



Draft Determination to resolve a dispute between BT and various communications providers about NTS outpayments

Consultation

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Section 1

Determination for resolving a dispute between the companies listed at Annex 4 and BT about NTS outpayments for 0845 and 0870 calls

WHEREAS:

- (A) section 188(2) of the Communications Act 2003 (the “Act”) provides that where there is a dispute between different communications providers, and Ofcom have decided pursuant to section 186(2) of the Act that it is appropriate for them to handle the dispute, Ofcom must consider the dispute and make a determination for resolving it. The determination that Ofcom makes for resolving the dispute must be notified to the parties in accordance with section 188(7) of the Act, together with a full statement of the reasons on which the determination is based. Section 190 sets out the scope of Ofcom’s powers on resolving a dispute, which may include, in accordance with section 190(2) of the Act, a direction requiring the payment of sums by way of adjustment of an underpayment or an overpayment;
- (B) on 3 August 2006 BT issued an Operator Charge Change Notice (“OCCN”) to the companies listed in Annex 4 (“the Providers”), amongst others, detailing proposed NTS origination payments (“outpayments”) payable by BT to the Providers for the provision of NTS services on the 0845 and 0870 number ranges from 1 October 2006;
- (C) on 16 January 2007, BT wrote to Ofcom referring a dispute between BT and the Providers on the basis that they had either rejected or neglected to sign the August OCCN. BT requested Ofcom to resolve the dispute by requiring the Providers to accept the terms of the OCCN;
- (D) on 5 February 2007, after considering the referral and contacting the parties, Ofcom decided pursuant to section 186(2) of the Act that it was appropriate for it to handle the dispute and informed the Providers and BT of this decision;
- (G) in order to resolve this dispute, Ofcom has considered, among other things, the information supplied by the Providers and BT and the relevant duties set out in sections 3 and 4 of the Act;
- (H) an explanation of the background to the dispute and Ofcom’s reasons for making this Determination are set out in the explanatory statement accompanying this Determination;
- (I) Ofcom issued a draft of this Determination and the explanatory statement on 26 April 2007 and responses were invited by 11 May 2007.

NOW, THEREFORE, PURSUANT TO SECTION 190 OF THE ACT, OFCOM MAKES THE FOLLOWING DRAFT DETERMINATION:

Resolution of a dispute between BT and various operators about NTS outpayments

1. BT shall amend its NTS outpayments methodology to allow for a call set-up payment of 2.55p for all 0845 calls, as set out in Option 3 in Section 6 of this explanatory statement.
2. The terms on which BT shall provide NTS Call Origination (including the provision of the outpayments) for calls to 0845 and 0870 number ranges shall be those set out in the 3 August 2006 OCCN with effect from 1 October 2006, other than the introduction of the call set-up payment (outlined in point 1 above), and an amended pence per minute rate (to take into account the call set-up payment as per Section 6). The discount rates applied by BT shall be those set out in its OCCN of 3 August 2006.
3. For the purposes of giving effect to paragraph 2 of this Determination:
 - a) where amounts have been paid by BT to the Providers which are greater than the amounts due under the methodology set out in points 1 and 2 above (using a call set-up payment), the Providers shall pay to BT such sums, as appropriate, by way of adjustment of any overpayment; and
 - b) where amounts have been or should have been paid by BT to the Providers which are lower than the amounts due under the methodology set out in points 1 and 2 above (using a call set-up payment), BT shall pay to the Providers such sums, as appropriate, by way of adjustment of any underpayment.
4. Words or expressions used in this Determination shall have the same meaning as in the Act, except as otherwise stated in this Determination and as follows:
 - (a) "Condition AA11" means the condition numbered AA11 set out in Part 2 of Schedule 1 to the Notification;
 - (b) "Net Retail Call Revenue" means the retail revenue for calls, excluding VAT and after any applicable discounts;
 - (c) "NTS Call Origination" means originating NTS Calls and retailing those NTS Calls to the End-User on behalf of the Third Party who has requested NTS call origination;
 - (d) "Notification" means the notification pursuant to sections 48(1) and 79 of the Act which is set out in Review of the fixed narrowband wholesale exchange line, call origination, conveyance and transit markets published by the Director on 28 November 2003;
 - (e) "Outpayment" means the Net Retail Call Revenue passed by BT to the Third Party that is purchasing NTS Call Origination, less the charges referred to in paragraph 4 of Condition AA11.

David Stewart

DIRECTOR OF INVESTIGATIONS

Section 2

Summary

- 2.1 Ofcom has published a Draft Determination under section 190 of the Communications Act 2003 (“the Act”) to resolve a dispute between British Telecommunications plc (“BT”) and the providers listed in Annex 5 to the Draft Determination (“the Providers”).
- 2.2 This dispute relates to BT’s payments to other providers which BT makes when passing NTS traffic for 0845 and 0870 number ranges (“the relevant number ranges”) to those providers.
- 2.3 On 1 October 2006 BT changed the pricing of residential 0845 calls by replacing the minimum call charge (“MCC”) with a call set-up fee (“CSF”).
- 2.4 BT has proposed a blended rate methodology for calculating payments to providers (“outpayments”), which averages outpayments over business and residential calls. The blended rate is a single pence per minute rate regardless of the call duration.
- 2.5 In addition, BT forecast future discount rates for the purposes of calculating NTS outpayments which resulted in material increases in discount rates. Since increasing discount rates results in lower payments from BT to the Providers, some Providers object to this change.

Discount rate calculations

- 2.6 Based on the responses Ofcom received from the Providers, their main concern was not over the new blended rate methodology proposed by BT, but rather over the materially higher discount rates introduced by BT.
- 2.7 The calculations and source data provided to Ofcom by BT give no indication of error in the way that forecast future discount rates have been estimated (since this is how discount rates for future periods have to be calculated), and Ofcom has found no evidence of miscalculation.

BT’s proposed methodology vs other methodologies

- 2.8 As a general rule, Ofcom believes a method of allocating outpayments is most likely to be fair and reasonable if it provides the best match of outpayments to revenues, subject to the costs of implementation being proportionate. Matching outpayments to revenues is also consistent with Ofcom’s Community duties (see Footnote 6 to para 5.9), which include the promotion of competition (in this context, including in markets for services provided using electronic communications accessed using NTS numbers).
- 2.9 A methodology that more closely matches the NTS outpayments with the revenues received by BT will help ensure a ‘level playing field’ for all Providers and should reduce any artificial incentives for Providers to encourage NTS calls of a particular type or length.
- 2.10 Ofcom regards BT’s proposed methodology as a reasonable method of calculating NTS outpayments in that it results in BT paying out the full amount of received NTS

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revenue less the allowed (regulated) retention amounts. It is also a simple methodology for both BT and the Providers to use to calculate outpayments.

- 2.11 However, there are other methodologies which also appear to be fair, reasonable and non-discriminatory, and which may more closely match revenues with outpayments.
- 2.12 One of these other methodologies involves the introduction of a fixed call set-up payment being paid by BT for each 0845 call it originates (this is given as Option 3 in Section 6 of this Draft Determination), whether it be from a business or a residential customer. Ofcom provisionally concludes that this option is the most appropriate because it offers the closest match of NTS outpayments to revenues (although Ofcom does not have evidence concerning the costs of implementation by BT and Providers of this method).
- 2.13 Ofcom is seeking comments on this draft determination and in particular invites the comments of the parties about which method is favoured and why.
- 2.14 This Draft Determination sets out more information to the parties to the dispute about the method proposed by BT (and the other potential methods available) to calculate outpayments. Ofcom seeks the views of all interested parties on which methodology is preferred.
- 2.15 Ofcom will make a final determination about which is the most appropriate method after considering any submissions received concerning this Draft Determination.

Potential for further disputes is a concern for Ofcom

- 2.16 Ofcom believes that there is the potential for ongoing disputes between BT and NTS Terminating Providers whenever BT recalculates its discount rates or changes its pricing methodology, since there is little or no incentive for Providers to agree to any new OCCNs, and BT has few obligations to disclose accurate or comprehensive information about proposed changes.
- 2.17 Ofcom believes that the potential for further disputes could be reduced if BT were to be more transparent in disclosing the methodologies and data used in calculating discount rates, together with a verification process undertaken by a 3rd party (possibly BT's independent auditors). Ofcom suggests that BT considers this approach although Ofcom would not necessarily accept 3rd party verification as being adequate to demonstrate that a proposed discount rate is acceptable.
- 2.18 Alternatively, BT and the Providers (and other purchasers of NTS call origination) might explore alternative mechanisms that provide for resolution of these issues rather than successive regulatory disputes covering substantially the same issues (save for the calculations of particular prices or outpayments).
- 2.19 Ofcom does not propose, at this stage, to intervene to require action by BT (or Providers) to give effect to this suggestion but does intend to consider whether regulatory intervention is required in upcoming policy projects looking at BT's compliance with charge controls.

Section 3

Background

Number Translation Services (NTS)

- 3.1 NTS (“Number Translation Services”) numbers are those number ranges listed in the National Telephone Numbering Plan (“NTNP”) as “Special Services” numbers.¹ NTS numbers start with 08 or 09.²
- 3.2 An NTS number does not relate to a specific location, but to a particular service. The NTS number dialled by a caller is ‘translated’ by the network to a geographic number to deliver the call to its destination.
- 3.3 This dispute relates to the amounts passed by BT to NTS providers of services on 0845 and 0870 numbers.³

NTS Regulation

- 3.4 On 25 July 2003 a new regulatory regime for electronic communications networks and services came into force which required the abolition of licences for telecommunications operators.
- 3.5 Following the ‘Review of the fixed narrowband wholesale exchange line, call origination, conveyance and transit markets’ published on 28 November 2003⁴ (“the relevant market review”), BT was found to have SMP in the markets identified in that review, and certain SMP conditions were imposed on BT including Condition AA11.

BT’s NTS Call Origination Condition

- 3.6 BT’s Condition AA11 ‘Requirement to provide NTS call origination’, published within the relevant market review on 28 November 2003 imposes an obligation to provide NTS Call Origination on fair and reasonable terms, and on such terms, conditions and charges as Ofcom may, from time to time, direct.
- 3.7 Condition AA11 specifies that the only charges that may be made for providing NTS call origination services are:
 - a) A charge for the Call Origination Service used to originate the NTS call;
 - b) A charge for the NTS Retail Uplift;
 - c) A charge for bad debt relating to the retailing by BT of Premium Rate Services calls.

¹ The current version of the NTNP was published on 13 February 2007 at: <http://www.ofcom.org.uk/telecoms/ioi/numbers/numplan0207.pdf>

² NTS also includes calls to the legacy 0500 (Freephone) and 0345 (local rate) ranges, which are not available for new allocations and are no longer listed in the NTNP. NTS does not include calls to 0844 04 numbers for Surftime Internet access or calls to 0808 99 numbers for unmetered dial-up Internet access based on FRIACO (Flat Rate Internet Access Call Origination).

³ 0844 and 0871 numbers have different retail pricing arrangements.

⁴ http://www.ofcom.org.uk/consult/condocs/narrowband_mkt_rvw/nwe/fixednarrowbandstatement.pdf

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- 3.8 BT's SMP Condition AA11 requires BT to pass the Net Retail Call Revenue (Net Retail Call Revenue means the retail revenue for calls, excluding VAT and after any applicable discounts), less the charges referred to above, to the third party purchasing the NTS Call Origination. In this document the payments passed on in accordance with Condition AA11 are referred to as outpayments, or POLOs (payments to other licensed operators).

How outpayments are calculated

- 3.9 BT is paid by its retail customers (residential and business) for all calls, including NTS calls, and is then obliged to pass the majority of the NTS revenues onto the relevant terminating communications provider ("TCP") that terminates the NTS call. BT is allowed to retain only the amounts set out in paragraph 3.7 above.
- 3.10 The calculation of how much BT owes to TCPs is carried out by the TCPs themselves, using a BT-provided tool known as the "NTS Calculator", an interactive spreadsheet that allows TCPs to see how much money they are entitled to be paid for a particular call type. This tool is provided by BT with the sole purpose of assisting Communications Providers.
- 3.11 The amount of BT's received retail revenue that it passes on is determined by the NTS formula, which is derived from Condition AA11. The NTS formula provides that BT retains $P - D + C$:
- P is the actual price,
 - D is the Deemed retail price of the call (after discounts and bad debt),
 - C is the pence per minute charge for conveyance over the relevant segment of BT's network plus an uplift to allow for retail costs incurred by the originating operator in handling these calls.
- 3.12 The amount passed on to the terminating provider is given by $D - C$. This outpayment is subject to fluctuations in the discount rate calculated by BT.

Section 4

History of the dispute

Changes to BT Retail pricing

- 4.1 On 1 October 2006 BT Retail ("BTR") changed the way it charged for residential 0845 calls, shifting from a minimum call charge ("MCC") to a call set-up fee ("CSF"). The MCC had applied only to calls below a certain length (around 90 seconds for 0845 daytime calls, longer for evening and weekend calls), where a pence per minute ("ppm") charge would result in a figure below the specified minimum charge of ~4.2p (excluding VAT).
- 4.2 BTR replaced the MCC of ~4.2p per call with a CSF of 2.55p (excluding VAT) that applied to all calls. The impact on BT's residential consumers was expected to be a net increase in retail call charges (based on recent call volumes and durations), so BTR wanted to offset this increase by increasing the discounts available to consumers under its "BT Together" call packages.
- 4.3 The change to a CSF occurred only on 0845 residential calls, and 0845 business customers continued to pay a MCC rather than a CSF.
- 4.4 These changes are relevant for NTS outpayments since BT's NTS call origination conditions require it to pass the retail revenue received for NTS calls onto the TCP less a regulated retention amount.
- 4.5 Therefore changes to the revenue received by BTR for residential or business calls, some of which will be NTS calls, will affect the outpayments made by BT to TCPs.

Outpayment changes notified to TCPs

- 4.6 In order to take account of the forecast changes to revenues received by BTR, BT Wholesale proposed changing the way it accounted for outpayments to TCPs.
- 4.7 The proposed changes were notified to TCPs in an Operator Charge Change Notice ("OCCN") sent out on 3 August 2006, with the changes proposed to take effect on 1 October 2006.
- 4.8 Subsequently some providers signed the OCCN (this is a requirement before BT may amend the outpayments it makes to TCPs) but others failed or refused to sign.
- 4.9 BT submitted a request for Ofcom to resolve a dispute between itself and those TCPs that had not signed the OCCN. A submission was initially made on 20 October 2006 although insufficient evidence (that negotiations had irrevocably broken down) was provided in order to allow Ofcom to open an investigation.
- 4.10 On 16 January 2007 BT re-submitted its request, along with additional evidence and information. On 5 February 2007 Ofcom opened an investigation into the dispute, setting out the scope of the dispute in a Competition Bulletin as follows:

"To determine, in connection with BT's OCCN of 3 August 2006:
- whether BT has acted consistently with BT's regulatory obligations
in proposing new NTS POLO charges,

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- whether BT has accurately calculated the average discount rates in connection with the retail revenue for calls for the purposes of NTS call origination services provided by BT and, in considering this question, whether each of BT's retail discounts are 'applicable' discounts for the purposes of net retail call revenue."

- 4.11 This draft determination is published on 26 April 2007, with a 2 week consultation period until 11 May 2007.
- 4.12 Ofcom will publish a final Determination on or before 4 June 2007.

Section 5

Submissions of the parties

BT Submissions

- 5.1 BT has made a number of submissions to Ofcom, including copies of correspondence received by BT from the Providers.
- 5.2 BT's main submission to Ofcom included:
 - 5.2.1 details of the background to the dispute;
 - 5.2.2 details of negotiations and correspondence between BT and all affected communications providers;
 - 5.2.3 a list of providers that had not signed the OCCN;
 - 5.2.4 copies of presentations made by BT to industry operators and to Ofcom; and
 - 5.2.5 a detailed methodology of how NTS discounts were produced.
- 5.3 Ofcom also requested a number of additional documents and data in order to assess the accuracy of BT's discount rate calculations, and the fairness and reasonableness of its proposed methodology for calculating outpayments.
- 5.4 These additional documents and data were used by Ofcom to produce the analysis contained in Sections 6 and 7 of this Draft Determination.

Other submissions

- 5.5 Ofcom has received submissions directly from some of the Providers, including C&W, Verizon UK, and Colloquium⁵.

Main concern over discount calculations

- 5.6 Providers who made submissions to Ofcom were mainly concerned about the increasing level of discounts as calculated by BT. There was a general concern over the lack of visibility for Providers as to how BT had arrived at the higher discount levels, and concern that there was no way for Providers to verify the accuracy of the higher levels.
- 5.7 In particular, the Providers were keen to gain a level of assurance from Ofcom that discount levels had been accurately calculated, and that the data used correctly captured which calls are eligible for discount.

Additional concerns over payment methodology

- 5.8 A couple of responses received also requested that the principle of removing the short/long call designation should be within the scope of the dispute.

⁵ See Annex 5 for further details of the Providers.

- 5.9 Ofcom recognises that the changes in retail pricing implemented by BT Retail (which are beyond the scope of this dispute) require changes to the outpayment methodology, and Ofcom has considered a number of alternative methodologies in order to assess which is most consistent with BT's regulatory obligation to provide NTS call origination on fair and reasonable terms, and also consistent with Ofcom's Community duties⁶ (which include the promotion of competition), which are applicable to the resolution of regulatory disputes.

6 In resolving disputes under the Act, Ofcom is required to act in accordance with the six European Community requirements (which give effect, amongst other things, to the requirements of Article 8 of the Framework Directive):

- 1) To promote competition;
- 2) To secure that Ofcom's activities contribute to the development of the European internal market;
- 3) To promote the interests of all persons who are citizens of the European Union;
- 4) To take account of the desirability of Ofcom's carrying out their functions in a manner which, so far as practicable, does not favour –
 - (a) One form of electronic communications network, electronic communications service or associated facility; or
 - (b) One means of providing or making available such a network, service or facility;
- 5) To encourage the provision of network access and service interoperability, to such extent as Ofcom consider appropriate for the purpose of securing efficiency, sustainable competition and maximum benefit for end-users of communications services; and
- 6) To encourage such compliance with the standards or specifications mentioned in section 4 (10) of the Communications Act 2003 as is necessary for -
 - (a) facilitating service interoperability; and
 - (b) securing freedom of choice for the customers of communications providers.

Section 6

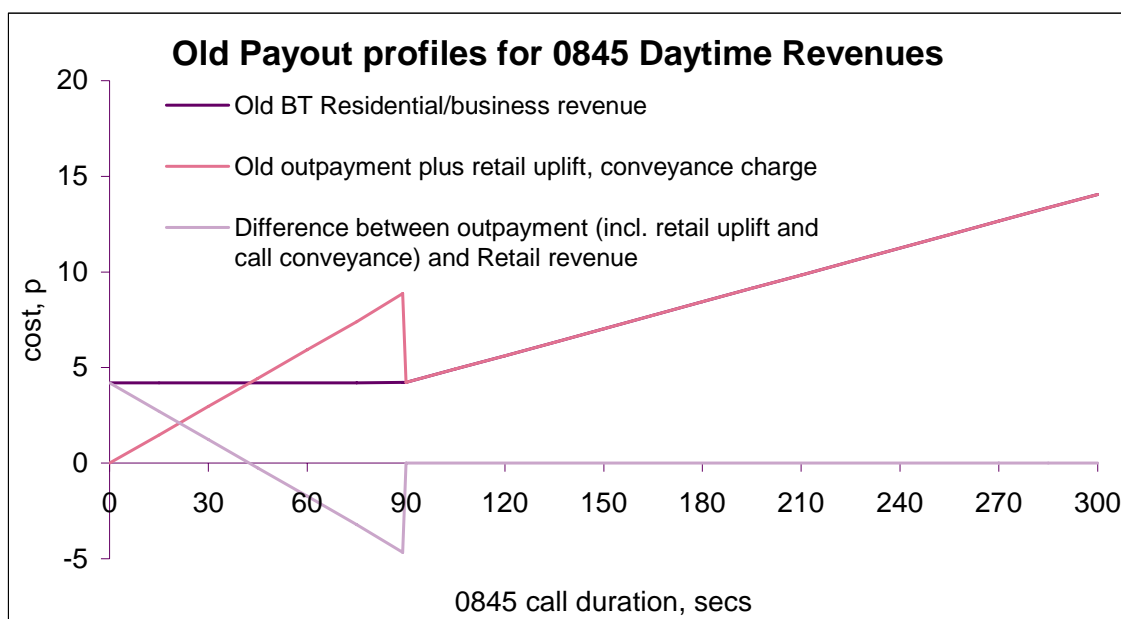
NTS outpayment methodology

- 6.1 BT Retail's prices for calls (including calls to NTS numbers) are not regulated directly. The price changes made by BTR on 1 October 2006 were made in this context.
- 6.2 However, the resultant changes to NTS outpayments that follow any such pricing movements are subject to regulatory scrutiny.
- 6.3 Ofcom notes that the change of calculation methodology is only relevant for 0845 NTS calls and does not apply for 0870 calls, where the NTS outpayment calculation methodology has always been based on a blended average ppm rate, and there is no change.
- 6.4 As a general rule, Ofcom believes that the closer the correlation between NTS retail call revenues and outpayments, the fairer and more consistent with Ofcom's duty to promote competition the method used to calculate them. A methodology that more closely matches the attendant NTS outpayments to an NTS call with the revenues received by BT will help ensure a 'level playing field' for all Providers and should reduce any artificial incentives for Providers to encourage NTS calls of a particular type or length.

The previous NTS outpayment methodology

- 6.5 Prior to the OCCN that triggered this dispute, TCPs calculated the payments they were due based on the number of short and long calls they received, and the number of seconds of all the calls received. TCPs received a certain ppm rate for short calls (i.e. those within the duration of the MCC), and a lower ppm rate for long calls.
- 6.6 Since residential and business calls were priced at the same headline rate, and using the same system, there was no need for TCPs to differentiate between residential and business NTS calls. Therefore all that the billing systems of TCPs needed to do was calculate the number of short calls, the number of long calls, and the total time generated by the calls.
- 6.7 The TCP would then submit these figures to BT along with a calculation of outpayments due, based on the NTS calculator, and BT would pay the calculated amount.
- 6.8 The payout profile (based on 0845 daytime calls) comparing BT's residential and business NTS revenues with its NTS outpayments, was as follows:

Figure 1: Payout profile for 0845 Daytime revenues using previous BT methodology



Source: NTS Calculator, BT data

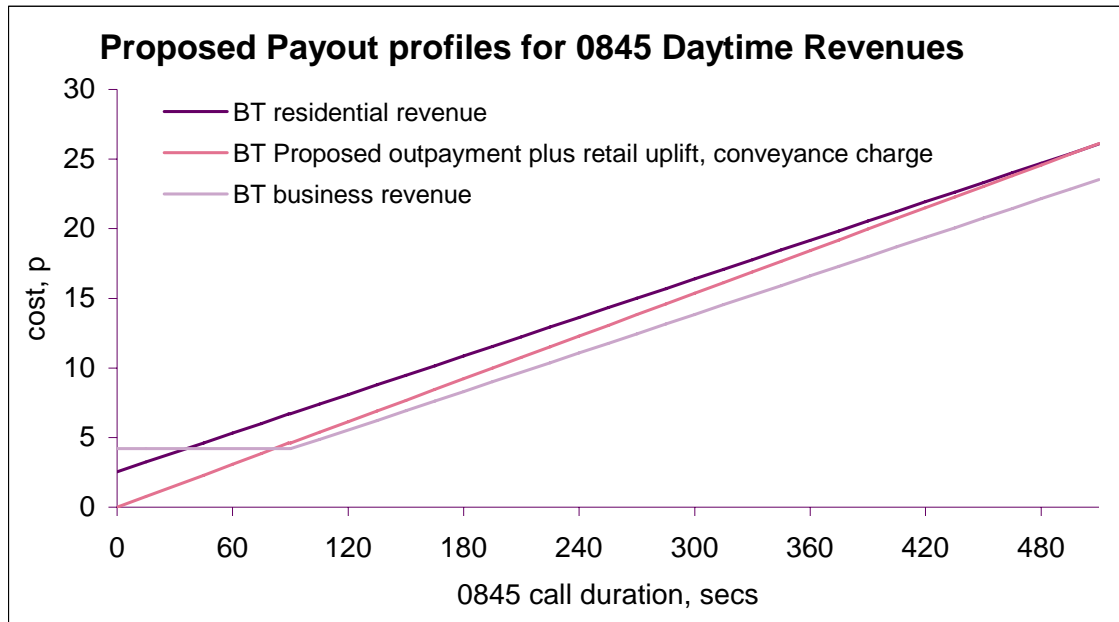
- 6.9 At call durations below the short/long call cut-off point (i.e. ~90 seconds for 0845 daytime calls) the payout profile is determined by an average rate of ~5.9ppm that results in outpayments (plus regulated retention) being very different from revenue, which is constant at 4.2p per call.
- 6.10 Above 90 seconds, the payout profile exactly matches the revenue profile.
- 6.11 Note that BT Retail's revenue streams for residential and business calls are the same, and are depicted by the "Old BT Residential/business revenue" line in the figure above.

Option 1: BT's proposed outpayment methodology

- 6.12 Since residential calls will attract a CSF and business calls will attract a MCC, and the Providers are unable to differentiate between residential and business calls (see Para 6.6 above), it is necessary for BT to construct a new outpayment system that allows revenues to be allocated as fairly as possible.
- 6.13 In a OCCN of 3 August 2006 BT set out the new proposed methodology, allocating revenues based on an average ppm rate across all call lengths (whether business or residential), eliminating the need for a short/long call distinction for TCPs.
- 6.14 The new methodology calculates outpayments based on ppm rates across call types, business or residential, such that there will be single rates for 0845 daytime (with no distinction between short or long calls), 0845 evening and 0845 weekend, and similarly three separate rates for 0870 daytime, evening and weekend calls (although for 0870 this does not represent a change from before).
- 6.15 The proposed methodology is simpler for TCPs, since it no longer requires them to differentiate between short and long calls, and total call duration is all that is required to calculate outpayments.

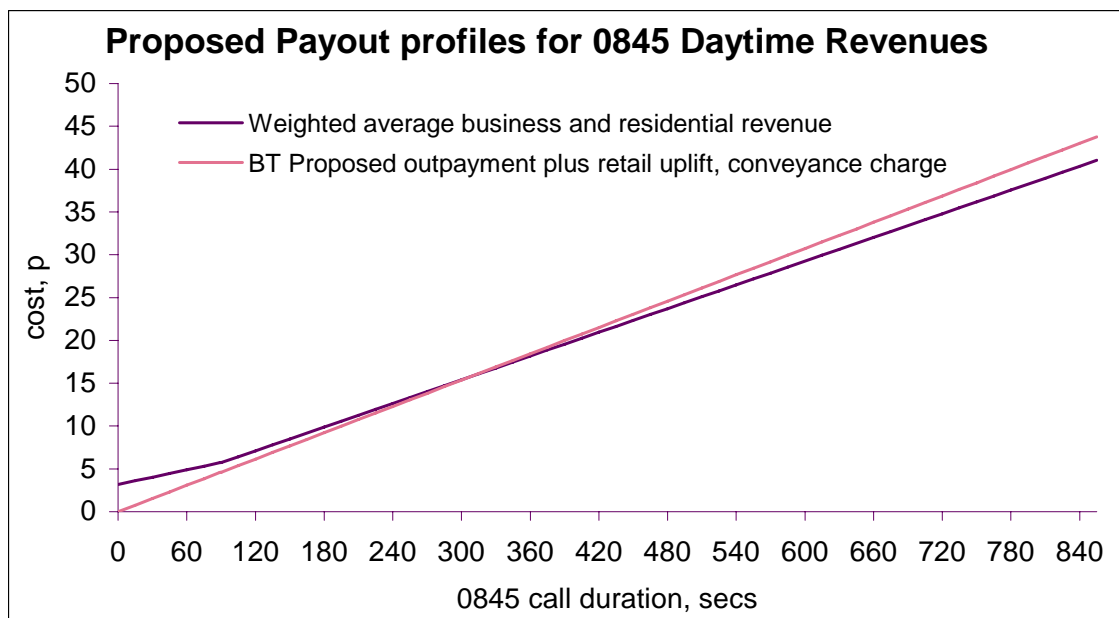
- 6.16 However, the methodology will disadvantage those TCPs that have a greater than average proportion of short duration residential calls, where outpayments are below BT's revenue after subtracting the originating operator's retention, as shown by the figure below.

Figure 2: Payout profile for 0845 Daytime revenues using proposed BT methodology



Source: BT data, NTS calculator

Figure 3: Weighted average revenue versus BT proposed outpayments for 0845 Daytime



Source: BT data, NTS calculator, Ofcom analysis

- 6.17 Using a ppm rate to calculate outpayments means that the outpayment line will always begin at the origin of the graph (i.e. a call of zero seconds will not result in

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any outpayment), whereas the residential revenue line will begin at 2.55p (i.e. the CSF).

- 6.18 As call durations increase, because the average ppm rate for outpayments takes into account the CSF, the value of outpayments increases faster than retail revenue, until at the average call duration, the outpayments (plus regulated retention) marginally exceed residential revenue.
- 6.19 Therefore, for all residential NTS calls below the average length, BT will retain a greater proportion of its received revenues, whilst above the average call length it will retain a lower proportion. On average, across all calls, BT pays out (and TCPs receive, in aggregate) the same as would occur under the previous outpayment methodology.
- 6.20 In Figure 3 above, calculating a weighted average revenue line as an amalgamation of the business and residential revenues (weighted by revenue) allows a closer comparison of how revenues are allocated as outpayments on an average basis. Ofcom notes that this sort of average analysis masks the effects on individual TCPs, but helps inform as to the question of matching revenues and payments on an aggregate basis.

How do BT's proposed methodology changes affect TCPs?

- 6.21 All providers are adversely affected by new, higher discount rates, which necessarily reduce payments.
- 6.22 The table below shows how 8 TCPs (chosen for their size and for their different call profiles) will experience changes to their monthly NTS termination revenue as a result of BT's proposed changes notified in the 3rd August 2006 OCCN.
- 6.23 The effect of new discount rates is to consistently lower revenues for all TCPs by 12-14% (NB. there may be minor rounding errors in the data), whereas the effects of the new CSF/blended rate methodology differ between TCP.
- 6.24 Those TCPs that have a high percentage of short duration calls are adversely affected by the new methodology, while those that have a relatively low percentage of short duration calls benefit from the new methodology.

Table 1: Effects of new methodology on monthly 0845 outpayments to selected TCPs

TCPs	Changes to monthly outpayments			% Short duration
	Effect of CSF/blended rate methodology (old discount rates)	Effect of new discount rates alone	Overall effect - new discount rates and new methodology	
[>]	4%	-13%	-9%	8.7%
[>]	-15%	-12%	-26%	22.6%
[>]	-3%	-12%	-16%	14.0%
[>]	4%	-13%	-9%	8.8%
[>]	7%	-14%	-7%	7.1%
[>]	7%	-14%	-7%	6.5%
[>]	15%	-14%	1%	0.4%
[>]	0%	-13%	-13%	13.1%

Source: BT data, Ofcom analysis

Other options

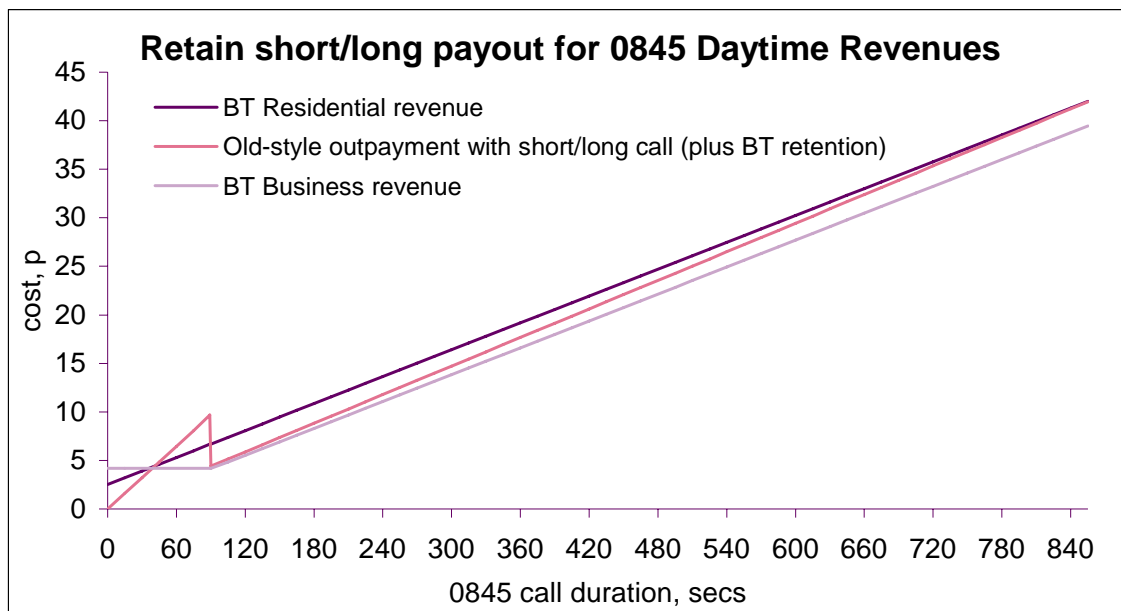
6.25 Ofcom has examined other options available to BT to calculate outpayments, and assessed the suitability of each. We would note that none of the options perfectly matches revenues with outpayments. The options identified are as follows:

- Option 2: Retaining a short/long call duration for 0845 outpayments.
- Option 3: Introduction of a fixed call set-up payment for all 0845 calls, business or residential.

Option 2: Retaining the short/long call duration for 0845

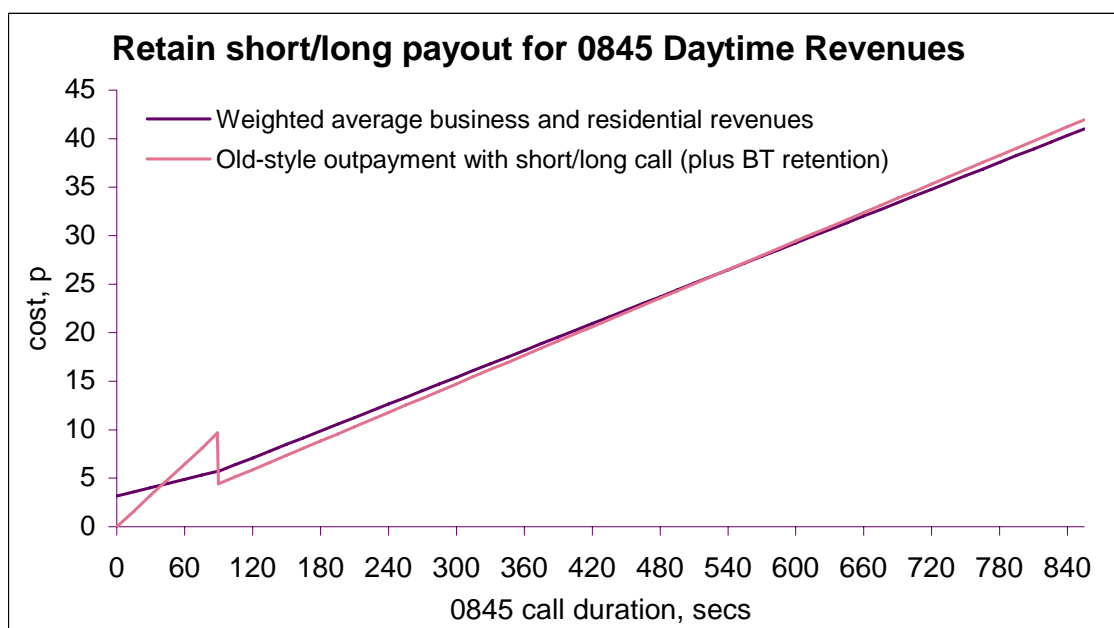
6.26 Retaining a short/long call duration for all 0845 calls, whether they are residential calls (which all attract a fixed CSF), or business calls (which still attract a MCC), would create a situation where revenue and outpayments are reasonably well matched above the short call duration, but there is a clear mismatch between revenues and outpayments for short calls.

Figure 4: Option 2 - Retaining the short/long duration for 0845



Source: BT data, Ofcom analysis

Figure 5: Option 2 - Weighted average revenues versus short/long outpayments



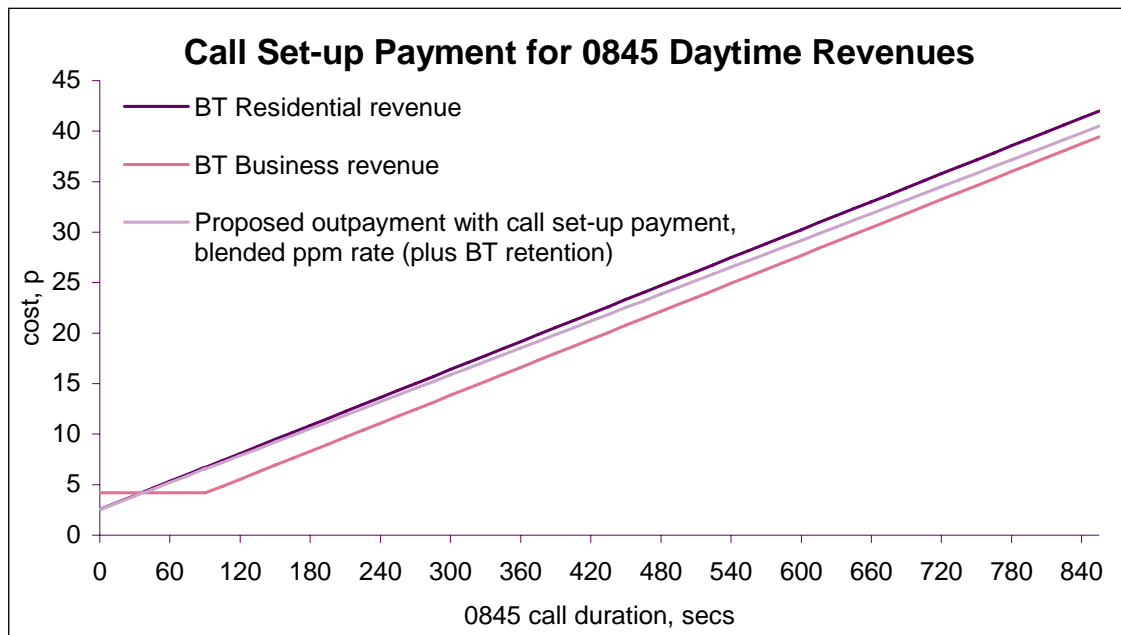
Source: BT data, Ofcom analysis

- 6.27 Retaining a short/long call duration would be relatively simple to implement and would ensure some consistency with the prior methodology, but does not give a great match between revenues and outpayments for short calls and therefore may not be the fairest means of allocating revenue.

Option 3: Introducing a fixed call set-up payment for all residential or business calls

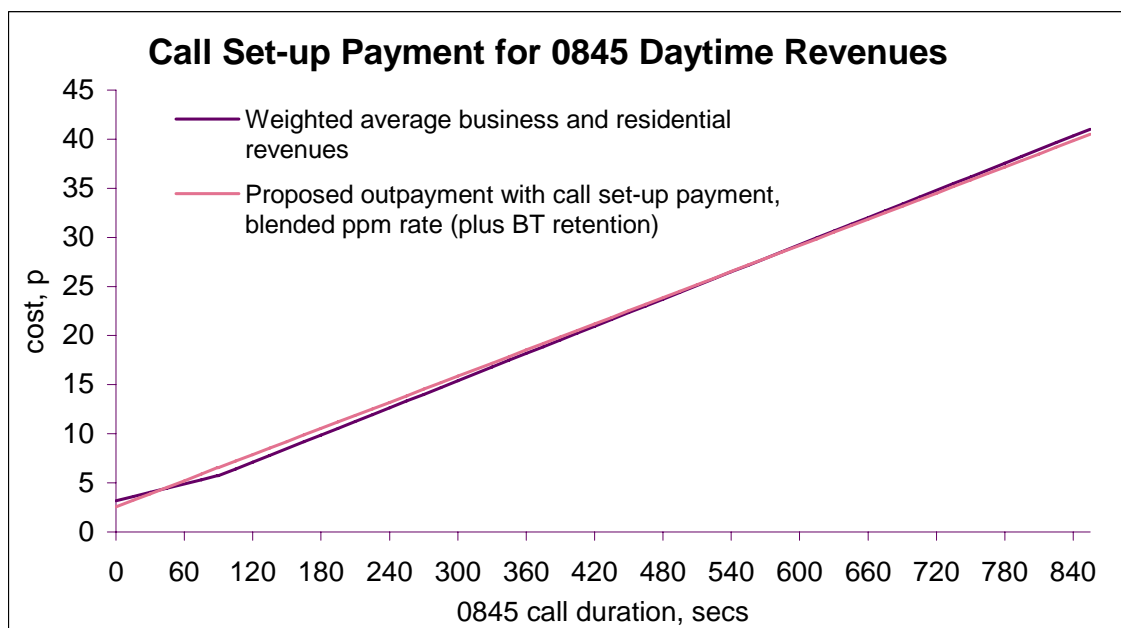
- 6.28 If a fixed call set-up payment (to match the call set-up fee of 2.55p) were to be introduced for residential 0845 calls, it would also need to be introduced for business calls because Providers are unable to differentiate between business and residential calls.
- 6.29 The introduction of a fixed call set-up payment for each call would require a recalculation of the ppm outpayment rates to ensure that BT continued to pay out the same proportion of its revenue as under its proposed blended rate ppm rate.
- 6.30 The profile would look as shown in the figure below. The outpayments would very closely match residential revenues at lower call lengths, but as call length increased, outpayments would tend towards (lower) business revenues.

Figure 6: Option 3 - Fixed call set-up payment for all residential and business calls



Source: BT data, Ofcom analysis

Figure 7: Option 3 - Blended revenues versus outpayments



Source: BT data, Ofcom analysis

- 6.31 Such a payment methodology may provide the closest match of outpayments to revenue. It will also benefit the revenue stream of some Providers and damage others.
- 6.32 Ofcom notes that such a methodology may be less simple to implement than continuing with a short/long duration or a blended ppm rate (simply because it involves introducing a new concept for Providers, i.e. a fixed charge) but it should not

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involve the need for any major changes to billing systems, and should therefore be cheap for Providers to implement.

Conclusion – Option 3 appears to be the fairest methodology

- 6.33 No methodology considered by Ofcom perfectly aligns revenues and outpayments. In addition, the virtues of a particular methodology need to be considered in the light of the likely implementation costs.
- 6.34 Ofcom provisionally considers that option 3 is the most appropriate and consistent with Ofcom's duties since it provides the closest match of NTS outpayments to revenues, and therefore is likely to afford Providers the fairest allocation of NTS outpayments available.
- 6.35 Ofcom seeks the views of Providers on these options (or any other options they have identified) which it will consider before proceeding to a final determination.

Table 2: Advantages and disadvantages of different methodologies

Methodology	Advantages	Disadvantages	Winners/Losers
Option 1: BT proposed methodology – blended average ppm rate	Simple. Easy for TCPs to incorporate into billing systems (i.e. no changes needed).	TCPs with predominantly very short duration calls are disadvantaged.	Providers with a relatively high % of long residential calls will benefit.
Option 2: Keeping the short/long call duration for 0845	Continuity.	The duration of short call for residential is arbitrary. The payout profile below the short call boundary does not closely resemble the revenue profile.	We believe this option ought to be broadly neutral for Providers when compared to the current system.
Option 3: Introduction of a call set-up payout to match the call set-up fee	Close match of revenues with outpayments for residential calls.	Introducing a fixed payment for business when revenues included a MCC results in a revenue mismatch.	This option may marginally benefit operators with shorter durations than average (although not very short durations).

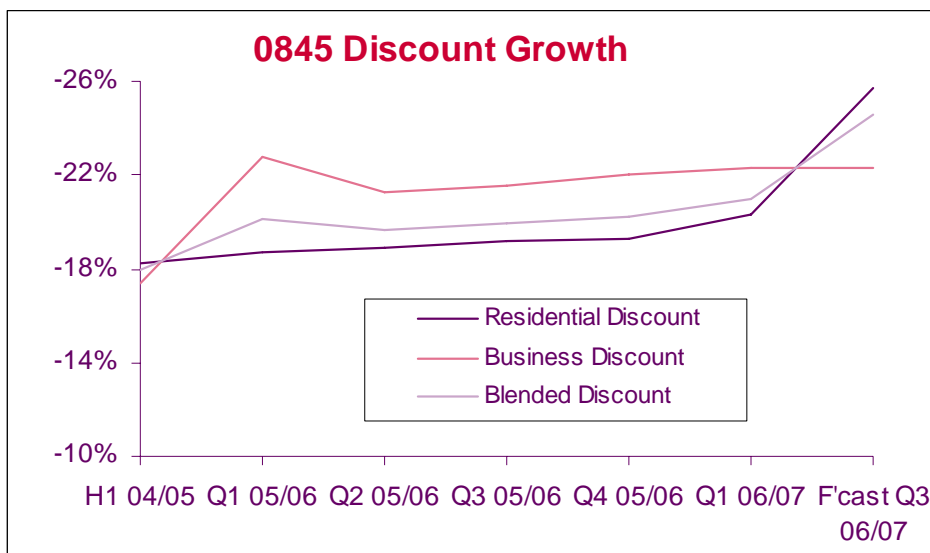
Section 7

Discount rate calculations

Historic trends suggest discount rates are rising

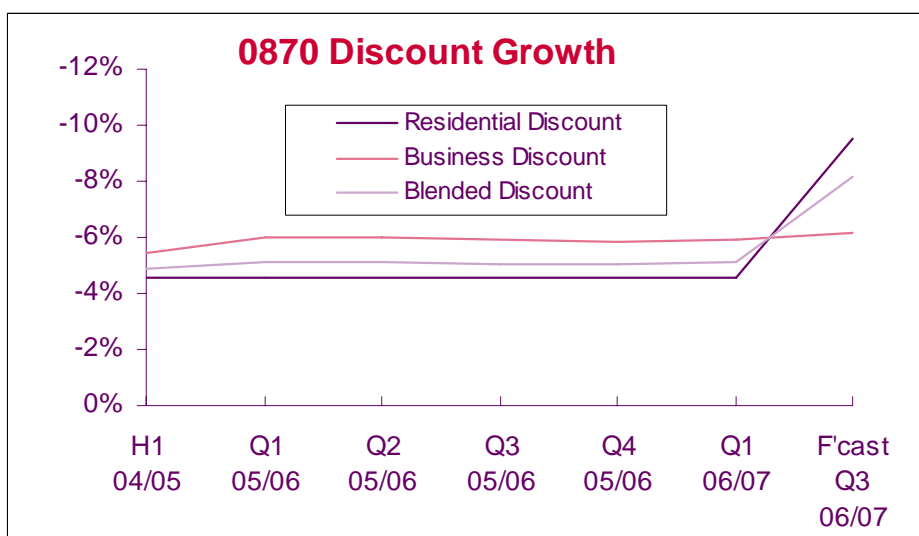
- 7.1 BT has submitted evidence showing that discount rates have risen over the last couple of years as uptake by consumers of inclusive calling packages has increased. In addition, when the CSF came into effect, the introduction of more discounts into existing call packages increased discount rates further.
- 7.2 As a result the predicted future discount rates that BT announced in the disputed OCCN have increased significantly, as shown by the figures below.

Figure 8: 0845 Discount Rate movement



Source: BT data

Figure 9: 0870 Discount Rate movement



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Source: BT data

How does BT estimate future discount rates?

- 7.3 At any point in time BT knows its most recent historic quarterly data, but not the future quarter data. Since OCCNs are prior notifications relating to future time periods BT has to estimate its expected future discount rates based on historic data.
- 7.4 In order to estimate future revenue from October 2006 onwards, BT used quarterly NTS data from Q1 06/07 (i.e. April to June 2006) and amended it to take into account expected changes in revenues.
- 7.5 In order to estimate discount rates for the following period, BT used its most recent call data (minutes, number of calls, revenue, etc), looked at the effect of introducing the new payout methodology with a CSF, and derived the total expected revenues before comparing that revenue with a figure calculated from headline BTR prices.
- 7.6 The difference between the two (i.e. headline rates multiplied by minutes vs adjusted recorded revenue) allows BT to deduce average discount rates, and thereby to generate a deemed price.
- 7.7 For 0845 residential calls, the difference between actual received revenues and revenues based on reported calls and minutes at headline rates was [\times]%, i.e. this was the deemed discount rate.
- 7.8 For 0845 business calls the difference was [\times]%, giving a blended average discount rate on 0845 of [\times]% in Q1 06/07.

Table 3: Discount rate calculations

0845 £m	Actual			With Call Set-up Fee		
	Residential	Business	Total	Residential	Business	Total
Revenue at headline rates						
Calling Plan discounts						
Fee-based discounts less fees	[\times]		[\times]	[\times]		[\times]
Revenue less discounts						
Discount %						24.6%

0870 £m	Actual			With Call Set-up Fee		
	Residential	Business	Total	Residential	Business	Total
Revenue at headline rates						
Calling Plan discounts						
Fee-based discounts less fees	[\times]		[\times]	[\times]		[\times]
Revenue less discounts						
Discount %						8.2%

Source: BT data

- 7.9 As shown in Table 3 above, with the introduction of a CSF instead of a MCC, BT expects revenues for 0845 residential calls to increase by [\times]% from £[\times]m to £[\times]m.
- 7.10 BT Retail has amended BT Together calling plans so that the impact for consumers from the CSF introduction is only a [\times]% increase in overall revenue on 0845. Therefore by increasing headline revenues by [\times]% and increasing the estimated figure for revenues after discounts by [\times]%, BT can deduce the calling plan discount amounts.

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- 7.11 For 0870 the increased revenue impact of a CSF is [X]% while the impact of new BTT rates and the CSF is [X]%.
- 7.12 Based on the evidence presented by BT and the additional analysis that Ofcom has produced, Ofcom has no reason to believe that BT's predicted future NTS discount rates have been incorrectly calculated.

Annex 1

Responding to this consultation

How to respond

- A1.1 Ofcom invites written views and comments on the issues raised in this document, to be made **by 5pm on 11 May 2007**.
- A1.2 Ofcom strongly prefers to receive responses using the online web form at <http://www.ofcom.org.uk/consult/condocs>, as this helps us to process the responses quickly and efficiently. We would also be grateful if you could assist us by completing a response cover sheet (see Annex 3), to indicate whether or not there are confidentiality issues. This response coversheet is incorporated into the online web form questionnaire.
- A1.3 For larger consultation responses - particularly those with supporting charts, tables or other data - please email nick.morris@ofcom.org.uk attaching your response in Microsoft Word format, together with a consultation response coversheet.
- A1.4 Responses may alternatively be posted or faxed to the address below, marked with the title of the consultation.
- Nick Morris
4th Floor
Competition Group Investigations
Riverside House
2A Southwark Bridge Road
London SE1 9HA
- Fax: 020 7783 4103
- A1.5 Note that we do not need a hard copy in addition to an electronic version. Ofcom will acknowledge receipt of responses if they are submitted using the online web form but not otherwise.
- A1.6 It would be helpful if your response could include direct answers to the questions asked in this document. It would also help if you can explain why you hold your views and how Ofcom's proposals would impact on you.

Further information

- A1.7 If you want to discuss the issues and questions raised in this consultation, or need advice on the appropriate form of response, please contact Nick Morris on 020 7783 4332.

Confidentiality

- A1.8 We believe it is important for everyone interested in an issue to see the views expressed by consultation respondents. We will therefore usually publish all responses on our website, www.ofcom.org.uk, ideally on receipt. If you think your response should be kept confidential, can you please specify what part or whether all of your response should be kept confidential, and specify why. Please also place such parts in a separate annex.

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- A1.9 If someone asks us to keep part or all of a response confidential, we will treat this request seriously and will try to respect this. But sometimes we will need to publish all responses, including those that are marked as confidential, in order to meet legal obligations.
- A1.10 Please also note that copyright and all other intellectual property in responses will be assumed to be licensed to Ofcom to use. Ofcom's approach on intellectual property rights is explained further on its website at <http://www.ofcom.org.uk/about/accoun/disclaimer/>

Next steps

- A1.11 Following the end of the consultation period, Ofcom intends to publish a Determination at the end of May 2007.
- A1.12 Please note that you can register to receive free mail Updates alerting you to the publications of relevant Ofcom documents. For more details please see: http://www.ofcom.org.uk/static/subscribe/select_list.htm

Ofcom's consultation processes

- A1.13 Ofcom seeks to ensure that responding to a consultation is easy as possible. For more information please see our consultation principles in Annex 2.
- A1.14 If you have any comments or suggestions on how Ofcom conducts its consultations, please call our consultation helpdesk on 020 7981 3003 or e-mail us at consult@ofcom.org.uk . We would particularly welcome thoughts on how Ofcom could more effectively seek the views of those groups or individuals, such as small businesses or particular types of residential consumers, who are less likely to give their opinions through a formal consultation.
- A1.15 If you would like to discuss these issues or Ofcom's consultation processes more generally you can alternatively contact Vicki Nash, Director Scotland, who is Ofcom's consultation champion:

Vicki Nash
Ofcom
Sutherland House
149 St. Vincent Street
Glasgow G2 5NW

Tel: 0141 229 7401
Fax: 0141 229 7433

Email vicki.nash@ofcom.org.uk

Annex 2

Ofcom's consultation principles

A2.1 Ofcom has published the following seven principles that it will follow for each public written consultation:

Before the consultation

A2.2 Where possible, we will hold informal talks with people and organisations before announcing a big consultation to find out whether we are thinking in the right direction. If we do not have enough time to do this, we will hold an open meeting to explain our proposals shortly after announcing the consultation.

During the consultation

A2.3 We will be clear about who we are consulting, why, on what questions and for how long.

A2.4 We will make the consultation document as short and simple as possible with a summary of no more than two pages. We will try to make it as easy as possible to give us a written response. If the consultation is complicated, we may provide a shortened version for smaller organisations or individuals who would otherwise not be able to spare the time to share their views.

A2.5 We will normally allow ten weeks for responses to consultations on issues of general interest.

A2.6 There will be a person within Ofcom who will be in charge of making sure we follow our own guidelines and reach out to the largest number of people and organizations interested in the outcome of our decisions. This individual (who we call the consultation champion) will also be the main person to contact with views on the way we run our consultations.

A2.7 If we are not able to follow one of these principles, we will explain why. This may be because a particular issue is urgent. If we need to reduce the amount of time we have set aside for a consultation, we will let those concerned know beforehand that this is a 'red flag consultation' which needs their urgent attention.

After the consultation

A2.8 We will look at each response carefully and with an open mind. We will give reasons for our decisions and will give an account of how the views of those concerned helped shape those decisions.

Annex 3

Consultation response cover sheet

- A3.1 In the interests of transparency and good regulatory practice, we will publish all consultation responses in full on our website, www.ofcom.org.uk.
- A3.2 We have produced a coversheet for responses (see below) and would be very grateful if you could send one with your response (this is incorporated into the online web form if you respond in this way). This will speed up our processing of responses, and help to maintain confidentiality where appropriate.
- A3.3 The quality of consultation can be enhanced by publishing responses before the consultation period closes. In particular, this can help those individuals and organisations with limited resources or familiarity with the issues to respond in a more informed way. Therefore Ofcom would encourage respondents to complete their coversheet in a way that allows Ofcom to publish their responses upon receipt, rather than waiting until the consultation period has ended.
- A3.4 We strongly prefer to receive responses via the online web form which incorporates the coversheet. If you are responding via email, post or fax you can download an electronic copy of this coversheet in Word or RTF format from the 'Consultations' section of our website at www.ofcom.org.uk/consult/.
- A3.5 Please put any parts of your response you consider should be kept confidential in a separate annex to your response and include your reasons why this part of your response should not be published. This can include information such as your personal background and experience. If you want your name, address, other contact details, or job title to remain confidential, please provide them in your cover sheet only, so that we don't have to edit your response.

Cover sheet for response to an Ofcom consultation

BASIC DETAILS

Consultation title:

To (Ofcom contact):

Name of respondent:

Representing (self or organisation/s):

Address (if not received by email):

CONFIDENTIALITY

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

Nothing

☐

Name/contact details/job title

☐

Whole response

☐

Organisation

☐

Part of the response

☐

If there is no separate annex, which parts?

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

DECLARATION

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

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

☐

Name

Signed (if hard copy)

Annex 4

List of Providers in dispute with BT

Eight Providers have refused or failed to sign the OCCN

A4.1 The following operators have refused or failed to sign the 3 August 2006 OCCN:

- Cable & Wireless UK (“C&W”);
- Colloquium UK (“Colloquium”);
- Interweb Design
- Verizon UK
- Nexus Telecomms
- Opal Telecommunications⁷
- Prodigy Internet
- Tiscali UK.

⁷ Totem Communications has also failed to sign the OCCN but, since it is owned by Opal Telecommunications, is treated as being synonymous with Opal.