insufficient for us to conclude that it is reasonable to expect BT to have

⁴² Draft direction under the provisions of Regulation 6(6) of the Telecommunications (Interconnection) Regulations 1997 resolving a dispute between Cable & Wireless Communications (Mercury) Limited ('C&W') and British Telecommunications plc ('BT') over a bad debt surcharge relating to calls to Premium Rate Services, 3 January 2003, published at: http://www.ofcom.org.uk/static/archive/oftel/publications/licensing/2002/nts1202_4.pdf

proactively removed the retail costs from the CPS cost stack when it came to review its CPS charges in November 2007.

- 4.36 The issues in dispute are also somewhat different. The present dispute is about whether BT is entitled to recover certain costs through the CPS set-up charge. As noted above, the level of the CPS set-up charge is not within the scope of this dispute. By contrast, in the PRS bad debt surcharge dispute, C&W accepted that BT was entitled to recover its costs associated with PRS bad debt, but wanted to ensure “that any bad debt retention which BT makes through the PRS bad debt surcharge recovers only those retail bad debt costs associated with PRS calls that are not recovered elsewhere”. The Director’s determination of the PRS bad debt surcharge dispute therefore focused on the methodology BT had used to calculate charges, whereas our determination of the current dispute focuses on the principle of whether the disputed costs should be included in the CPS cost stack.
- 4.37 On the basis of the reasoning at paragraphs 4.32-4.36 above, Ofcom concludes that its proposal that BT is not required to make repayments to the CPSOs is not inconsistent with the Director’s determination of the PRS bad debt surcharge dispute.

The first NTS dispute

- 4.38 On 3 April 2003 BT announced a number of changes to its retail prices for calls to 0845, 0820 and 0870 numbers. On 4 July 2003, BT issued a pricing letter notifying changes to the level of payments made by BT to TCPs for the termination of calls to those numbers. BT proposed that those changes should take effect from 1 June 2003. On 24 October 2003 BT issued a second pricing letter notifying the same changes, with effect from 29 August 2003.
- 4.39 Ofcom directed the parties to accept the terms of BT’s pricing letter (subject to some adjustments to the amount of payments, made as a result of errors in BT’s data that Ofcom had uncovered during its consideration of the dispute). Ofcom’s determination of 27 May 2004 required the parties to make repayments to each other as appropriate from 29 August 2003, the effective date of the pricing letter (being 56 days after 4 July 2003 when BT told the industry what the new rates were going to be).
- 4.40 In its draft determination, Ofcom explained that BT accepted that the date of the pricing letter was the first formal notification to the industry of this change (although BT considered that this represented a compromise from its original position that the new rates should apply from an earlier date based on when BT had informed providers informally). Other providers had argued that a later date should apply, because the change in the level of payments they received from BT meant they needed to renegotiate agreements with third parties.⁴³
- 4.41 Ofcom concluded that the proposed application date gave the parties “sufficient notification” of the price change and concluded that the new charges should take effect from that date. At paragraph 5.32 of its direction of the first NTS dispute, Ofcom stated that:

“Ofcom considers that, were it to direct BT and the Providers to accept the terms [...] from any date other than 29 August 2003, it would reduce the incentive on other termination providers to enter

⁴³ See paragraphs 4.14-4.18 of the draft determination in the first NTS dispute, published at: http://www.ofcom.org.uk/consult/condocs/nts_dispute/nts_polo/exp_statmnt/section4/

into future negotiations in good faith. It would, in fact, provide them with an incentive to delay the acceptance of new proposals”.

Ofcom’s response

- 4.42 In the first NTS dispute, BT was required by its SMP obligations (SMP Condition AA11, or the “NTS call origination condition”) to reflect the change in its retail prices by recalculating its outpayments to TCPs. At paragraph 5.11 of the first NTS dispute, Ofcom stated that BT had “acted in line with its regulatory obligations in proposing new outpayments”. The key question in determining from what date the new rates should apply was therefore when the industry had been properly notified of the changes.⁴⁴ Ofcom concluded that 29 August 2003 (56 days after BT’s formal notification of the changes) gave providers “sufficient notification” of the changes.
- 4.43 However, in the current case, the relevant issue is not whether BT had given CPSOs adequate notice of the price change. Rather, the key issue is at what point BT should have removed the disputed costs from its cost stack given that Ofcom had not, by 1 November 2007 (when BT changed its CPS charges), indicated with sufficient clarity to BT, that it was not reasonable for it to include the disputed costs in the CPS cost stack or that these costs were not costs of providing CPS facilities under SMP Condition AA8. This contrasts with the first NTS dispute where, as discussed in the previous paragraph, the pricing change that prompted the dispute was found to be consistent with BT’s SMP obligations.
- 4.44 The respondents have not submitted arguments as to why they think the first NTS dispute supports their argument that we should require BT to make repayments. In the absence of such arguments, it is Ofcom’s view that the first NTS dispute does not support a determination that BT should be required to make repayments for the disputed charges it recovered prior to Ofcom’s consideration of this dispute.
- 4.45 On the basis of the reasoning at paragraphs 4.42-4.44 above, Ofcom concludes that its proposal that BT is not required to make repayments to the CPSOs is not inconsistent with Ofcom’s determination of the first NTS dispute.

The WLR ISDN2 charges dispute

- 4.46 We discussed the WLR ISDN2 charges dispute at paragraphs 5.78-5.80 of the Draft Determination (and paragraphs 5.73-5.75 of the Timing Consultation), which are repeated below for convenience:

“5.78 In its determination of a dispute relating to BT’s charges for WLR ISDN2 (“the WLR ISDN2 charges dispute”) Ofcom concluded that BT had over-recovered from its wholesale customers the costs it incurred in providing WLR ISDN2 between 28 November 2003 and 30 September 2004. Ofcom’s determination of 9 March 2005 required BT to make repayments by way of adjustment to the charges that applied over that period.

5.79 In the WLR ISDN2 charges dispute, Ofcom concluded that for a period of time BT’s charges for WLR ISDN2 services were not based on the forward-looking LRIC of providing those services and that BT was therefore over-recovering its costs. Ofcom therefore required BT

⁴⁴ See paragraphs 5.27-5.34 of the first NTS dispute.

to make repayments in respect of the period for which it was over-recovering its costs, 28 November 2003-30 September 2004.

5.80 In the WLR ISDN2 charges case, Ofcom had never set BT's charges. BT was therefore responsible for ensuring that it was complying with its cost orientation obligations without a signal from Ofcom as to what level of charge would be appropriate. The current dispute, by contrast, relates to a charge that was originally set by the Director in 2002 and revised by Ofcom in 2005."

- 4.47 In addition (as noted at paragraph 5.83 of the Draft Determination and 5.78 of the Timing Consultation), the WLR ISDN2 charges dispute considered whether the costs that BT was recovering through its WLR ISDN2 charges were reflective of LRIC. By contrast, the level of the CPS set-up charge, and the question of whether the disputed costs (or indeed any other cost in the CPS cost stack) are based on the forward-looking LRIC of providing the service, is not within the scope of this dispute.
- 4.48 The respondent that submitted that the approach taken in the WLR ISDN2 charges dispute is not consistent with the position taken in the Timing Consultation (who has asked not to be named), has not explained in its response why it believes the interpretation set out above is incorrect. Ofcom stands by its interpretation, as set out in the Draft Determination and Timing Consultation. We do not therefore consider it necessary to expand on the reasoning set out in the Draft Determination and the Timing Consultation on the WLR ISDN2 charges dispute any further here.

The Opal dispute

- 4.49 We discussed the Opal dispute at paragraphs 5.74-5.77 of the Draft Determination and 5.69-5.72 of the Timing Consultation, which are repeated below for convenience:

"5.74 As set out at paragraph 2.30 above, Ofcom's determination of the Opal dispute was published on 16 May 2006 but took effect from 28 November 2003.

5.75 The Opal dispute related to BT's recovery of the costs of CPS Facilities (including CPS Per Provider Set-up Costs, CPS Per Provider On-going Costs and CPS Per Customer line Set-up Costs, including transaction charges). Ofcom found that BT had been under-recovering its Per-provider costs and over-recovering its Per-customer costs and, on that basis, was able to calculate the point at which BT broke even. Ofcom concluded that BT had recovered its costs of providing CPS Facilities at the end of November 2003, and that an offer by BT to backdate its charges to 28 November 2003 was therefore reasonable. Ofcom required BT to make repayments by way of adjustment to the other charges in dispute to the same date.

5.76 The current dispute relates to costs that BT incurs (and recovers from other providers) on a transaction-by-transaction basis. As BT has consistently recovered these costs over the period in dispute, there is no "break even" point. We cannot therefore adopt the methodology that we used in resolving the Opal dispute in deciding whether BT should be required to make payments to CPSOs in this case.

5.77 Opal did not ask Ofcom to modify or withdraw the CPS charges Ofcom had set in the earlier August 2005 Direction. Rather, Opal asked for the “retrospective application” of certain of BT’s charges for the provision of CPS as set by Ofcom in the 2005 Direction. The facts in the current dispute are different, as C&W’s request to Ofcom to require BT to make payments to the CPSOs by way of adjustment for overpayments since 28 November 2003 can arguably be seen as a request to modify or withdraw the August 2005 Direction.”

- 4.50 The Opal dispute considered whether the individual cost items that BT was recovering through its CPS charges were cost oriented. By contrast, the level of the CPS set-up charge, and the question of whether the disputed costs (or indeed any other cost in the CPS cost stack) is based on the forward-looking LRIC of providing the service, is not within the scope of this dispute. Ofcom did not, in the Opal dispute, determine that BT was not entitled to recover certain cost items. The Opal dispute required BT to make repayments by way of adjustment for the overpayment of CPS charges set at a level that enabled BT to recover the disputed costs (in line with the August 2005 Direction).
- 4.51 The respondent that submitted that the approach taken in the Opal dispute is not consistent with the position taken in the Timing Consultation (who has asked not to be named) has not explained in its response why it believes the interpretation set out above is incorrect. Ofcom stands by its interpretation, as set out in the Consultation and Timing Consultation. We do not therefore consider it necessary to expand on the reasoning set out in the Draft Determination and the Timing Consultation on the Opal dispute any further here.

The second NTS dispute

- 4.52 On 1 October 2006, BT announced changes to the way it charged for retail calls to 0845 numbers. BT notified consequent changes to its outpayments to TCPs by way of an OCCN of 3 August 2006, effective from 1 October 2006.
- 4.53 BT submitted a dispute to Ofcom after a number of communications providers failed to sign the OCCN. Ofcom accepted the dispute and considered whether BT’s proposed changes were consistent with its regulatory obligations.
- 4.54 Ofcom directed BT to amend the methodology it used to calculate the outpayments in dispute. Ofcom’s determination of 4 June 2007 required the parties to make repayments to each other as appropriate from 1 October 2006, the effective date of BT’s OCCN.

Ofcom’s response

- 4.55 In its determination of the second NTS dispute Ofcom does not consider the repayment date in any detail. BT’s response (included as an annex to Ofcom’s determination) supports Ofcom’s proposal for its determination of the second NTS dispute to apply from 1 October 2006. The “main concern” and “additional concerns” addressed in the second NTS dispute do not include any consideration of the appropriate date for repayments⁴⁵. Ofcom directed BT to adopt a new methodology, and required the parties to make repayments to reflect that methodology from 1

⁴⁵ See paragraphs 5.5-5.9 of the draft determination in the second NTS dispute, published at: http://www.ofcom.org.uk/consult/condocs/deter_nts/nts.pdf, and section 5 of the final determination.

October 2006. Ofcom made it clear that it was imposing the “most reasonable” of three reasonable options.

- 4.56 In the present dispute, the key question is at what point BT should have removed the disputed costs from its cost stack, given that Ofcom had not, by 1 November 2007 (when BT changed its CPS charges), indicated with sufficient clarity to BT, that it was not reasonable for it to include the disputed costs in the CPS cost stack or that these costs were not costs of providing CPS facilities under SMP Condition AA8.
- 4.57 The respondents have not submitted arguments as to why they think the second NTS dispute supports their argument that we should require BT to make repayments. In the absence of such arguments, it is Ofcom’s view that the second NTS dispute does not support a determination that BT should be required to make repayments for the disputed charges it recovered prior to Ofcom’s consideration of this dispute.
- 4.58 On the basis of the reasoning at paragraph 4.57 above, Ofcom concludes that its proposal that BT is not required to make repayments to the CPSOs is not inconsistent with Ofcom’s determination of the second NTS dispute.

The mobile termination rates disputes

- 4.59 C&W and another respondent (who asked not to be named) note that Ofcom’s redetermination of the mobile termination rates disputes required the parties to make repayments (plus interest) in order to implement Ofcom’s determination that mobile providers are not entitled to recover their costs of terminating 3G mobile calls through their termination charges for 2G mobile calls (the costs of 3G termination having previously been included in the mobile providers’ costs stacks).
- 4.60 In its redetermination of the mobile termination rates disputes, Ofcom was required by the CAT to order the parties to make repayments in order to reflect the CAT’s decision that Ofcom’s original decision had been incorrect. Ofcom does not consider that its redetermination of the mobile termination rates disputes is therefore a relevant precedent for the current dispute. Ofcom notes that neither its August 2005 Direction, that set the CPS charge at a level that included the disputed costs, nor its subsequent determination of the Opal dispute, which was based on the charges set in the August 2005 Direction, was appealed.
- 4.61 Ofcom considers that its proposal that BT is not required to make repayments to the CPSOs is not inconsistent with Ofcom’s redetermination of the mobile termination rates disputes.

Relevance of disputes raised by other stakeholders: conclusion

- 4.62 Ofcom must determine disputes based on the facts of each case in a way that supports its statutory duties and regulatory obligations and is fair and reasonable as between the parties to the dispute. This includes a consideration of Ofcom’s duty to ensure consistency. Ofcom has therefore reviewed its approach in the various disputes mentioned by the parties and, in light of its conclusion on the date from which its Determination on the first two issues in dispute should apply, and for the reasons set out in this document, Ofcom does not consider that its proposal not to require BT to make any repayments to CPSOs in this dispute is inconsistent with past practice.

- 4.63 As set out at paragraph 3.27 above, one respondent (who asked not to be named) argued that there was an “established practice” by the regulator of ordering repayments or retrospective adjustment of charges to comply with:
- “new requirements around cost-orientation”;
 - “new methodologies to assess appropriate cost recovery”; and
 - “new approaches to cost calculations whereby specific cost items have been excluded from calculations”.
- 4.64 Ofcom does not consider that the examples considered above relate to “new requirements around cost-orientation”. We do not consider that, in any of the examples considered above, “specific cost items have been excluded from calculations”.
- 4.65 Ofcom agrees that in the NTS retail uplift dispute, the PRS bad debt surcharge dispute, the second NTS dispute and the WLR ISDN2 dispute, the scope of the disputes considered “new methodologies to assess appropriate cost recovery”. In this case, the scope of the dispute was to determine whether BT is entitled to recover the disputed costs through the CPS set-up charge (and if so, how much the charge needs to fall and whether BT is required to make repayments to CPSOs as a result). The level of the CPS set-up charge is not (as discussed at paragraph 3.24 of the Draft Determination) within the scope of this dispute. Ofcom does not therefore consider that these examples provide applicable guidance on the appropriate date for repayments in this dispute.
- 4.66 In these examples, while Ofcom has ordered repayments (or the Director has determined disputes with retrospective effect), this has generally been to the date of the relevant pricing notification (whether issued by BT or another party), and not to some earlier date requested by the parties in dispute. For example, in the PRS bad debt surcharge dispute, the Director rejected Energis’s request to him to recalculate the PRS bad debt surcharge from 1 October 1997. The exception to this is the NTS retail uplift dispute which, as noted above, was clearly due to the exceptional circumstances of that case. Ofcom considers that none of the examples stakeholders have provided support the view of C&W and other stakeholders that BT should be required to make repayments to 2003.
- 4.67 Ofcom has also considered whether, for consistency with previous disputes, it would be appropriate to require BT to make repayments to other providers to the date of the relevant pricing notification, which is 1 November 2007, the repayment date that Ofcom originally proposed (although we note that none of the respondents to the Timing Consultation have made explicit arguments that the previous disputes mean that Ofcom should order repayments to that date).
- 4.68 None of the examples that stakeholders have given us shares the key features of the current dispute, which are that Ofcom has now directed BT to remove certain costs from the cost stack, having previously set charges at a level that enabled allowed BT to recover those costs.
- 4.69 In other words none of the disputes mentioned by the respondents seems to relate, as one respondent suggests (see paragraph 3.27 above), to “whether the regulated operator, at the time the charge was originally set, would have known that a particular cost item could not be included”.

- 4.70 C&W submits (in relation to the first NTS dispute) that “BT couldn’t have known that Ofcom would require them to calculate the charges differently at the time, yet Ofcom still considered retrospection to be appropriate, irrespective of any earlier ‘signalling’ to the contrary”. Another respondent (who asked not to be named) submits that “it has never been suggested by Ofcom that the regulated operator would have had to be explicitly told beforehand that a particular cost item should not be included in a regulated charge in order for backdating to be a possible remedy” (echoed in the same respondent’s comment that in none of the disputes we have considered above was there “any previous indication to the regulated operator that the original charges were too high”).
- 4.71 However, for the reasons as set out in paragraphs 4.42-4.46 above, Ofcom does not believe that its determination of this dispute is inconsistent with the first NTS dispute. In addition, Ofcom notes that its determination in this dispute must be viewed within the entire factual context of the dispute including the fact that the binding August 2005 Direction set charges at a level that enabled BT to recover the disputed costs, while Ofcom’s determination of the Opal dispute was based on the charges set by Ofcom in the August 2005 Direction, and did not suggest that the disputed costs should be removed from the CPS charges.

Wider implications of Ofcom’s proposal not to require repayments

- 4.72 C&W argues (see paragraph 3.32 above) that Ofcom’s proposal not to require BT to make repayments places on BT an incentive to attempt to recover costs that it is not entitled to recover in the expectation that Ofcom will not require it to make repayments to other parties in the event of a dispute.
- 4.73 Ofcom’s Determination confirms that BT is not entitled to recover the disputed costs through the CPS set-up charge, because the disputed costs are not “costs of providing CPS” as set out in SMP Condition AA8. As noted at paragraphs 7.19-7.20 of the Timing Consultation, Ofcom considers that its decision in this dispute may provide guidance as to the treatment of other retail costs in the context of SMP Condition AA8. However, Ofcom has not considered any other element of the CPS set-up charge or BT’s other CPS charges. We do not therefore agree with the suggestion of one respondent (see paragraph 3.11 above) that Ofcom’s proposals in this dispute mean that BT is only required “to adjust its CPS charges as and when Ofcom explicitly requires it to do so”.
- 4.74 Ofcom is not, as one respondent suggests (see paragraph 3.34 above), saying that BT is not required to review its regulated charges until Ofcom provides explicit guidance as to what costs can and cannot be included. As discussed at paragraphs 1.11-1.23 above, BT has a duty to comply with its SMP obligations. However, in this case, Ofcom has concluded that Ofcom did not, prior to the Draft Determination, indicate that (contrary to the August 2005 Direction) it was no longer reasonable for BT to include the disputed costs in the CPS cost stack or that these costs were not costs of providing CPS facilities under SMP Condition AA8, which meant that while BT did indeed review its regulated charges, it was reasonable for it to include the disputed costs in the CPS cost stack under SMP Condition AA8.
- 4.75 The current dispute relates to a specific charge for one product that BT is required to provide as a result of SMP Condition AA8. In other cases, other regulatory obligations, Ofcom statements and guidance will be relevant, and the parties cannot therefore infer from this decision what will be a fair and reasonable outcome in relation to repayments in possible future disputes involving other SMP-related products.

- 4.76 C&W suggests (see paragraph 3.33 above) that Ofcom's proposal not to require BT to make repayments will encourage BT to review statements made by Ofcom to identify "evidence that they can use to exploit their SMP obligations and increase their charges".
- 4.77 C&W appears to be describing a hypothetical scenario in which BT attempts to increase a charge on the basis that Ofcom had not made any clear statement about what costs BT can and cannot include. Ofcom notes that the current dispute does not relate to an attempt by BT to start recovering costs that it had not previously been recovering. Ofcom must determine an appropriate outcome based on the facts of each individual dispute.
- 4.78 One respondent suggests that Ofcom's determination of this dispute will give BT an incentive to "prevaricate and delay" negotiations as long as possible. In resolving disputes, Ofcom has to consider what is fair and reasonable as between the parties. Ofcom recognises that proper commercial negotiations take time. The length of the negotiations that led to the current dispute is not a reason for requiring repayments to a date at which BT could not reasonably have been expected to remove the disputed costs from its cost stack in order to ensure consistency with its SMP obligations, as that would not, in our view, represent a fair balance between the parties.
- 4.79 As noted above, Ofcom's decision on repayments is made on the facts of this case, and communications providers cannot infer from this decision that Ofcom will not require repayments in other disputes. BT and others will not therefore have an incentive to "exploit" any opportunity (see paragraph 3.38 above) as a result of this dispute.
- 4.80 Another respondent suggests that Ofcom's decision creates an incentive on non-SMP providers to "challeng[e] every single BT charge as soon as possible".
- 4.81 It is not clear whether the respondent means that they will have an incentive to immediately challenge BT on price changes (which we consider would be within normal commercial practice), or whether they mean that they would refer disputes to Ofcom as soon as possible. Ofcom notes that in this case C&W and others initiated negotiations only when BT changed its prices. They could in any event have initiated negotiations, or approached Ofcom to consider the issue, before that point but chose not to do so.

BT's comments

- 4.82 Ofcom notes BT's ACCN 925, effective 16 February 2009, which implements the Determination by notifying a new CPS set-up charge of £1.69 (see paragraph 1.13 above). Ofcom notes that it did not, strictly speaking, direct the level of the CPS set-up charge (as BT's comment suggests) – rather, the Determination required BT to reduce the CPS set-up charge by the amount of the disputed costs.
- 4.83 Ofcom does not agree that BT had "absolutely no reason" to foresee Ofcom's decision on recovery of the disputed costs. While the August 2005 Direction allowed BT to continue to recover the disputed costs, at the same time it was clear from stakeholders' comments that the industry did not agree that BT was entitled to recover the disputed costs. In the same statement Ofcom had indicated that it considered it appropriate to look at the issue in more detail as part of its planned 2006 review of CPS charges. Ofcom has not indicated to BT, prior to this dispute, that it should have removed the disputed costs from the CPS cost stack. However, Ofcom considers that its approach to WLR could have indicated to BT that, when

Ofcom came to explicitly address the recovery of the dispute costs through the CPS set-up charge, it might reach the conclusion that it has in this dispute.

- 4.84 Ofcom has not taken a view on BT's comment, as set out at paragraph 3.49 above, on Ofcom's power to "reverse" a decision already taken. In reaching this decision, we have considered our power to require repayments as set out at section 190(2)(d) of the 2003 Act. It has not been within the scope of this dispute to consider whether Ofcom can "reverse" a decision.

The application of Ofcom's duties

- 4.85 Ofcom has a duty to resolve certain disputes. When Ofcom decides that it is appropriate for it to handle a dispute, it must consider the dispute and make a determination resolving it. The Determination of 13 February 2009 was made in line with this duty.
- 4.86 Ofcom's powers in resolving disputes are set out at section 190 of the 2003 Act. Ofcom has a discretion to use these powers to resolve disputes in a way that supports its statutory duties and regulatory obligations. One of these powers is a power to order the payment of sums between parties to a dispute by way of adjustment of an underpayment or overpayment.
- 4.87 In considering whether to exercise its discretion, Ofcom must consider whether on the facts of each particular dispute, it is appropriate and proportionate to do so, taking into account its general statutory duties and community obligations under sections 3 and 4 of the 2003 Act. In particular, regard must be had to its duty under section 3(1)(b) of the 2003 Act to further the interests of consumers in relevant markets, where appropriate by promoting competition, in line with its duty under section 4 of the 2003 Act to promote competition in communications markets in accordance with the policy objectives of Article 8 of the Framework Directive.⁴⁶
- 4.88 Pursuant to s.3(3) of the 2003 Act, in performing its duties under s.3(1) Ofcom must have regard in all cases to the principles under which regulatory activities are transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed, and any other principles which appear to Ofcom to represent the best regulatory practice.
- 4.89 In addition, the CAT (in its TRD core issues judgment) gave further guidance that:
- "Ofcom must have regard to what is fair as between the parties and what is reasonable from the point of view of the regulatory objectives set out in the Common Regulatory Framework Directives and in the 2003 Act."
- 4.90 It is in the context of these duties and principles that we have considered the third of the issues in dispute, namely the date from which Ofcom's determination of the first two issues in dispute should apply, and whether BT is required to make repayments to the other parties in dispute by way of adjustment for overpayments.
- 4.91 Ofcom considers that the Determination supported its obligation to further the interests of consumers, where appropriate by promoting competition, since, in the Determination, Ofcom has now confirmed that BT's retail costs should be removed

⁴⁶ Directive 2002/21/EC of the European parliament and of the Council of 7 March 2002 on a common regulatory framework for electronic communications networks and services.

from the CPS cost stack. Ofcom's determination of this dispute therefore supported Ofcom's principal duty at section 3(1)(b) of the 2003 Act, as well as its duty under section 4 of the 2003 Act to promote competition in communications markets in accordance with the Framework Directive.

- 4.92 Ofcom considers that, by providing guidance that BT's retail costs should be removed from the CPS cost stack (and by requiring BT to remove those costs from the CPS set-up charge with immediate effect, which BT has now done), its conclusion of this dispute was in line with the policy objectives of Article 8 of the Framework Directive.
- 4.93 Ofcom considers that this will also help to level the playing field for BT's competitors. This supports Ofcom's obligations at section 3(2)(b) of the 2003 Act to secure the availability of a wide range of communications services, as well as its duty under section 4 of the 2003 Act to encourage the provision of network access (here, CPS) for the purposes of securing efficiency and sustainable competition for the benefit of consumers.
- 4.94 By providing clarity as to how BT's regulatory obligations will operate in practice, Ofcom considers that its conclusion of this dispute, by supporting the competition-related duties set out above, also supported Ofcom's principal duty to further the interests of consumers. By clarifying BT's SMP obligations for all parties, Ofcom's determination of this dispute increased regulatory certainty which will support competition between communications providers, benefiting consumers in the form of greater competition, leading to downward pressure on prices, availability of a wider range of services, and improved quality of service.
- 4.95 Ofcom considers that the Determination was fair and reasonable as between the parties to the dispute, and that this was in line with Ofcom's duty to ensure that its regulatory activities are transparent, accountable, proportionate, consistent and targeted.
- 4.96 Finally, Ofcom considers that the Draft Determination, the Determination, the Timing Consultation and this statement clearly set out the parties' arguments, Ofcom's response to stakeholders' responses, and Ofcom's reasoning that leads to its conclusion. In particular, in the Timing Consultation, Ofcom gave the parties an additional opportunity to comment on its proposals regarding repayments, in the interests of fairness. Ofcom considers that this supported its duty to ensure that its regulatory activities are transparent, accountable, proportionate, consistent and targeted.
- 4.97 Ofcom has carefully considered the representations made by stakeholders in response to the Timing Consultation in relation to the date from which its Determination of the first two issues in dispute should apply, and whether BT is required to make repayments to CPSOs. Ofcom has set out above both those representations and Ofcom's response. Ofcom has also considered the approach it has taken to repayments in previous disputes.
- 4.98 In light of the analysis of previous disputes set out at paragraphs 4.15-4.71 above, and the specific facts of this case, Ofcom is satisfied that its proposals are consistent with the approach it has taken in previous disputes, and that it has met its statutory duty to ensure consistency in its regulatory approach.
- 4.99 C&W and others have suggested that Ofcom's proposals do not fulfil Ofcom's competition related duties, first, because they "create uncertainty" in the market, and

second, because the sums that CPSOs have paid to BT has led to a “competitive distortion”.

- 4.100 The Determination specified changes that BT needed to make to its charges on a forward looking basis, which BT has now made. Ofcom considers that the resolution of this dispute was in line with its earlier positions (the August 2005 Direction and the Opal dispute determination) and made a clear statement of Ofcom’s view on recovery of the disputed charges for the future. Ofcom had not previously made a clear statement on the disputed costs prior to the publication of the Draft Determination and the subsequent Determination. The current dispute related to a specific charge for one product that BT is required to provide as a result of SMP Condition AA8. In other disputes, other regulatory obligations, Ofcom statements and guidance will be relevant, and the parties cannot therefore infer from Ofcom’s determination of this dispute what will be a fair and reasonable outcome in relation to repayments in possible future disputes involving other SMP-related products. Ofcom does not therefore agree that its resolution of this dispute leads to “uncertainty” in the market. Rather we consider our approach promotes regulatory certainty in the market and encourages and promotes competition, consistent with our duties.
- 4.101 On the second point – that existing payments have led to “competitive distortion” – as noted at paragraph 4.13 above, an assessment of whether BT’s historic recovery of the disputed costs constituted discrimination (and thereby lead to “competitive distortion”) was not within the scope of this dispute, and Ofcom has not made any assessment of, or reached any conclusions in relation to this question.
- 4.102 Ofcom does not agree with one stakeholder’s comment that its proposals for resolving this dispute contradict its duty “to act in a proportionate and transparent manner”. The Timing Consultation and this document clearly set out the parties’ arguments and Ofcom’s reasoning that leads to its conclusion that BT is not required to make any repayments to CPSOs. Ofcom notes that the parties had an opportunity to comment on Ofcom’s original proposals, and a further opportunity to comment on Ofcom’s proposals on repayments, and that this supported Ofcom’s duty to ensure that its regulatory activities are transparent, accountable, evidence-based and consistent. Further, Ofcom considers that its decision not to require BT to make any repayments to CPSOs is proportionate, in that it strikes a fair balance between the parties to the dispute.

Conclusion

- 4.103 On the facts of this dispute, we have decided that it is not reasonable to expect BT to have known, before the determination of this dispute, that Ofcom would require it to remove the disputed costs from the CPS cost stack.
- 4.104 When SMP Condition AA8 was introduced in 2003, BT took the view that in complying with SMP Condition AA8 it was reasonable to include the disputed costs in the cost stack for CPS.
- 4.105 In 2005, Ofcom set BT’s charges for CPS in the August 2005 Direction. The disputed costs were included in the cost stack that Ofcom used to set the charges, thus by implication, Ofcom affirmed the reasonableness of BT’s decision to include those costs in the cost stack in 2003.⁴⁷

⁴⁷ Further detail can be found at paragraphs 7.39 to 7.41 of the Timing Consultation.

- 4.106 In January 2006, Ofcom published a statement setting charge ceilings for a number of WLR services. The cost stack that Ofcom used for this exercise expressly did not include “sales and marketing costs” (which would have included costs analogous to the disputed costs in this case). However, Ofcom made no reference to CPS in that statement, and did not state that BT should similarly remove the equivalent costs from the CPS cost stack.
- 4.107 In May 2006, Ofcom resolved the Opal dispute in a way which enabled BT to continue to recover the disputed costs in line with the August 2005 Direction. The August 2005 Direction, therefore remained unchanged and continued to be binding on BT.
- 4.108 In the Determination of 13 February 2009, Ofcom concluded that BT is not entitled to recover the disputed CPS set-up charges from CPSOs. However, as set out above, at no time prior to the Draft Determination did Ofcom indicate that it was no longer reasonable for BT to include the disputed costs in the CPS cost stack or that these costs were not costs of providing CPS facilities under SMP Condition AA8.
- 4.109 The CPSOs have argued that BT has since 2003 failed to comply with SMP Condition AA8, by recovering the disputed costs through the CPS set-up charge. They consider that Ofcom should therefore require BT to reimburse CPSOs for the amounts which they claim BT has overcharged since 2003. BT contests that position.
- 4.110 BT has a continuing obligation to comply with SMP Condition AA8. In 2003, BT decided to include the disputed costs in its CPS cost stack, on the basis that to do so was in compliance with its obligation to comply with SMP Condition AA8. Ofcom impliedly affirmed that position when it included the disputed costs in the charges it set in the binding August 2005 Direction. Ofcom has not, prior to the Draft Determination, indicated that it was no longer reasonable for BT to include the disputed costs in the CPS cost stack.
- 4.111 On the facts of this dispute, Ofcom has concluded that it was reasonable for BT to include the disputed costs in its cost stack for CPS charges under SMP Condition AA8 from November 2003 to 13 February 2009, when Ofcom determined that those costs should no longer be included for the purposes of that condition. Ofcom does not therefore need to go on to consider whether it would be appropriate to require BT to make any repayments to CPSOs as a result of Ofcom’s determination of the first two issues in this dispute. Ofcom is not therefore making any further determination in relation to this dispute.