



# Draft Determination of a dispute between THUS and BT about payment terms for PPCs, IECs and IBCs

## Draft Determination

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## Section 1

# [Draft] Determination

**[Draft] Determination under sections 188 and 190 of the Communications Act 2003 for resolving a dispute between THUS plc (“THUS”) and British Telecommunications plc (“BT”) concerning BT’s payment terms in contracts for the provision of partial private circuits (“PPCs”), interconnect extension circuits (“IECs”) and intra building circuits (“IBCs”).**

### WHEREAS:

- (A) Section 188(2) of the Communication Act 2003 (the “Act”) provides that where there is a dispute between different communications providers, and Ofcom has decided pursuant to section 186(2) of the Act that it is appropriate for it to handle the dispute, Ofcom must consider the dispute and make a determination 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;
- (B) Section 190 of the Act sets out the scope of Ofcom’s powers when making a determination to resolve a dispute which include pursuant to section 190(2) of the Act the power to give a direction fixing the terms or conditions of transactions between the parties and, for the purpose of giving effect to a determination by Ofcom of the proper amount of a charge, to give a direction, enforceable by the party to whom sums are to be paid, requiring the payment of sums by way of an adjustment of an underpayment or overpayment;
- (C) Following the review of the fixed narrowband wholesale exchange line, call origination, conveyance and transit markets and acting under sections 45, 87 and 88 of the Act, the Director General of Telecommunications on 28 November 2003 by way of publication of a Notification imposed on BT SMP Condition AA1(a).2 pursuant to which BT is required to grant Network Access using IEC and IBC products on fair and reasonable terms, conditions and charges and on such terms, conditions and charges as the Director may from time to time direct (“SMP Condition AA1(a).2”);
- (D) Following the review of the retail leased lines, symmetric broadband origination and wholesale trunk segments markets and acting under sections 45, 78 and 79 of the Act, Ofcom on 24 June 2004 by way of publication of a Notification imposed on BT SMP Conditions G1.2, GG1.2 and H1.2 pursuant to which BT is required to provide Network Access using PPC products on fair and reasonable terms, conditions and charges and on such terms, conditions and charges as Ofcom may from time to time direct (“SMP Conditions G1.2, GG1.2 and H1.2”);
- (E) On 22 August 2006, THUS referred to Ofcom a dispute between THUS and BT relating to BT’s payment terms in contracts for the provision of PPCs, IECs and IBCs. THUS submitted that commercial negotiations between THUS and BT had failed to resolve the dispute;
- (F) On 12 September 2006, Ofcom decided pursuant to section 186(2) of the Act that it was appropriate for it to handle the dispute and informed the parties of this decision;
- (G) In order to resolve the dispute, Ofcom has considered, among other things, the information provided by the parties and Ofcom’s relevant duties as set out in section 3 and 4 of the Act;

- (H) Ofcom issued a draft of this Determination and the explanatory statement on [ ] and responses were invited by [ ];
- (I) An explanation of the background to the dispute and Ofcom's reasoning for making this Determination are set out in the explanatory statement accompanying this Determination;

**NOW, THEREFORE, PURSUANT TO SECTIONS 188 AND 190 OF THE ACT, OFCOM MAKES THE FOLLOWING DETERMINATION:**

1. It is hereby declared that BT's refusal to offer payment terms of the provision of Network Access comprising PPCs, IECs and IBCs other than billing quarterly in advance, with 30 days to pay, is not in accordance with the requirement to provide those services on fair and reasonable terms, conditions and charges pursuant to SMP Conditions AA1(a).2, G1.2, GG1.2 and H1.2.
2. Ofcom directs that under SMP Conditions AA1(a).2, G1.2, GG1.2 and H1.2 BT must change its payment terms for PPCs, IECs and IBCs with effect from 1 January 2008 to provide these services to THUS on payment terms that include the option of billing monthly in advance, with at least 30 days to pay.
3. Ofcom directs that under SMP Conditions AA1(a).2, G1.2, GG1.2 and H1.2 and with immediate effect BT must adjust its current payment terms by extending the time THUS is allowed to pay quarterly invoices by 60 days until the changes of paragraph 2 are put in place.
4. Ofcom directs that BT must pay THUS a sum by way of adjustment for the overpayment of charges for IEC and IBC products to cover the loss occurred through the early payment of charges during the period of 28 November 2003 up to and including the day before the date of this Determination. The sum shall be the difference between the level of payments made by THUS since 28 November 2003 for IEC and IBC products under BT's current payment terms and the level of payments that THUS would have paid had BT invoiced IEC and IBC products at the same price but monthly in advance, with 30 days to pay.
5. Ofcom directs that BT must pay THUS a sum by way of adjustment for the overpayment of charges for PPC products to cover the loss occurred through the early payment of charges during the period of 24 June 2004 up to and including the day before the date of this Determination. The sum shall be the difference between the level of payments made by THUS since 24 June 2004 for PPC products under BT's current payment terms and the level of payments that THUS would have paid had BT invoiced PPC products at the same price but monthly in advance, with 30 days to pay.
6. Words and expressions used in this Determination (including the recitals above) shall have the same meaning as in the Notification of 28 November 2003 and the Notification of 24 June 2004 as appropriate, and otherwise any words and expressions shall have the same meaning as in the Act, except as otherwise stated in this Determination.

## Section 2

# Summary of proposals

- 2.1 Following a review of the fixed narrowband wholesale exchange line, call origination, conveyance and transit markets and a review of the retail leased lines, symmetric broadband origination and wholesale trunk segments markets, Ofcom found BT to have significant market power ("SMP") in certain markets, and Ofcom imposed a number of conditions on British Telecommunications plc ("BT"). Under SMP conditions AA1(a).2, G1.2, GG1.2 and H1.2 BT is obliged, among other things, to offer partial private circuits ("PPCs"), interconnect extension circuits ("IECs") and intra building circuits ("IBCs") on fair and reasonable terms, conditions and charges.
- 2.2 A dispute about the payment terms offered by BT for PPCs, IECs and IBCs was referred to Ofcom by THUS plc ("THUS") on 22 August 2006. THUS alleges that payment terms offered by BT for these services are unfair and/or unreasonable, in contravention of BT's obligations to provide the services on fair and reasonable terms. On 12 September 2006 Ofcom decided that it was appropriate for it to handle the dispute and notified the parties accordingly.
- 2.3 The dispute is about the timing of payments, the length of the period covered by one invoice and in particular, payment in advance versus payment in arrears.
- 2.4 THUS submits that the current payment terms simply reflect what BT was able to impose on its customers at the time the product was launched by virtue of its significant market power. THUS suggests that BT's payment terms do not reflect the norm when compared with payment terms offered by 28 incumbent telecoms operators across the world for wholesale leased lines and connection links. THUS also submits that BT's current payment terms are not fair and reasonable because they impose an additional cost on purchasers as a result of the impact on working capital. THUS submits that this places it at a competitive disadvantage relative to BT's retail arms. THUS also suggests that the current regulated prices for PPCs (i.e. as set by Ofcom) do not incorporate assumptions that reflect the payment terms offered for PPCs.
- 2.5 BT submits that its current payment terms are fair and reasonable. BT argues that the benchmarking data presented by THUS is not reliable, as some of the countries included in the selected sample are not likely to be large suppliers of interconnect circuits and therefore do not provide a fair comparison. BT submits that its payment terms for PPCs, IECs and IBCs are in line with a selection of benchmark payment terms. BT also submits that prices should rise if the payment terms are adjusted, to rebalance the prices to take account of the change in working capital. Finally, BT states that the change requested by THUS would mean all charges are raised in arrears on the next invoice, which would increase BT's risk of non-payment whilst reducing the purchaser's risk. BT believes that the risk involved should be shared equally between BT and the purchaser.
- 2.6 After assessing the relevant considerations it is Ofcom's opinion that there is a range of terms which may be fair and reasonable, depending on the circumstances of the case, rather than one set of narrowly defined fair and reasonable payment terms. In order to reach a view on whether the terms currently offered by BT for PPCs, IECs and IBCs are fair and reasonable, Ofcom has considered what factors may suggest that particular terms are not fair and/or reasonable.

- 2.7 In Ofcom's opinion, there are a number of different considerations, such as the ability of the firm with SMP to resist competitive pressures and the question of whether the terms are capable of harming competition, which may suggest that terms are not fair and/or reasonable. Ofcom acknowledges that under certain circumstances terms, conditions and charges for the provision of Network Access may even be considered not fair and/or reasonable when they fail to promote competition.
- 2.8 In the present case Ofcom has considered the submissions of the parties and the evidence presented. In particular, Ofcom has considered three main strands of evidence:
- 2.8.1 the potential impact on competition of the payment terms;
  - 2.8.2 the question of consistency between the payment terms currently offered by BT and the implicit assumptions about payment terms made when the prices were set by Ofcom for the relevant services; and
  - 2.8.3 benchmarking data relating to payment terms offered by other European incumbents for comparable services, and the payment terms offered by BT for other wholesale and Openreach services.
- 2.9 It is Ofcom's view that in line with the policy objectives set under the Framework Directive, and Ofcom's obligations under section 4 of the Communications Act 2003, the most important consideration in the resolution of this particular dispute is the potential impact on competition.
- 2.10 Ofcom considers that within the scope of this dispute when assessing the impact on competition from particular payment terms, it is not necessary to demonstrate an actual harm to competition, but rather, whether the terms are capable of harming competition. Ofcom's preliminary view is that BT's current payment terms offered for PPCs, IECs and IBCs are capable of harming competition for the reasons set out in this explanatory statement.
- 2.11 This provisional view is further supported by the weight of the benchmarking evidence. Although the benchmarking data are not, by themselves, persuasive evidence that the current payment terms are not fair and/or reasonable, they are relevant considerations together with the evidence relating to the implied assumptions in the price. Ofcom has considered whether the question of consistency with the price control provides a countervailing factor sufficient to weigh against that conclusion and provisionally concludes that it does not.
- 2.12 Therefore, Ofcom provisionally concludes that BT's current payment terms for PPCs, IECs and IBCs are not fair and/or reasonable, and in consequence, are and were not in accordance with BT's SMP conditions AA1(a).2, G1.2, GG1.2 and H1.2 since those conditions came into effect. Ofcom, therefore, proposes to require BT to offer THUS payment terms of billing monthly in advance, with 30 days to pay, for PPCs, IECs and IBCs, in order to comply with said SMP conditions, and to pay THUS a sum by way of adjustment for the overpayment of the proper amount of the relevant charges to cover the loss occurred through the early payment of charges. The draft determination to resolve this dispute is set out above.

## Section 3

# Background of the dispute and submissions

## Background

- 3.1 THUS is communications provider (“CP”) which provides voice, data and internet services throughout the UK using its own national network.
- 3.2 BT is a CP whose principal activities include networked IT services, local, national and international telecommunications services, and higher-value broadband and internet products and services. In the UK, BT serves more than 20 million business and residential customers with more than 30 million exchange lines, as well as providing network services to other licensed operators<sup>1</sup>.
- 3.3 BT is under an obligation to provide PPCs, IECs and IBCs on fair and reasonable terms, conditions and charges and on such terms, conditions and charges as Ofcom may from time to time direct, as a result of conditions imposed on BT following a finding that BT has SMP in certain relevant markets:
  - 3.3.1 On 28 November 2003, following the review of the fixed narrowband wholesale exchange line, call origination, conveyance and transit markets, the Director General of Telecommunications (“Of tel”) imposed SMP Condition AA1(a).2 on BT, pursuant to which BT is required to grant Network Access using IEC and IBC services on fair and reasonable terms, conditions and charges and on such terms, conditions and charges as the Director may from time to time direct (“SMP Condition AA1(a).2”);
  - 3.3.2 On 24 June 2004, following the review of the retail leased lines, symmetric broadband origination and wholesale trunk segments markets, Ofcom imposed SMP Conditions G1.2, GG1.2 and H1.2 on BT, pursuant to which BT is required to provide Network Access using PPC services on fair and reasonable terms, conditions and charges and on such terms, conditions and charges as Ofcom may from time to time direct (“SMP Conditions G1.2, GG1.2 and H1.2”).
- 3.4 PPCs, IECs and IBCs are also subject to regulatory price controls<sup>2</sup>.

## History of the dispute

- 3.5 THUS purchases the services which are the subject of this dispute from BT. PPCs, IECs and IBCs are wholesale interconnection services provided by BT which are inputs into retail services supplied by THUS, and which BT either uses itself or reflect capabilities BT provides to itself in analogous ways to enable BT to offer retail services in competition with THUS.

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<sup>1</sup> Source: BT’s website see <http://www.btplc.com/Thegroup/Companyprofile/Companyprofile.htm>

<sup>2</sup> See [http://www.ofcom.org.uk/consult/condocs/ppc\\_charge\\_control/statement/](http://www.ofcom.org.uk/consult/condocs/ppc_charge_control/statement/) (PPCs) and <http://www.ofcom.org.uk/consult/condocs/charge/statement/> (IECs/IBCs)



- 3.6 The referral to Ofcom of the dispute between THUS and BT over payment terms represents the failure of some 18 months of negotiations between THUS (on its own behalf and as a member of the UK Competitive Telecommunications Association ("UKCTA")<sup>3</sup>) and BT. According to THUS, these negotiations can be broadly divided into two phases:
- 3.6.1 Phase 1 (March 2005 to December 2005) "focused on the payment terms for IECs, which were clearly anomalous (invoiced annually in advance) and represented a potential quick win for UKCTA. BT agreed in December 2005 to change to invoicing quarterly in advance"<sup>4</sup>; and
- 3.6.2 Phase 2 (April 2006 to August 2006) focused on payment terms for PPCs, IECs and IBCs. No alternative solutions were discussed during the second phase of negotiations, as BT maintained that its current terms are reasonable.
- 3.7 Ofcom is convinced that the possibility of further negotiation between the parties has been exhausted. The issues that are the subject of this dispute have been the subject of protracted negotiations and have been raised at CEO level between THUS and BT Wholesale.
- 3.8 On 10 July 2006, BT wrote to UKCTA, stating "BT Wholesale has concluded that its payment terms are both reasonable and proportionate. BT Wholesale therefore does not plan to pursue UKCTA's request to change payment terms." On 11 July 2006 an email was sent from THUS to BT, acknowledging BT's letter of 10 July and indicating that it was likely that THUS/UKCTA would wish to refer the dispute to Ofcom for resolution.
- 3.9 A dispute about the payment terms offered by BT for PPCs, IECs and IBCs was referred to Ofcom by THUS on 22 August 2006. THUS alleges that payment terms offered by BT for these services are not fair and/or reasonable, therefore breaching BT's obligations to provide the services on fair and reasonable terms.
- 3.10 Section 188(2) of the Act provides that where there is a dispute between different CPs, and Ofcom has decided pursuant to section 186(2) of the Act that it is appropriate for it to handle the dispute, Ofcom must consider the dispute and make a determination 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.
- 3.11 On 12 September 2006 Ofcom decided that it was appropriate for it to handle the dispute and notified the parties.

## **Submissions of the parties**

### **THUS**

- 3.12 THUS submits that "BT has never given an objective justification for its quarterly in advance payment terms. These terms simply reflect what BT was able to impose on

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<sup>3</sup> Neither UKCTA itself nor any other member of UKCTA is a party to this dispute.

<sup>4</sup> Submission from THUS dated 21 August 2006

its customers at the time the product was launched by virtue of its significant market power.”<sup>5</sup>

- 3.13 THUS also submits that BT’s current payment terms are not fair and reasonable because they impose an additional cost on purchasers as a result of the impact on working capital. In particular, THUS refers to the difference between the payment terms offered by BT (quarterly in advance, with 30 days to pay) and the payment terms THUS can offer its retail customers (for services using PPCs as inputs, varying between annual to quarterly to monthly invoicing, with 30 to 60 days to pay; for retail voice services for which IECs and IBCs are inputs, typically monthly in arrears with 30 or 60 days to pay.) THUS submits that the resulting squeeze on its working capital places THUS at a competitive disadvantage relative to BT’s downstream businesses.
- 3.14 THUS suggests that the current regulated prices for PPCs do not reflect the payment terms offered for PPCs. THUS believes that the current regulated prices may already reflect payment terms more favourable to THUS and therefore THUS submits that prices should not increase if the payment terms are adjusted.
- 3.15 THUS also suggests that BT’s payment terms do not reflect the norm when compared with payment terms offered by other incumbent telecoms operators for wholesale leased lines and connection links. THUS submitted to Ofcom a report prepared by a professional services firm<sup>6</sup> which provides evidence as to the payment terms offered by 28 incumbent telecoms operators across the world for wholesale leased lines and connection links.
- 3.16 THUS states, “We anticipate that BT will argue that it will take it many months to implement the necessary changes to its billing systems and we do not believe it is appropriate that [we] should have to wait until this has been done before seeing an improvement in working capital”.<sup>7</sup> Therefore, THUS requests that Ofcom resolve the dispute by requiring BT offer amended payment terms from 1 January 2008 and to offer an interim arrangement “with immediate effect, whereby the payment period for invoices is extended by N days, where N is chosen to give an equivalent impact on average working capital”.<sup>8</sup>

## **BT**

- 3.17 BT submits that its current payment terms are fair and reasonable. BT argues that the benchmarking data presented by THUS are not reliable, as some of the countries included in the selected sample are not likely to be large suppliers of interconnect circuits and therefore do not provide a fair comparison. BT submits that its payment terms for PPCs, IECs and IBCs are in line with a selection of benchmark payment terms.
- 3.18 BT lists some of the standard terms that BT Global Services has been offered by other CPs within the UK. BT argues that this list shows that BT’s terms are not outside the norm, as only one of the companies listed has payment terms that are better than BT’s.
- 3.19 BT also advanced an argument that the changing of the payment terms would unfairly disadvantage BT. BT states that the risk of non-payment involved should be

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<sup>5</sup> Annex A to submission from THUS dated 21 August 2006

<sup>6</sup> Ofcom has been requested to treat the name of the firm as confidential.

<sup>7</sup> Submission from THUS dated 21 August 2006

<sup>8</sup> Submission from THUS dated 21 August 2006

shared equally between BT and the purchaser. BT submits that the change to payment terms requested by THUS would mean all charges are raised in arrears on the next invoice, which would increase BT's risk whilst reducing the purchaser's risk. Although BT later confirmed that "BT considers that bad debt, is not an issue for PPCs, as the customers tend to be the [financially sound CPs], any extension of a change in the payment terms to other products that have a different customer base may be more of a risk to BT." For example, IECs and IBCs are currently bought by a broader base of customers, so the impact on bad debt may vary.

- 3.20 BT submits that prices should rise if the payment terms are adjusted, to rebalance the prices to take account of the change in working capital. This submission implicitly presupposes that the existing payment terms are consistent with, and reflected in, the setting of the existing price controls.
- 3.21 BT states that in addition to the possible financial impact of changing the payment terms, there are a number of potential issues that may arise that are not purely financial, including the one-off task to change all of the prices, the increased staff capacity required to process the invoices; and the development of BT's billing systems required to support different payment terms for PPCs, IECs and IBCs.<sup>9</sup>

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<sup>9</sup> BT's submission "Response to additional question" 2 November 2006

## Section 4

# Ofcom's analysis and reasoning

- 4.1 This dispute has been referred to Ofcom under section 185 of the Communications Act 2003 and Ofcom must consider the dispute and make a determination for resolving it based on the evidence available.

### Ofcom's role in resolving a dispute

- 4.2 When Ofcom is required to resolve a regulatory dispute, it does so as the regulator, and not in the role of a third-party arbitrator. Ofcom's determination is a form of regulation, and must therefore reflect and be consistent with Ofcom's statutory duties, as well as being sufficient to resolve the dispute.<sup>10</sup>
- 4.3 The resolution of regulatory disputes must essentially be aimed at achieving the policy objectives of Article 8 of the Framework Directive. Section 4 of the Communications Act 2003 ("the Act") therefore requires that, when resolving such disputes, Ofcom acts in accordance with the six Community requirements that give effect to Article 8. In summary those requirements are:
- 4.3.1 To promote competition in communications markets;
  - 4.3.2 To secure that Ofcom contributes to the development of the European internal market;
  - 4.3.3 To promote the interest of all European Union citizens;
  - 4.3.4 To act in a manner which, so far as practicable, is technology-neutral;
  - 4.3.5 To encourage to the extent Ofcom considers it appropriate, the provision of network access and service interoperability; and
  - 4.3.6 To encourage such compliance with certain international standards as is necessary for facilitating service interoperability and securing freedom of choice for the consumers of communication providers.
- 4.4 Where the parties to the dispute are unable to agree terms and conditions for network access, Ofcom is under a duty to consider those disputes which it has decided to handle and then to make a determination resolving each dispute and has to do so in the light of the above Community principles.
- 4.5 Ofcom must resolve disputes within four months unless exceptional circumstances apply.
- 4.6 This has important implications for the investigation undertaken by Ofcom in order to enable it to reach a decision as to how to resolve the dispute. In practical terms, the effect of this time limit tends to increase the significance of the evidence and submissions made by the parties to the dispute. At the same time, Ofcom must (and

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<sup>10</sup> The section on regulatory disputes in Ofcom's "Draft guidelines for the handling of competition complaints, and complaints and disputes concerning regulatory rules" has a more expansive discussion on this topic. See: <http://www.ofcom.org.uk/consult/condocs/enforcement/>

does) make every effort to use the time available to gather what additional evidence it can sufficient to assist it in resolving the dispute.

- 4.7 Another important implication of this timetable to resolve disputes is that the process of dispute resolution takes Ofcom's duties and applies them to the existing regulatory rules to consider how to resolve the dispute. It follows that Ofcom's dispute resolution process does not normally re-open questions already resolved previously, such as the existence of SMP or the scope and nature of SMP giving rise to the need to impose particular SMP conditions.

### **The nature of the obligation to offer services on 'fair and reasonable' terms**

- 4.8 The requirement to offer terms that are fair and reasonable is imposed as part of a broader condition requiring the undertaking with SMP, i.e. the dominant provider, to provide access to, and use of, specific network elements and associated facilities on reasonable request.<sup>11</sup>
- 4.9 The decision to impose the SMP conditions on BT was based on the finding in the relevant market reviews that BT had SMP in those markets and should be under an obligation to provide network access in those markets on reasonable request. Under this general access obligation BT would be obliged to supply on fair and reasonable terms any services falling within the relevant markets.
- 4.10 As an example of the potential reading of the term "fair and reasonable" Ofcom stated in section 6.41 of its review of the retail leased lines, symmetric broadband origination and wholesale trunk segments markets that the words "fair and reasonable" would be interpreted by Ofcom as meaning *inter alia* terms which in effect do not amount to a refusal to supply on commercially viable terms.<sup>12</sup>
- 4.11 However, it was not the intention of this statement to confine the test of what is fair and reasonable exclusively to this one example. What ultimately constitutes "fair and reasonable" terms or conditions in relation to a particular dispute needs to be judged on a case by case basis. It is Ofcom's opinion that depending on the circumstances of the case, terms could be not fair and/or reasonable for a number of reasons, a non-exhaustive list of which is set out in the following:
- 4.11.1 The terms reflect the ability of the firm with SMP to resist competitive pressures that would otherwise allow customers to negotiate terms and conditions that suited their needs (for example, the terms could be observed to be at variance with terms and conditions observed in other similar markets unaffected by the presence of SMP).<sup>13</sup>
- 4.11.2 The terms impose requirements or raise rivals costs in ways that are capable of distorting or harming competition in a market.<sup>14</sup> Ofcom notes

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<sup>11</sup> See, Conditions AA1(a) imposed by the review of the fixed narrowband wholesale exchange line, call origination, conveyance and transit markets (28 November 2003) and G1, GG1 and H1 imposed by the review of the retail leased lines, symmetric broadband origination and wholesale trunk segments markets (24 June 2004). An imposition of such requirements is provided for in Article 12 of the Access Directive, which in the post-amble to Article 12(1) states that "[n]ational regulatory authorities may attach to those [access] obligations conditions covering fairness, reasonableness and timeliness."

<sup>12</sup> See: <http://www.ofcom.org.uk/consult/condocs/llmr/statement/>

<sup>13</sup> For example, highly favourable boilerplate terms that are offered on a 'take it or leave it' basis

<sup>14</sup> The market affected may be a market for downstream services (if the terms unreasonably raise rivals costs, reducing competitive pressures in that market) or could be a different market (for

that such a capability to harm competition is not necessarily the same as being discriminatory (and firms may have both an obligation to provide services on fair and reasonable terms, and an obligation of non-discrimination) – although clearly a term that is capable of harming competition and that which otherwise falls within the criteria set out in the Guidelines on undue discrimination by SMP providers<sup>15</sup> could be *both* not fair and reasonable *and* discriminatory.

- 4.11.3 The terms are sufficiently onerous so as to comprise a constructive refusal to supply the service.<sup>16</sup>
- 4.11.4 The terms could be inconsistent with other regulatory obligations on the firm with SMP (for example, the terms could undermine or circumvent an established price control through tying (requiring the purchase of additional unwanted services as a condition of the contract)).
- 4.11.5 The terms are not fair or reasonable when considered in the commercial context within which they occur (for example, compared with other similar services offered by the same firm or by comparable firms).
- 4.11.6 The terms are contrary to public policy in some other way that would make it unreasonable to permit them to stand.<sup>17</sup>
- 4.11.7 Ofcom acknowledges that under certain circumstances terms, conditions and charges for the provision of Network Access may even be considered not fair and/or reasonable when they fail to promote competition.
- 4.12 However, it is important to recognise that what constitutes fair and reasonable is not capable of precise definition, and that Ofcom should particularly exercise restraint in relation to terms that have been the subject of commercial negotiation or, in some cases, long-standing commercial practice. The mere fact that terms are favourable to one party or another (for example, the firm with SMP) is not, by itself, an indication that the terms are unreasonable or that they would not be present in a competitive market.<sup>18</sup>
- 4.13 Payment terms are a 'non-price' term of a contract to supply circuits, but payment terms affect the timing of working capital requirements: hence other things being equal, terms that require payment in advance of the service being supplied are generally more favourable to the supplier than terms requiring payment in arrears.

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example, a term that required a purchaser to refrain from competing with the SMP firm in some other, unrelated market).

<sup>15</sup> <http://www.ofcom.org.uk/consult/condocs/undsm/contraventions/>

<sup>16</sup> See, for example, the discussion on requirements of fairness and reasonableness in the ERG common position on remedies at p46: "NRAs may attach conditions covering fairness, reasonableness and timeliness, conditions which are set out in the access requirement ... Such requirements may be particularly useful to protect against strategies aimed at covert rather than overt attempts to deny access.

<sup>17</sup> For example, a term that would serve to prevent a purchaser of the service from taking steps required for it to comply with a regulatory obligation.

<sup>18</sup> For example, it is common in contracts for the provisions of communications services to exclude liability for consequential or indirect loss in relation to breach of contract by the supplying firm. Such clauses are strongly favourable to suppliers, and are typically not negotiable, but are widely recognised as being appropriate given the difficulty that firms who supply such services would have in being able to insure against the risk of such losses, and purchasers can get insurance for this eventuality.

- 4.14 Ofcom considers that there will usually be a range of different payment terms which may be fair and reasonable, depending on the circumstances.
- 4.15 As was indicated above, what is 'fair and reasonable' in the present dispute can depend on many factors, including comparison with benchmark data of similar services, price, the relative bargaining power of supplier and customer and whether there are any other competition issues. Therefore, it is not possible for Ofcom to determine whether BT's current payment terms for PPCs, IECs and IBCs are fair and reasonable without consideration of related matters, such as the relative bargaining positions of the parties and the price. Ofcom must determine what is fair and reasonable between the parties to the dispute and in the particular circumstances of this dispute.

### **Ofcom's analysis and reasoning**

- 4.16 Ofcom's consideration of the dispute is predominantly based on the evidence submitted by the parties as outlined below, together with Ofcom's understanding of the regulatory regime enacted under the Act and its wider context (for example, the Directives) and Ofcom's view as a specialist sectoral regulator as to the particular issues and sensitivities governing competition between CPs.
- 4.17 As explained in paragraph 2.8 above, Ofcom has considered three main strands of evidence:
- 4.17.1 Primarily, the potential impact on competition of the payment terms;
  - 4.17.2 As a check to avoid inconsistency, Ofcom has considered whether there would be any inconsistency between the payment terms currently offered by BT and the implicit assumptions about payment terms made when the prices were set by Ofcom for the relevant services; and
  - 4.17.3 Ofcom has considered as a relevant context, and as a way of providing a separate perspective of what might constitute 'fair and reasonable', benchmarking data relating to payment terms offered by other European incumbents for comparable services, and the payment terms offered by BT for other wholesale and Openreach services.
- 4.18 Ofcom considers that the most important consideration in the resolution of this dispute is the potential impact on competition.
- 4.19 Each strand of evidence will be considered in turn below.

### **(1) Impact on competition**

#### **Capable of harming competition**

- 4.20 In its dispute referral, THUS provided a summary of the business objective that it was seeking in bringing this dispute to Ofcom. This was as follows:
- 4.20.1 "to reduce the working capital required to support the quarterly in advance payments for these products." THUS stated that this working capital requirement places a significant burden on THUS's business in terms of additional borrowing costs and a squeeze on the capital available to invest in growing THUS's business.



- 4.20.2 “to address the competitive disadvantage that the current payment terms place on THUS relative to BT’s downstream business.” THUS asserted that this exists because THUS and other CPs typically have a higher cost of capital than BT’s retail arms (whose cost of capital is effectively that of BT Group), and are less able to smooth out peak and troughs in cashflow (whereas BT’s treasury is managed at Group level). THUS argued that any increase in working capital will therefore impose greater costs on BT’s competitors than its own downstream businesses and place them at a competitive disadvantage in associated retail markets.
- 4.21 The SMP conditions imposed on BT require that BT’s terms and conditions should be fair and reasonable. By definition, an SMP condition is imposed by virtue of, and in response to, the impact SMP may have on the competitive process, therefore the SMP condition exists at least in part to address the potential for competition to be distorted because of BT’s market power.
- 4.22 Ofcom notes that BT has SMP in the markets for provision of relevant services whilst THUS is a customer in markets where Ofcom – at least for PPCs – concluded in its market review that currently countervailing buyer power is weak<sup>19</sup>, and that PPCs, IECs and IBCs are essential inputs into THUS’s service.
- 4.23 In assessing whether the current payment terms are fair and reasonable, Ofcom has considered whether these terms are capable of restricting competition between BT and THUS. This approach is consistent with Ofcom’s duty under Section 4 of the Communications Act to resolve disputes in accordance with the Community Requirements that give effect to Article 8 of the Framework Directive, specifically the requirement to resolve disputes in a manner that promotes competition in communications markets.
- 4.24 Therefore, Ofcom considers that should BT’s payment terms in the present dispute be *capable* of harming competition they fall outside the range of fair and reasonable terms.
- 4.25 In its submissions THUS has made reference to the differences between the wholesale terms required by BT and those which THUS is able to apply to its own retail customers<sup>20</sup>. THUS’s retail customers are won in markets in which THUS has no market power where billing is said to be typically monthly in arrears with 30 to 60 days to pay<sup>21</sup>. The difference between retail and wholesale terms therefore gives rise to a working capital requirement, in order to finance the wholesale creditor (BT) until the retail debtor pays. In practice this requirement is not faced by BT’s downstream business to the same extent. THUS argues that this difference is in itself harmful to competition between itself and BT and therefore not reasonable.
- 4.26 In light of the difference between the less onerous payment terms THUS is able to enforce in retail markets (in which THUS has not been found to hold a position of SMP) and the more onerous payment terms that BT is able to enforce in the wholesale markets for the inputs relevant to this dispute (in which BT has been found to hold a position of SMP) and in light of the fact that, in practice, BT does not face the same discrepancy, Ofcom considers that BT’s payment terms are capable of

<sup>19</sup> For example, see Annex B at:

[http://www.ofcom.org.uk/consult/condocs/llmr/statement/fin\\_statement\\_chapters/](http://www.ofcom.org.uk/consult/condocs/llmr/statement/fin_statement_chapters/)

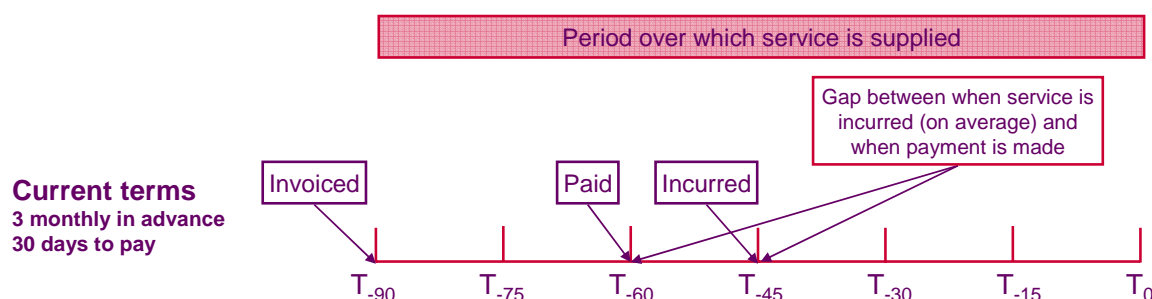
<sup>20</sup> Section 3.3 of Appendix A to THUS’s submission dated 21 August 2006

<sup>21</sup> According to THUS’s submission. BT did not dispute this assertion, and it is consistent with Ofcom’s understanding. However, it should be noted that Ofcom has not conducted any exhaustive information gathering on this point.



harming competition. In reaching this view, Ofcom is mindful of BT's ability to impose payment terms for PPCs, IECs and IBCs which are advantageous to BT. Furthermore, in the event that these payment terms are not replicated in BT's regulatory transfer charging practices, they would impose a greater need for working capital than would be reflected in any downstream financial statements produced by BT.

- 4.27 THUS argues that the effect of BT's payment terms, relative to those which it considers reasonable, is to increase its working capital requirements by an amount equivalent to an additional cost of approximately £1 million per annum. This is equal to about 2% - 2½% of the £40 to £50 million per annum which it spends on the services covered by this dispute. THUS states that when other factors are taken into account, the overall cost of BT's commercial stance is likely to be greater than this but does not provide quantification. The figure of 2% - 2½% is however broadly consistent with Ofcom's own estimates of the cost of the additional working capital required as a result of the requirement to pay quarterly in advance (see paragraph 4.32 below).



- 4.28 In light of the impact that BT's payment terms have on THUS' working capital requirement, Ofcom provisionally considers that the current payment terms are capable of harming competition.
- 4.29 Therefore, and by way of conclusion, for these reasons Ofcom provisionally considers that the current payment terms are capable of harming or distorting competition.

## Materiality

- 4.30 Ofcom has also considered the materiality of the difference between the payment terms apparently reflected in the cost base and the terms actually offered.
- 4.31 Ofcom estimated how much lower the prices for the relevant regulated services might have been if the cost data had directly reflected the actual payment terms offered. Firstly Ofcom established the average delay in months between rental services on average being provided and when they were paid for a) based on what happens in practice and b) as apparently reflected in the transfer charges between wholesale and retail activities reported in BT's regulatory financial statements. Secondly Ofcom worked out the difference between the average delay in these two cases to measure the inconsistency between the two bases. Thirdly Ofcom converted this difference, measured in months, into a percentage figure to be applied to the prices actually charged.
- 4.32 The difference between these two gaps is 2½ months, which is a measure of the extent of the apparent discrepancy in the cost base used to set prices and the terms actually offered. If the cost base had reflected the terms actually offered, prices could

therefore have been lower by the saving in the cost of financing BT's working capital for this 2½ months gap i.e. 2½ months at BT's regulated cost of capital. Using BT's current cost of capital (11.4%) for wholesale regulated services this equates to prices being lower to the order of 2½%<sup>22</sup>.

- 4.33 Ofcom's provisional view is that this calculation suggests that the possible detrimental impact of the payment terms on THUS and other customers is material. It also appears to support THUS's submission that the impact of the payment terms is equivalent to approximately £1 million per annum (see paragraph 4.27 above).

## Replicability

- 4.34 The impact of BT's current payment terms for PPCs has previously been considered in the context of Ofcom's work on replicability.<sup>23</sup> In this work package Ofcom considered the extent to which certain of BT's services were replicable by other CPs, in order to assess whether it was appropriate to reduce the regulatory obligations in place on BT in certain retail markets, for example by allowing BT to offer unpublished bespoke pricing to business customers in these markets. In so doing, Ofcom considered whether some of BT's wholesale services (including PPCs) facilitated the development of competition in downstream business retail markets, by enabling competitors to use BT wholesale services to compete with BT in those retail markets fairly, and on level terms.
- 4.35 During the course of this review, concerns were expressed by CPs that BT's contract terms (which include payment terms) for PPCs meant that third parties could not effectively compete with BT for customers in business retail markets. Concerns were expressed that the contract terms for PPCs were onerous when compared with other wholesale markets and that they, therefore, could lead to a distortion of competition.
- 4.36 In the statement<sup>24</sup> issued at the end of this review Ofcom confirmed that payment terms for PPCs were a bar to CPs replicating BT's downstream services (i.e. the contract terms in themselves were a barrier to effective competition at the retail level).<sup>25</sup>
- 4.37 It should be stressed that Ofcom does not consider 'replicability' to necessarily equate to 'reasonableness'. Whilst discussing concerns raised in relation to the reasonableness of PPC contract terms (which include payment terms) in the statement on replicability<sup>26</sup>, Ofcom did not reach a final view on whether or not such terms are reasonable. However, Ofcom considers that the fact that PPC contract terms are a bar to replicability tends to suggest potential harm for competition and therefore suggests that the terms may not be fair and reasonable.
- 4.38 The extent to which BT's regulatory financial statements, notably through its transfer charging practices, reflect the actual terms of trade offered to third parties for PPC services is separately being investigated as part of Ofcom's short review of BT's PPC current transfer charging, a piece of follow up work signalled in Ofcom's statement on replicability in April 2006.

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<sup>22</sup> Ofcom converted BT's annual cost of capital into its monthly equivalent and then compounded it by 2½ months.

<sup>23</sup> <http://www.ofcom.org.uk/consult/condocs/busretail/statement/>

<sup>24</sup> <http://www.ofcom.org.uk/consult/condocs/busretail/statement/>

<sup>25</sup> See paragraph 6.85

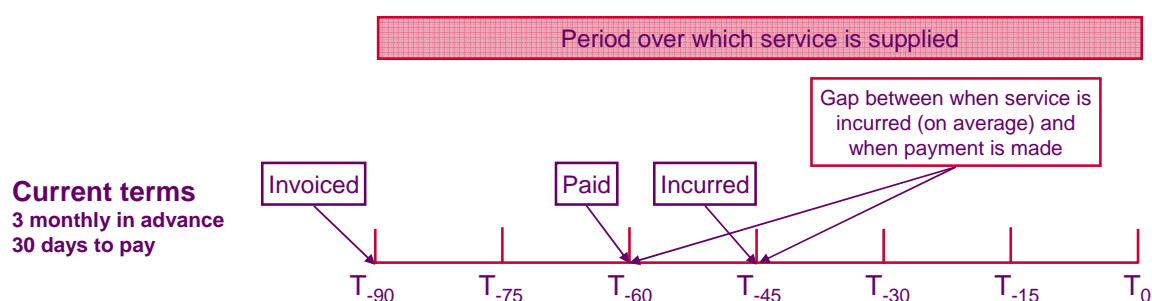
<sup>26</sup> <http://www.ofcom.org.uk/consult/condocs/busretail/statement/>

## Impact on competition - conclusion

- 4.39 In resolving disputes Ofcom is required under Section 4 of the Communications Act to take into account the Community Requirements set out in Article 8 of the Framework Directive – see paragraph 4.3 above for a summary of these requirements. The first Community requirement is that Ofcom resolves disputes in a way that promotes competition in communications markets. This is the main Community Requirement that is relevant in this dispute. However, when resolving this dispute Ofcom has also taken the requirement for it to encourage the provision of network access into account.
- 4.40 For the reasons set out in paragraphs 4.20 to 4.39 above Ofcom provisionally concludes that the payment terms for PPC, IEC and IBC services are, indeed, capable of harming or distorting competition, as there are strong indications that the current terms have an impact on BT's wholesale customers' ability to compete with BT in downstream markets.
- 4.41 Therefore, Ofcom provisionally concludes that BT's current payment terms for PPCs, IECs and IBCs are not in accordance with its obligations to offer network access on fair and reasonable terms under SMP conditions AA1(a).2, G1.2, GG1.2 and H1.2.

## (2) Apparent inconsistency between payment terms and prices

- 4.42 As noted above, there is a strong linkage between payment terms and price. Terms that require early payment tend to reduce the working capital requirements of the supplier of a product while increasing the working capital requirements of the purchaser. From BT's perspective, the opportunity benefit of this reduced working capital requirement is determined by its regulated cost of capital as well as the extent of prepayment.



- 4.43 Ofcom agrees with both parties that there is a relationship between the payment terms offered and the level of charges for services which are subject to a cost-orientation obligation. This is because the cost base of a service will also include the cost of capital employed in providing the service and this capital employed should include (within debtors) the value of service provided by BT at any one point (on average) that has not yet been paid for. Not to include this value in the cost base would mean, regardless of when BT were to be eventually paid for the services provided, that it would receive exactly the same sum. In this (theoretical) case BT would be offering 'free' credit terms.
- 4.44 The principle of including the value of service provided but not yet paid for in the cost base for capital employed also applies where BT is on average paid in advance. In this case there should be a reduction in the mean capital employed (within creditors) to reflect the extent to which it has on average received payment for service before it has actually been supplied to the customer.

- 4.45 BT has argued that prices should increase if the payment terms are changed.
- 4.46 THUS suggests that the current prices for PPCs do not reflect the payment terms currently offered for PPCs. THUS suggests, on the basis of what it understands of the original PPC pricing model, “that the current prices probably reflect the more generous payment terms/payment profile associated with retail leased lines.” Therefore, THUS argues that prices should not increase if payment terms are changed, because the current prices do not reflect the terms currently offered, but already reflect terms which would be more favourable to THUS.
- 4.47 Alongside the submissions of the parties in this respect, Ofcom has also considered what payment terms were assumed when the relevant price controls were set. Those considerations are set out in the following.

#### **Relationship between payment terms and regulated prices: PPCs**

- 4.48 Ofcom set the current RPI-X price control on PPC services effective from 1 October 2004. Assumptions around payment terms are primarily incorporated into a price control via the cost base of the starting prices. However, although Ofcom considered resetting prices at the start of the price control, Ofcom did not adjust starting charges because the pricing model proposed by BT at that time suggested an increase in overall charges of approximately 30%, which was contradicted by evidence from BT’s regulatory financial statements that returns across all PPC services were roughly in line with BT’s cost of capital. Instead, given the absence of more robust figures, Ofcom used the then current prices as starting charges for the new control and applied the value of X to those.<sup>27</sup>
- 4.49 Therefore, to determine the relationship between payment terms and prices Ofcom has considered the relationship assumed in 2002, when the Director General of Telecommunications (“Of tel”) directed that PPCs should be provided.
- 4.50 PPC prices were first determined by Of tel in September 2002 based on a BT pricing model which, amongst other sources, used data taken from BT’s 2000/01 regulatory financial statements as a cost base for its calculations. It is Ofcom’s understanding that these statements reflected payment terms for all wholesale services, regulated and unregulated, approximately equivalent to monthly billing in arrears with 30 days to pay from the date of the issue of the invoice.
- 4.51 BT had developed an offline spreadsheet model from which it derived a set of proposed prices. BT’s explanation of the workings of this model was included in Annex F (‘BT’s description of its pricing model’) of the September 2002 consultation document. BT did not mention making an adjustment to the cost base to reflect the payment terms eventually reflected in the prices set i.e. quarterly in advance with 30 days to pay. None of Of tel’s required adjustments to the prices proposed by BT related to the difference between the payment terms reflected in the cost base and the payment terms actually offered.
- 4.52 Therefore it appears to Ofcom that PPC prices have been set in 2002 on the basis of cost data which reflected payment terms which differ from the payment terms actually offered for PPC rental services. BT’s current payment terms (quarterly in advance, with 30 days to pay) differ from the terms apparently implied in the cost data used to set PPC prices (approximately monthly in arrears, with 30 days to pay).

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<sup>27</sup> See [http://www.ofcom.org.uk/consult/condocs/ppc\\_charge\\_control/statement/](http://www.ofcom.org.uk/consult/condocs/ppc_charge_control/statement/)

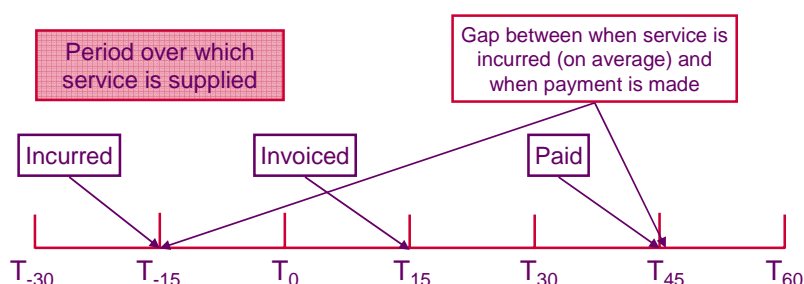
- 4.53 The precise payment terms reflected in BT's cost base were set out in note 5 (Inter Business Balances) to BT's 2000/2001 regulatory financial statements as follows:

*"The mean capital employed statements for the Businesses and disaggregated activities include balances relating to the charges from the Network Business to the Retail Systems Business and its disaggregated activities. The Retail Systems Business is deemed to settle these charges in the same 59 day period as other operators."*

- 4.54 Ofcom's understanding is that the 59 days is approximately equivalent to monthly billing in arrears with 30 days to pay, comprising the following elements:

- the 2 weeks it was assumed that it took BT to issue an invoice for the previous month's services;
- the 30 days that the purchaser had to pay the invoice; and
- the average amount of services provided but not yet invoiced i.e. 15 days worth.

**Terms reflected in  
BT's 2000/01  
regulatory financial  
statements**



- 4.55 Ofcom asked BT whether it agrees with Ofcom's interpretation of BT's regulatory financial statements. BT disagrees with Ofcom's interpretation and states that 59 days quoted in the regulatory accounts is a notional figure for debtor days. BT states:

*"There is a fundamental difference between the debtor days calculation, which is just the average BT debt divided by the number of days BT customers take to pay it AND our billing terms and conditions, which may vary by product and contain a mix of services charged in advance or arrears. This will depend on the contractual T&Cs the customer has signed up to."*<sup>28</sup>

BT also submits that the figure of 59 days in the regulatory financial statements applies the same assumption on debtors to internal trading between BT Retail and BT Wholesale as that experienced between BT and external customers.

- 4.56 Ofcom has considered BT's comments, but remains of the opinion that this figure reflects an implied assumption of payment terms which differs from the payment terms currently offered for PPCs, IECs and IBCs (quarterly in advance, with 30 days to pay). Ofcom notes that notional debtors also includes any unbilled revenue (i.e. accrued income) and that BT's handling of payment terms in the regulatory financial statements appears to be at odds with the need to reflect the actual payment terms offered for individual services rather than on a standardised (i.e. the 59 days) basis. Ofcom remains of the view that this '59 days' is derived from a monthly billing in arrears with 30 days to pay scenario. On this basis, it appears to Ofcom that there is a discrepancy between the payment terms actually offered (quarterly in advance with

<sup>28</sup> Email from BT to Ofcom, 7 December 2006

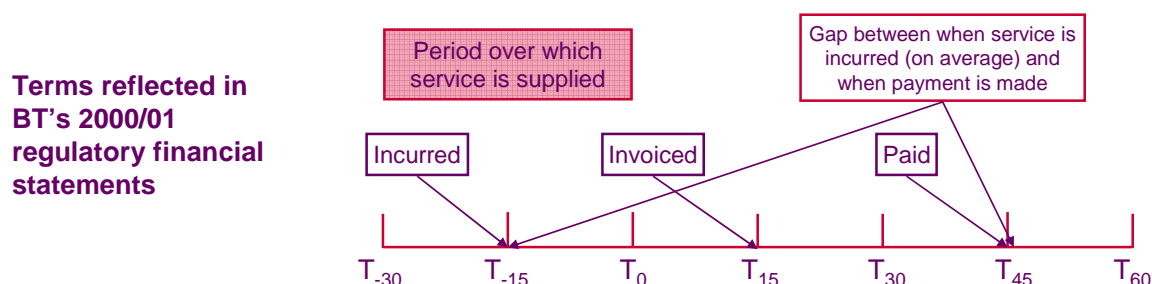
30 days to pay) and the cost base (approximately, monthly in arrears with 30 days to pay).

### Relationship between payment terms and regulated prices: IECs and IBCs

- 4.57 As previously noted in paragraph 4.48, assumptions around payment terms are incorporated into a price control through starting prices. For IECs and IBCs, the last time the starting charges were set for the relevant price control was in 1997.<sup>29</sup> (Although these services have since been subject to a number of revised price controls<sup>30</sup>, the subsequent price controls did not re-set starting charges.) The starting charges were derived from BT's 1995/96 cost information which appears to have reflected the settlement terms under BT's standard interconnect contract: approximately monthly in arrears with 30 days to pay.
- 4.58 It appears from the Director General's statement published in July 1997<sup>31</sup> that no adjustments were made to reflect the actual payment terms offered.
- 4.59 As explained in paragraph 4.55 above, Ofcom asked BT whether it agrees with Ofcom's interpretation of BT's regulatory financial statements. BT disagrees with Ofcom's interpretation and states that the figure quoted in the regulatory accounts is a notional figure for debtor days. As explained in paragraph 4.55 above, BT suggests there is a fundamental difference between debtor days and BT's terms and conditions.
- 4.60 However, for the same reasons as set out in paragraph 4.56 above, Ofcom considers that it is reasonable to conclude that the notional debtors (i.e. the 59 days) reflected in the cost base for the services in dispute is approximately equivalent to payment terms of monthly in arrears with 30 days to pay.
- 4.61 Therefore Ofcom provisionally concludes that the IBC/IEC prices set in 1997 are based on cost data which reflects payment terms that differ from the payment terms actually offered for IBC / IEC rental services.

### Implied assumption about payment terms

- 4.62 As explained in paragraphs 4.48 to 4.61 above, after careful consideration Ofcom believes that the relevant cost information in BT's regulatory financial statements reflects the equivalent of payment terms of monthly in arrears with 30 days to pay, and this created the implied assumption when the relevant price controls were set, although such assumption was not made explicit and the potential discrepancy highlighted above did not come to Ofcom's attention at that time.

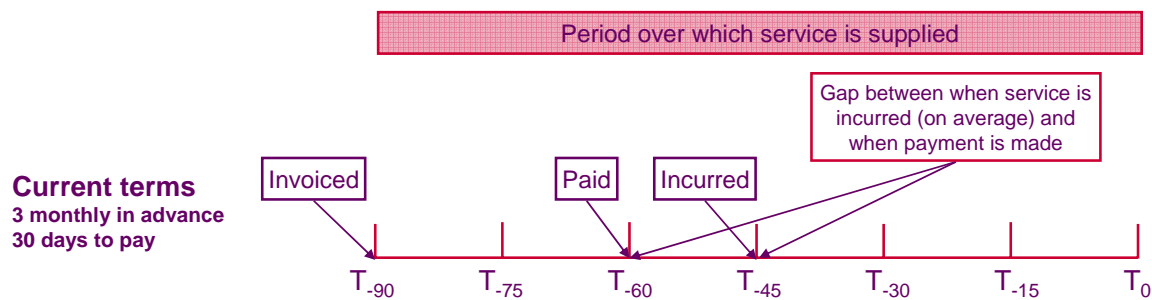


<sup>29</sup> [http://www.ofcom.org.uk/static/archive/oftel/publications/1995\\_98/pricing/ncct797.htm](http://www.ofcom.org.uk/static/archive/oftel/publications/1995_98/pricing/ncct797.htm)

<sup>30</sup> Most recently in 2005 see: <http://www.ofcom.org.uk/consult/condocs/charge/statement/>

<sup>31</sup> Network charges from 1997 - Statement (July 1997) available at: [http://www.ofcom.org.uk/static/archive/oftel/publications/1995\\_98/pricing/ncct797.htm](http://www.ofcom.org.uk/static/archive/oftel/publications/1995_98/pricing/ncct797.htm)





- 4.63 One of the factors to consider when determining fair and reasonable payment terms is the relationship between the payment terms and price. Thus, if current prices do not reflect current payment terms, one might argue that the payment terms are not necessarily fair and reasonable terms for the current price. However, Ofcom considers that the apparent difference between payment terms assumed in the price and actual terms offered does not, by itself, necessarily mean that the terms currently offered by BT are not fair and/or reasonable. Rather, the conclusion Ofcom intends to draw from this discrepancy is that the range of fair and reasonable terms is likely to include terms which differ from BT's current terms.

### Relationship between costs and price

- 4.64 As explained above, it appears that the current payment terms may differ from the payment terms on which Ofcom based its analysis when setting the relevant price controls for PPCs, IECs and IBCs.
- 4.65 Ofcom recognises that there is a degree of uncertainty in the current relationship between costs and price, and that due to data inadequacies in the most recent review the data actually used in this price setting exercise relates to an earlier period. Therefore, Ofcom considers that the difference between the terms implied in the price controls and actual payment terms does not, by itself, necessarily justify a requirement for BT to change its payment terms.
- 4.66 However, Ofcom notes the apparent inconsistency between the payment terms which appear to have been implicitly assumed when Ofcom set the current (regulated) prices (approximately monthly in arrears, with 30 days to pay) and BT's current payment terms (quarterly in advance, with 30 days to pay). Ofcom considers that this apparent inconsistency suggests prices do not necessarily need to increase if the payment terms are changed. Furthermore, Ofcom is of the view that the exercise of accurately aligning prices and payment terms is best done within the framework of the next charge control for the relevant products and services when a thorough analysis can be based on an up-to-date pricing model.

### Bad debt

- 4.67 In principle, Ofcom recognises that changing payment terms may change the amount of debt eventually written off should a particular customer be unable to pay its bills. Ofcom has considered the submissions of the parties, and notes that BT has stated during the course of this dispute that:

*"BT considers that bad debt is not an issue for PPCs, as the customers tend to be the 'chunky' altnets".*<sup>32</sup>

However, BT also stated that:

<sup>32</sup> BT's submission "Response to addition question", 2 November 2006

*“any extension of a change in the payment terms to other products that have a different customer base may be more of a risk to BT. IECs and IBCs are currently bought by a broader base of customers, so the impact on bad debt would vary”.<sup>33</sup>*

### (3) Benchmarking data

- 4.68 Ofcom has considered report commissioned by THUS on the payment terms associated with the services of other national telecommunications incumbents, other UK regulated network industries, other UK CPs and BT’s own wholesale services. Ofcom has also taken into account BT’s response to THUS’s submission stating that the benchmarking data is unreliable. Based on this evidence, Ofcom’s provisional view is that payment terms of quarterly in advance are, in comparison to a variety of benchmarks, outside the norm. Payment terms of monthly in advance are more closely in line with available comparators.
- 4.69 THUS has presented data showing payment terms for wholesale leased line services provided by other national telecommunications incumbents. The report suggests that the payment terms offered by 22 other incumbents (81%) were more favourable than BT, 3 incumbents (11%) were the same as BT and 2 incumbents (7%) were less favourable than BT. See summary table below:

<b>Worse than BT</b>	<b>Same as BT (quarterly in advance)</b>	<b>More favourable than BT (monthly in advance)</b>	<b>Much more favourable than BT (monthly in arrears)</b>
Telia (Sweden) Deutsche Telekom	Eircom (Ireland)* TDC (Denmark) Saudi Telecom*  <i>* possibly Influenced by UK precedent</i>	CRAI (India) CWWI (West Indies) Telstra (Australia) Telekom New Zealand Jersey Telecom France Telecom KPN (Holland) Telekom Austria Swisscom Maltacom (Malta) Telecom Italia EPT (Luxembourg) Bell South (USA) Belgacom (Belgium) HT (Croatia) AT&T (USA) OTE (Greece)	Telefonica (Spain) Telecom Slovenia Eesti Telekom (Estonia)* Singapore Telecom Romtel (Romania)  <i>*invoice period is 15 days not a month</i>
<b>Total 2 (7%)</b>	<b>Total 3 (11%)</b>	<b>Total 17 (63%)</b>	<b>Total 5 (19%)</b>

\*Source: Submission by THUS summarising report by a professional services firm<sup>34</sup>, 28 July 2006

- 4.70 The data illustrate that a very wide range of payment terms are applied in other markets, from yearly in advance to monthly in arrears. However, of the incumbents in

<sup>33</sup> BT’s submission “Response to addition question”, 2 November 2006

<sup>34</sup> Ofcom has been requested to treat the name of the firm as confidential.



European states, which given the common European framework Ofcom considers as the closest comparators to the UK, the majority offer terms of monthly in advance (among others the French, Dutch, Belgian, Italian incumbent). The remainder of European incumbents are equally divided between offering terms that are more favourable (e.g. the Spanish incumbent) and less favourable than monthly in advance (namely the Irish, Danish, Swedish and German incumbent).

- 4.71 Ofcom considers that the data provided by THUS on payment terms of telecoms incumbents in other (not only European) national markets should be handled with some caution. The payment terms may have been determined by National Regulatory Authorities, which are likely to have taken into account factors that are specific to each national telecommunications market. Nevertheless, based on the benchmark data presented it is Ofcom's provisional view is that the widespread use of monthly in advance terms seems to suggest that such terms are reasonable, at least if prices are consistent with the payment terms offered.
- 4.72 BT lists some of the standard terms that BT Global Services has been offered by other CPs within the UK. BT argues that this list shows that BT's terms are not outside the norm, as only one of the companies listed has payment terms that are better than BT's:

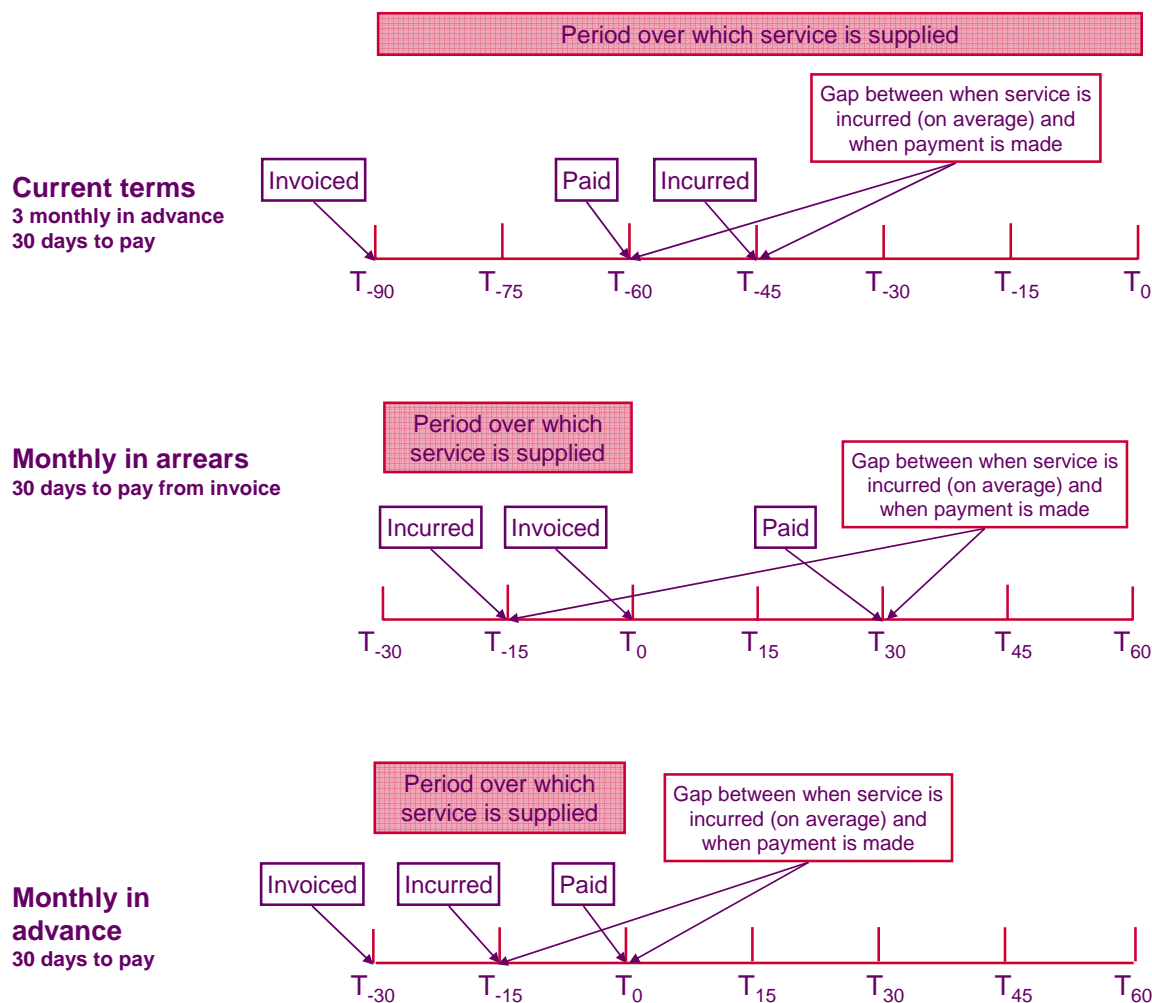
CP	Payment terms offered
✂	✂
✂	✂
✂	✂
✂	✂
✂	✂
✂	✂
✂	✂

\*Source: BT's letter dated 25 October 2006 accompanying BT's response to notification under s191 of the Act.

- 4.73 Ofcom has also considered the data provided by the parties on the payment terms associated with BT's other regulated services, and payment terms offered for regulated services in other UK utilities markets, in particular, the electricity and gas sector. When doing so, Ofcom noted that the payment terms for both WLR and LLU services, services which are similar to those subject to this dispute, are monthly in advance.
- 4.74 BT's interpretation of the benchmarking data provided to Ofcom is that they do not show the current payment terms offered by BT in the supply of PPCs, IECs and IBCs to be outside the range of what could be considered fair and reasonable. However, on balance, Ofcom considers that the data suggest that the current payment terms are more favourable to BT than is the norm.

## Fair and reasonable payment terms

- 4.75 Ofcom has considered what payment terms may be fair and reasonable, in the circumstances of this dispute.
- 4.76 THUS has requested payment terms of monthly in arrears, with 30 days to pay, or other terms as determined by Ofcom. BT wants to keep the existing terms of quarterly in advance with 30 days to pay, unless the price is adjusted.
- 4.77 The diagrams below demonstrate the impact on working capital arising from different payment terms.



- 4.78 As explained in paragraph 4.14 above, Ofcom considers that there is a range of terms which may be fair and reasonable, depending on the circumstances. Ofcom does not consider it feasible based on the available information to define the exact range of payment terms which may be fair and reasonable in these circumstances or determine the exact cut-off point between terms which are fair and reasonable and those terms which are not. However, Ofcom acknowledges its duty to make a determination to resolve this dispute in the light of the submissions of the parties and the evidence available. Therefore, having provisionally concluded that BT's current payment terms are not fair and reasonable, Ofcom must reach a view on what terms appear to be fair and reasonable (i.e. that fall within the range of fair and reasonable payment terms) taking into consideration the submissions and available evidence.

- 4.79 Ofcom has considered the payment terms for other BT services which may be comparable to PPCs, IECs and IBCs. The payment terms for other wholesale services are set out in the tables below.

#### **BT Wholesale services with SMP**

<b>Product</b>	<b>Billing Cycle</b>	<b>Settlement days</b>
Partial Private Circuits	Quarterly in advance	30
Intra Building Circuits	Quarterly in advance	30
Interconnect Extension Circuits	Quarterly in advance	30
Radio Base Station Backhaul	Quarterly in advance	30
Retail Private Circuits <sup>35</sup>	Quarterly in advance	28
In Span Interconnect (Standard)	Quarterly in advance	30
In Span Interconnect (Nominated)	Annually in arrears	30
Customer Sited Interconnect	Quarterly in advance	30
IPStream	Monthly/Quarterly in advance	28
Datastream	Monthly/Quarterly in advance	28
CPS In life Management	Monthly in advance	28

#### **Openreach services with SMP**

<b>Product</b>	<b>Billing Cycle</b>	<b>Settlement days</b>
Wholesale Line Rental	Monthly in advance	28
Wholesale Extension Services	Quarterly in advance	30
Backhaul Extension Services	Quarterly in advance	30
Backhaul Network Services	Quarterly in advance	30
Openreach Backhaul Network Services	Quarterly in advance	30
Local Loop Unbundling:		
Plan and Build	Quarterly in advance	30
Full MPF	Monthly in advance	30
Shared MPF	Monthly in advance	30
Sub-loop unbundling	Monthly in advance	30

\*Source: BT response dated 25 October 2006 to notification under s191 of the Act.

- 4.80 Submissions from neither party suggest that Ofcom should require BT to introduce payment terms of two monthly in advance, with 30 days to pay, as such terms do not appear to be commonly used by industry. Furthermore, the benchmark data available also seems to suggest that such terms might not be within the norm and therefore also provides an indication that they could be seen as not fair and reasonable. Therefore, the focus of Ofcom's deliberations has been between monthly in advance with 30 days to pay, and monthly in arrears with 30 days to pay.
- 4.81 THUS has requested monthly in arrears with 30 days to pay. Although Ofcom does not consider monthly in arrears to be necessarily outside the range of fair and reasonable terms, Ofcom is not persuaded that such terms would be the only fair and

<sup>35</sup> Whilst not a BT wholesale product, this is included here for comparison purposes.

reasonable terms in the circumstances. In particular, Ofcom notes that the comparative data on the terms offered by other European incumbents, the majority of which offer payment terms of monthly in advance, and payment terms offered for BT's other regulated wholesale services, which are predominantly invoiced either quarterly or monthly in advance, do not appear to support a change to monthly in arrears. Furthermore, Ofcom is not persuaded that it should impose such terms in order to resolve this dispute consistently with its duties.

- 4.82 Ofcom has considered possible payment terms of monthly in advance, with 30 days to pay. Ofcom notes from the benchmark data that terms of monthly in advance appear to be commonly offered by other European incumbents, for example, by the Austrian, Dutch, Belgian, Italian and French incumbents. Ofcom also notes that payment terms for WLR and LLU (comparable infrastructure rental services) are monthly in advance (see table in paragraph 4.79 above). Therefore, on balance, Ofcom considers that payment terms of monthly in advance, with 30 days to pay, would be most likely to fall within the range of fair and reasonable terms.
- 4.83 Therefore, Ofcom proposes to require BT to amend its payment terms for PPCs, IECs and IBCs to monthly in advance, with 30 days to pay.

### **Ofcom's proposals to resolve the dispute**

- 4.84 For the reasons outlined above, Ofcom proposes to require BT to amend its payment terms for PPCs, IECs and IBCs to monthly in advance, with 30 days to pay.
- 4.85 Ofcom considers that this dispute is about the timing of payments, the length of the period covered by one invoice and in particular, payment in advance versus payment in arrears for PPCs, IECs and IBCs. Ofcom's preliminary view is that BT's current payment terms are capable of harming competition and therefore appear to be not fair and/or reasonable, in contravention of BT's SMP obligations. Furthermore, this view is supported by the weight of the benchmarking evidence. Ofcom has considered whether the question of consistency with the price control provides a countervailing factor sufficient to weigh against that conclusion and provisionally concludes that it does not.
- 4.86 Therefore, Ofcom proposes to require BT to amend the payment terms, in accordance with its SMP obligations. However, given the recognised uncertainty in the relationship between costs and prices in the current charge controls, Ofcom does not propose to make any changes to the current prices. It may be appropriate for Ofcom to consider the link between payment terms and price more fully when the price controls are next reviewed in 2008 (PPCs) and 2009 (IECs/IBCs).
- 4.87 Ofcom notes that the requirement that BT's payment terms be changed to monthly in advance will also promote competition between BT and CPs, as it is aimed to alleviate the difference between retail and wholesale terms and will help to reduce the cost associated with increased working capital, and that this is consistent with Ofcom's obligations for resolving disputes. As outlined above, the resolution of regulatory disputes must essentially be aimed at achieving the policy objectives of Article 8 of the Framework Directive. Section 4 of the Communications Act therefore requires that, when resolving such disputes, Ofcom acts in accordance with the six Community requirements that give effect to Article 8 (summarised at paragraph 4.3 above). Ofcom considers that resolving this dispute in the proposed way is in accordance with the Community requirements, in particular with the first requirement of promoting competition in communications markets.

- 4.88 In resolving this dispute Ofcom is proposing to require that BT change its payment terms to level the playing field between BT and CPs in downstream retail markets. Again, Ofcom notes that this course of action is also consistent with objectives of Ofcom's work on replicability, as it will further enable CPs to compete with BT in these markets fairly, and on level terms.
- 4.89 In consideration of the submissions of both parties regarding the implementation of changes to the payment terms<sup>36</sup>, and in recognition of the fact that changing the payment terms may require purchasers of these services to also amend their processes and procedures, Ofcom proposes to require BT to amend its payment terms for PPCs, IECs and IBCs with effect from 1 January 2008. As an interim measure, Ofcom proposes to require BT to adjust its current payment terms by extending the time allowed to pay quarterly invoices by 60 days until the payment terms are amended.

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<sup>36</sup> See paragraphs 3.16 and 3.21 above.

## 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 12 January 2007**.
- A1.2 This is a shorter period than the 10 weeks usually allowed by Ofcom, as Ofcom has a statutory duty to resolve disputes within 4 months. As explained in the guidance on Ofcom's approach to complaints and disputes (see: [http://www.ofcom.org.uk/bulletins/eu\\_directives/](http://www.ofcom.org.uk/bulletins/eu_directives/)), the consultation period for disputes will usually be 10 working days. However, in this case, the consultation period will be 5 working days from the date of publication on Ofcom's website, as an embargoed copy of the draft determination was provided to the parties to the dispute on 22 December 2006.
- A1.3 Ofcom strongly prefers to receive responses using the online web form at <http://www.ofcom.org.uk/consult/condocs/draftbtthus/howtorespond/form>, 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.
- A1.4 For larger consultation responses - particularly those with supporting charts, tables or other data - please email [ruth.gibson@ofcom.org.uk](mailto:ruth.gibson@ofcom.org.uk) attaching your response in Microsoft Word format, together with a consultation response coversheet.
- A1.5 Responses may alternatively be posted or faxed to the address below, marked with the title of the consultation.
- Ruth Gibson, Floor Four  
Competition Group, Ofcom  
Riverside House  
2A Southwark Bridge Road  
London SE1 9HA
- Fax: 020 7783 4109
- A1.6 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.
- A1.7 It would be helpful if your response could include direct answers to the questions asked in this document, which are listed together at Annex X. It would also help if you can explain why you hold your views and how Ofcom's proposals would impact on you.

## Further information

- A1.8 If you want to discuss the issues and questions raised in this consultation, or need advice on the appropriate form of response, please contact Ruth Gibson on 020 7783 4340.

## Confidentiality

- A1.9 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](http://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.
- A1.10 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.
- A1.11 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/account/disclaimer/>

## Next steps

- A1.12 Following the end of the consultation period, Ofcom intends to publish a final determination in January 2007.
- A1.13 Please note that you can register to receive free mail Updates alerting you to the publications of relevant Ofcom documents. For more details please see: [http://www.ofcom.org.uk/static/subscribe/select\\_list.htm](http://www.ofcom.org.uk/static/subscribe/select_list.htm)

## Ofcom's consultation processes

- A1.14 Ofcom seeks to ensure that responding to a consultation is easy as possible. For more information please see our consultation principles in Annex 2.
- A1.15 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](mailto: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.
- A1.16 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](mailto: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](http://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/](http://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

# Annex 4

### Details of how Ofcom assessed materiality of the apparent inconsistency between the assumptions about payment terms reflected when setting the prices and the actual payment terms

Ofcom assessed this materiality in terms of how much lower prices would have been if there had been no such inconsistency.

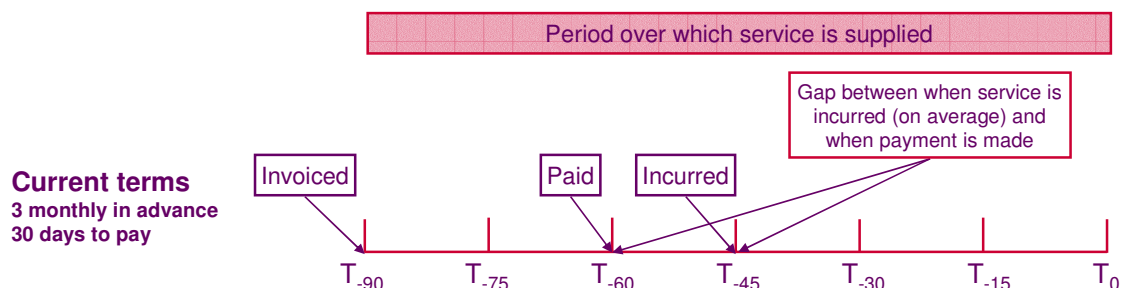
Wording of 4.32 on page 14

The difference between these two gaps is 2½ months, which is a measure of the extent of the apparent discrepancy in the cost base used to set prices and the terms actually offered. If the cost base had reflected the terms actually offered, prices could therefore have been lower by the saving in the cost of financing BT's working capital for this 2½ months gap i.e. 2½ months at BT's regulated cost of capital. Using BT's current cost of capital (11.4%) for wholesale regulated services this equates to prices being lower to the order of 2½%<sup>1</sup>.

### Explanation

The diagram immediately below has been extracted from paragraph 4.42 on page 16 and illustrates the relevant timelines for BT's customers under the current payment terms.

This shows a gap of negative ½ month between payment being made and the charge (on average) being incurred

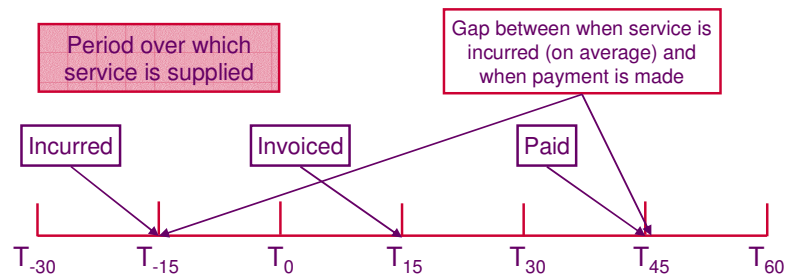


The second diagram below has been extracted from paragraph 4.54 on page 18 and illustrates the timelines reflected within BT's own 2000/01 regulatory financial statements.

<sup>1</sup> Ofcom converted BT's annual cost of capital into its monthly equivalent and then compounded it by 2½ months.

This shows a gap of positive 2 months between the charge (on average) being incurred and payment being made.

**Terms reflected in BT's 2000/01 regulatory financial statements**



The difference between these two gaps (referred to in paragraph 4.32) is therefore  $2\frac{1}{2}$  months (i.e. 2 months minus minus  $\frac{1}{2}$  a month).

The benefit in receiving early payment against what was assumed when setting prices is this  $2\frac{1}{2}$  month gap evaluated at BT's cost of capital.

BT's current relevant annual cost of capital is  $11.4\%^2$ .

$2\frac{1}{2}$  months cost of capital is  $11.4\%$  expressed not on an annual basis but on a  $2\frac{1}{2}$  month basis.

This is calculated by the following formula  $(1+0.114)^{(2.5/12)}-1$  expressed as a percentage.

$^{\wedge}$  = to the power of  
 $2.5/12$  relates to the  $2\frac{1}{2}$  months over 12 months.

The result of this calculation is  $2.27\%$  which is approximately equal to  $2\frac{1}{2}\%$ .

<sup>2</sup> Ofcom's approach to risk in the assessment of the cost of capital - Final Statement, 18 August 2005 (See: [http://www.ofcom.org.uk/consult/condocs/cost\\_capital2/statement/](http://www.ofcom.org.uk/consult/condocs/cost_capital2/statement/)).