IN THE COMPETITION APPEAL TRIBUNAL

Case Nos. 1205-1207/3/3/13

Victoria House,
Bloomsbury Place,
London WC1A 2EB

29th October 2013

Before:
THE HON. MR. JUSTICE ROTH
(Chairman)
STEPHEN HARRISON
PROFESSOR COLIN MAYER

(Sitting as a Tribunal in England and Wales)

B E T W E E N:

BRITISH TELECOMMUNICATIONS PLC Appellant

- and -

OFFICE OF COMMUNICATIONS Respondent

AND B E T W E E N:

(1) CABLE & WIRELESS WORLDWIDE PLC
(2) VIRGIN MEDIA LIMITED
(3) VERIZON UK LIMITED Appellants

- and -

OFFICE OF COMMUNICATIONS Respondent

AND B E T W E E N:

(1) BRITISH SKY BROADCASTING LIMITED
(2) TALKTALK TELECOMMUNICATIONS GROUP PLC Appellants

- and -

OFFICE OF COMMUNICATIONS Respondent

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H E A R I N G D A Y O N E

A P P E A R AN C E S

Mr. Rhodri Thompson QC, Mr. Graham Read QC, Ms. Sarah Lee, Mr. Ben Lynch and Ms. Georgina Hirsch (instructed by BT Legal) appeared on behalf of the Appellant, British Telecommunications PLC.

Mr. Meredith Pickford and Mr. Julian Gregory (instructed by Herbert Smith Freehills LLP) appeared on behalf of the Appellants (1) British Sky Broadcasting Limited and (2) TalkTalk Telecommunications Group PLC.

Ms. Dinah Rose QC and Mr. Tristan Jones (instructed by Olswang LLP) appeared on behalf of the Appellants (1) Cable & Wireless Worldwide plc, (2) Virgin Media Limited and (3) Verizon UK Limited.

Mr. Pushpinder Saini QC, Ms. Kate Gallafent, Mr. Hanif Mussa and Ms. Emily Neill (instructed by the Legal Department, Office of Communications) appeared on behalf of the Respondent.

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THE CHAIRMAN: Good morning. Before we start just a couple of preliminary matters. First of all, there is of course some confidential material in the papers before the court. We have noted there is nothing confidential in the skeletons, which we appreciate, and relatively little in the pleadings. If, and this may arise particularly in the cross-examination of some witnesses, it becomes necessary to refer to confidential material we hope that it can be done simply be directing the witness and the Tribunal to a particular figure or line in a paragraph and avoid reading anything out. If it should become necessary to do so we can, of course, sit in private with only those within the confidentiality ring in the Tribunal present, but we would like to avoid that if at all possible.

Two matters in that regard. One is if you look at the determination itself in the confidential version, which I think is core bundle B, on p.15 there is the table showing the repayments ordered to the various CPs where all the figures have been marked as confidential. I wonder whether it is really necessary for the totals. I can understand that the individual amounts payable to individual CPs are confidential, but whether the totals in the right-hand column for each year need be confidential and particularly I do not see that the final overall total in the bottom right can be confidential. This table indeed appears again in Chapter 15, but I note that on I think the very last page of the determination, which is para.15.153.2, the total is not marked as confidential. So one would assume from that that it is not. I will not read it out, but it is the figure in 15.153.2. So perhaps over the next day or two you can consider whether the annual totals aggregated across the CPs really is a confidential figure. You need not address that now but if you can let us know.

MR. PICKFORD: I thought I might just add, Sir, in relation to that that we have relied on the non-confidentiality of that final total at the end in various figures that we have built up on that, which we have also said are non-confidential and no one has raised any objection to that so I think that has already gained some momentum.

THE CHAIRMAN: I think the overall total that might be just out of caution that it was put in the table, but the annual totals, perhaps that can be clarified. Secondly, we have had a request from a journalist who is present for copies of the skeletons. The skeletons, as I have mentioned, do not contain any confidential information. It is certainly in the High Court quite normal for journalists to be given copies of skeletons because they are, in a sense, part of counsels' opening. Is there any objection by any party to copies of those skeletons being provided? (After a pause): Very well. I do not know who the individual is but if he makes himself known to the parties standing at the back, and if there are copies of the skeletons that can be given to him. Are there copies available now? It would be helpful. If it can be

arranged for copies to be given because it will help him follow the opening.

Secondly, Ms. Rose, we are conscious that your clients are not directly involved, I think, in one part of the appeal of Sky and TalkTalk. It may be that the experts always span a number of issues but if, at any point, as a result of that you want to absent yourself from the cross-examination of a particular witness you, of course, have permission to do so.

Finally, by way of preliminary matter, concerning Ground 4 of BT's appeal, I suspect that Ground 4 may not be the most important part of this case, but it is a ground that we, of course, have to address. We have been copied in the correspondence between BT and Ofcom, regarding the evidence of Mr. Coulson and the position on Ground 4. There has been no application by any party to exclude Mr. Coulson's evidence, which I think was served with the notice of appeal and so if there is no application to exclude it, it would not be appropriate to exclude it.

There is a distinct question, although perhaps a related one, and certainly related to the guidance that the Court of Appeal gave in the 080 evidence appeal, which is whether it is appropriate on an appeal by BT against the determination of the dispute resolution to set aside an adjustment that has been made to BT's own regulatory financial statement on the basis of the methodology which BT never put forward to Ofcom in the course of the dispute resolution process. This is, of course, an appeal on the merits but it is still an appeal and this Tribunal is not sitting as second tier regulator. So we think there is a real question as to how far, if at all, the CAT should get into evaluating a methodology for determining cost allocation or cost assessment that was never considered by Ofcom because it was never canvassed before Ofcom when it was of the dispute. We do not want to take up significant time on that. We do not want preliminary submissions on that Mr. Read, but in the opening, when you come to Ground 4, perhaps you may want to say something about that point.

MR. READ: Sir, Mr. Thompson and I are doing something of a double act as you already know, and Ground 4 is the area I was going to be dealing with and I was going to specifically deal with the issue of what is and is not within the scope of this appeal when dealing with Ground 4.

THE CHAIRMAN: Very well. I think that is all I want to say by way of preliminary matters, unless anybody has something they wish to raise at this stage. If not, we can then proceed to the opening. It is Mr. Thompson who starts off.

MR. THOMPSON: Yes, I am grateful, Sir, gentlemen. BT will take a democratic approach as Mr. Read has said. I will speak until about 12 o'clock and then Mr. Read until about 1 o'clock and, in due course, the Tribunal will hear from Miss Lee and Mr. Lynch.

THE CHAIRMAN: Can I just interrupt to say I do not propose to take a break in the morning or afternoon session today, but we will when we start at 10, but starting at 10.30 I think we can run through until 1o'clock.

MR. THOMPSON: Fine, there may be some to-ing and fro-ing when Mr. Read takes over but we will do that as quickly as we can.

The time for openings has been limited, so I will make a relatively formal presentation mostly limited to core bundle E, and I will give references and verbatim quotations where possible, but we will need to look at the CRF and the conditions in LLMR 2004 at least. I will focus on the legal issues under Ground 5 and Ground 1. Mr. Read will then comment on Grounds 3 and 4. Grounds 2 and 6 will be extensively addressed in expert evidence and in our closing. I will not address the "Please, sir, I want some more" appeals of the five disputing CPs. Our basic submission on these appeals is that they are completely unmeritorious and should be dismissed on a summary basis.

I will address five points. First, the parties, secondly, the underlying policy issue raised by Ofcom's assertion of a power to make retrospective orders for repayment. Thirdly, the lack of legal basis for Ofcom's asserted jurisdiction to acquire retrospective repayments, fourthly, the correct interpretation of condition HH3.1; and fifthly, and relatively briefly, the issue of connections and rentals.

First, the parties. I essentially make two submissions in relation to each of the principal groups of parties. In relation to the disputing CPs, Sky and TalkTalk Group are BT's principal consumer retail competitors. They have expanded rapidly during the period relevant to the dispute. They have clear financial and strategic incentives in placing the maximum pressure on Ofcom and BT to support their continuing rapid expansion in the UK market. Cable & Wireless, Virgin and Verizon are now the UK subsidiaries of much larger global players. Cable & Wireless is part of the Vodafone Group, which is the largest mobile phone operator outside China and one of the largest companies in the UK. Virgin is part of Liberty Global another extremely large US telecoms company. Verizon is part of the Verizon Group, one of the largest telecoms groupings in the world, and a successor of AT&T after its break up under US anti-trust law.

In summary, although Ms. Rose and Mr. Jones like to call their clients the "Altnets", which sounds like some form of subordinate grouping, they are certainly not a backing group for Ofcom, Sky and TTG, but the UK arms of three enormous global telecoms businesses. So my submission in this respect is that any suggestion that these five companies lack the sophistication or resources to negotiate effectively with BT to raise

disputes with Ofcom whenever it suits their strategic aims, or to pursue litigation to assert their commercial rights needs to be viewed with extreme scepticism. This is particularly obvious whereas here BT is subject to intrusive SMP regulation and direct supervision by Ofcom.

In relation to BT, as is well known, BT was the inheritor of the formally State owned UK telecoms network, and remains the principal network provider in the United Kingdom. That has led to a number of SMP findings under the CRF regime, and means that BT is one of the most highly regulated companies in the United Kingdom and probably the world.

First, it is subject to general and specific obligations imposed under the Authorisation Directive of the EUCRF including both SMP and universal service obligations.

Secondly, it is subject to consequential reporting obligations and monitoring over large parts of its UK telecoms businesses and to potential enforcement action by Ofcom, including the imposition of penal sanctions in the event of breach and the Tribunal will hear from Mr. Dolling in relation to BT's accounting obligations in particular. It is also subject to the so-called 'equality of input' undertakings entered into pursuant to sections 154 to 167 of the Enterprise Act 2002, exposing it to further enforcement action in the event of breach, and the Tribunal will hear from Miss Norman in relation to those obligations.

Fourthly, and insofar as civil liability is concerned, both s.104 of the 2003 Act, and s.167 of the 2002 Act confer rights of civil action for breach of conditions and undertakings.

Then finally, and inevitably, BT is also exposed to competition law complaints or enforcement action, particularly on those markets where it has been found to enjoy SMP, which is explicitly modelled on concept of dominance under Article 102 of the Treaty on the Functioning of the European Union, and s.18 of the 1998 Act.

My second submission is that any discussion of the incentives arising from the imposition by Ofcom of retrospective payment obligations in the context of dispute resolution needs to take account of all the incentives that are already in place with BT under UK and EU law.

The policy justification put forward by Ofcom and the disputing CPs for an additional power of this kind needs to be viewed in the full context of the UK telecoms market.

In making this preliminary submission BT does not seek to argue that the presence of this range of incentives acts as any guarantee that BT will never be found to have breached any of its regulatory obligations. Indeed, para. 9 of BT's notice of appeal accepts that, in the

present case, for some periods and some products, BT is not in a position to demonstrate that its prices conformed to its cost orientation obligations. The point I am making is that BT is already exposed to exceptionally wide-ranging regulatory and private law constraints and that this fact needs to be taken fully into account in assessing whether retrospective payment obligations are needed to impose yet another and, in my submission, unique form of regulatory pressure on BT.

I now come to my second topic, the underlying policy issue raised by Ofcom's assertion of a power to make retrospective orders for repayment. The Tribunal has been presented with a great deal of information and lengthy pleadings for the purposes of this appeal, and it will hear much more over the next few weeks. Standing back from the detail of the facts and the law in dispute here, there is a large and important issue of policy that the Tribunal needs to have well in mind.

The effect of the decision in this case is that BT's customers, including the five very large commercial companies that we have referred to as the 'disputing CPs' or, as they like to call themselves, the 'Sky TGG' and the 'Altnets', have been found by Ofcom to enjoy rights under the CRF which bring money claims on a retrospective basis going back to 2006 and, in principle, to 2004, with three very remarkable qualities without bearing any burden of proof as to their alleged losses, without bearing any costs risks and, so far as one can tell, without Ofcom recognising any constraint on their powers imposed by any Statute of limitation.

Indeed, as operated by Ofcom it now appears that its intention is to shift the balance yet further in favour of the claimants in such cases by, first, a presumption of payment in full and, secondly, a presumption of interest on such claims.

The implications of such an approach, if it is legally sound are not difficult to understand.

THE CHAIRMAN: You need to bear in mind we are not hearing an appeal from a Court of Appeal Judgment in PPC.

MR. THOMPSON: My Lord, I have that very well in mind. The implications of such an approach, if it is legally sound, are not difficult to understand. They are manifested by these disputes and, in particular, by the further appeals brought by Sky, TTG, Cable & Wireless, Virgin and Verizon. Ofcom itself has rightly characterised the first ground in the Sky TTG appeal as no better than an opportunistic punt. For the disputing CPs this approach has obvious commercial and strategic attractions. They are liberated from most, if not all of the constraints, normally considered salutary under English law. They have every incentive to pursue such windfall payments whenever and wherever they can find a

credible cause for complaint knowing that there is no effective sanction even if the case is rejected as wholly without merit.

For BT this initiative has equally obvious downsides, particularly on those markets where BT has been held to enjoy a significant market power. BT has none of the usual protections from speculative litigation that have been developed by the English courts, and that would apply to conventional claims provided for under s.104 of the 2003 Act, s.167 of the 2002 Act, or under competition law.

Moreover, given the absence of any Statutory conditions or any administrative guidance imposing express constraints on this new power claimed by Ofcom, notably any limitation period for such retrospective claims to be brought, BT is exposed to great uncertainty in knowing if and when a further historic dispute of this kind may be raised or on what basis.

Just as BT had no idea in 2004 or 2006 what Ofcom's regulatory policies would be at the end of 2012, so it has no idea now what those priorities may be if another dispute of this kind is determined by Ofcom in 2018 or 2020. Indeed, given the absence of any provision for such claims in the CRF (a matter to which I will of course return) it is very difficult to know when or where this newly asserted EU based power is said by Ofcom to have arisen.

For Ofcom itself the position appears to BT to be ambivalent at best. In the decision and in its pleaded case and evidence Ofcom has adopted the position that dispute resolution can and should be seen as the major additional incentive for BT to comply with its regulatory obligations. However, Ofcom must be aware, as I have explained, that dispute resolution is only one of the regulatory risks to which BT is exposed. You must also be aware that without any limiting principles or rules this approach risks generating large numbers of historical money claims that are highly resource intensive for Ofcom to investigate, diverting its limited resources away from current cases, and that such stale investigations of past events are particularly likely to lead to long and complex appeals. These consequences are directly contrary to Ofcom's well-known desire to streamline appeal processes.

Again, this case is a vivid illustration of the difficulties that Ofcom has brought down on its own head. The events with which this case is concerned relate, to a large extent, to conditions set in 2004 and were revoked in 2008. The market has obviously changed radically since even the most recent events with which the Decision is concerned. It is far from clear why Ofcom has embarked on this expansionist strategy rather than using its extensive statutory powers of setting, monitoring and enforcing current and future conditions, leaving it to the ordinary processes of civil litigation, including the specific statutory provisions governing such litigation in the telecoms field to address historical

claims.

THE CHAIRMAN: When you say revoked in 2008, for a low band width they were continued, were they not, after 2008 in the 2008 review?

MR. THOMPSON: They were reintroduced, yes sir.

THE CHAIRMAN: Yes, and indeed, part of the relevant period goes beyond 2008, does it not?

MR. THOMPSON: Yes, sir.

THE CHAIRMAN: So it does not come to an end in 2008, does it?

MR. THOMPSON: I will come to it in a moment, sir. It is para.8.30 of the BCMR 2008 review.

THE CHAIRMAN: Yes, so it continues below band width, together with no charging traffic?

MR. THOMPSON: Yes. In informal terms, though sir, para.8.30 states that all of the SMP conditions introduced by the 2003 review should no longer apply once that statement is published, which is 8th December 2008.

THE CHAIRMAN: Yes, but it is then reintroduced in the same terms, is it not?

MR. THOMPSON: Yes.

THE CHAIRMAN: Indeed, if it no longer applied, there could be no order in the Determination going beyond 2008. Is that not right?

MR. THOMPSON: Sir, there were obligations imposed in the up to one mb band width.

THE CHAIRMAN: Yes, and part of the Determination is an overcharge in respect of that.

MR. THOMPSON: Indeed.

THE CHAIRMAN: So going beyond 2008.

MR. THOMPSON: We now come to the key part of the case from the legal perspective, which is effectively our ground 5, which is the lack of legal basis for Ofcom's asserted jurisdiction to require retrospective repayments.

In this respect, we say that given this highly unusual policy background to the case it is appropriate to look with some care to determine whether there is in fact any legal basis for Ofcom's newly-asserted jurisdiction to determine retrospective money claims and to impose historic repayment obligations on BT in the context of dispute resolution.

THE CHAIRMAN: Can you, before you develop legal base, just clarify for our benefit what, if any, power you say Ofcom has where it finds an overcharge in breach of an SMP condition to order repayment? Do you say it has no power, or there has been suggestion I think in your skeleton argument that it is from when the dispute is formally presented – I think that is how you put it at one point?

MR. THOMPSON: Yes, I think we have taken it from the enabling legislation itself.

THE CHAIRMAN: Wherever you are taking it from, can you just clarify for us what do you say,

to what extent (never mind the source) can Ofcom order repayment?

MR. THOMPSON: I only refer to the legislation because it puts it clearly. It says in the event of a dispute arising in relation to an existing obligation, so that is the trigger.

THE CHAIRMAN: That may be the trigger, but to what extent can Ofcom order? It can obviously make an order for the future; there is no dispute about that. But to what extent can Ofcom, if it finds there has been overcharging – you are not now saying that the period of these disputes should not have been considered by Ofcom; they should have rejected the disputes and refused to accept them because they are too historic? There is no challenge to that. Indeed, there was an appeal, I think, on the acceptance of part of the dispute. So legitimate for Ofcom to determine whether there was overcharging, but what period then, in BT's submission, could Ofcom properly order repayment?

MR. THOMPSON: It is for the period of the dispute, so the period from which Ofcom accepted the dispute.

THE CHAIRMAN: So for the period from which Ofcom accepted the dispute.

MR. THOMPSON: Sir, I should put it as from the time when Ofcom received the dispute.

THE CHAIRMAN: Just a moment. From the time Ofcom received the dispute. So although the parties may have been negotiating before a dispute was referred to Ofcom, if they have not actually made the reference to Ofcom no repayment can cover that earlier period of negotiation. Is that your position?

MR. THOMPSON: That comes from --

THE CHAIRMAN: Never mind where it comes from, is that your position? I just want to know.

MR. THOMPSON: Yes, sir.

THE CHAIRMAN: That is all I want to know. You can explain where you get it from later.

MR. THOMPSON: I am well aware that Ofcom, and indeed the disputing CPs, have put pressure on this part of our case, and I can see that there is a difficulty in defining exactly when the date arises.

THE CHAIRMAN: It is very important.

MR. THOMPSON: Well, it is important, but it is not the only important question in the cases.

THE CHAIRMAN: No, but that is why, because it is important, to know what your case is. But you said it is from the time when Ofcom received the dispute, that is your position?

MR. THOMPSON: Yes.

THE CHAIRMAN: Thank you.

MR. THOMPSON: The reason why I am bridling slightly, sir, is that in my submission there is a larger question which it is for Ofcom to satisfy the tribunal of, that the CRF provides for a

retrospective power. If it does not, then there is a question about the scope of s.192(d) and I have an answer to that. But the larger question is whether the CRF provides for a retrospective power.

THE CHAIRMAN: Yes, and you will address us, then, in that regard to what the Court of Appeal said.

MR. THOMPSON: Sir, in my submission the Court of Appeal did not address that question.

THE CHAIRMAN: Just bear with me one moment. (Pause) Yes.

MR. THOMPSON: The first point to make is that it is common ground, as has been found in repeated cases before the Tribunal and the Court of Appeal, that any power to impose obligations and undertakings operating in this sector must be found in one of the CRF directives if it is to exist at all. That is certainly correct in this case. There is no UK precedent for any such domestic administrative power to impose retrospective payments without proof of loss or limitation of action. On the contrary, such a regime is directly contrary to long-established principles of UK litigation intended to prevent speculative and stale claims.

As we noted in our reply and skeleton argument, these points have been very recently confirmed in the ongoing proposals for reform of competition or litigation. In addition, there is no Parliamentary or other material that suggests that this possibility was ever contemplated when the 2003 act was adopted. In particular, there is absolutely no evidence that Parliament intended to gold plate the implementation of the CRF, either in 2002 or in 2009 by introducing such an unusual administrative power to order retrospective payments to third parties. In any event, it would almost certainly have been unlawful for it to do so unless the power was specifically provided for in the CRF.

Turning to the CRF itself, however, no such power is to be found anywhere in it. There is undoubtedly no express provision for a power to that effect, and there is no reason to imply such a provision. On the contrary, the implication of such a retrospective power would be clearly contrary to general principles of EU law.

I have got three *dicta* here. I was not proposing to take the Tribunal to the authorities just because of time, but I will read them out. First of all, retrospectivity of financial burdens is generally unlawful under EU law, subject to very stringent condition. That is case of *Salumi* bundle 5 authorities tab 62 paras.10 to 12:

> "In general, the principle of legal certainty precludes a Community measure from taking effect from a point in time before its publication and it may be otherwise only exceptionally where the purpose to be achieved so demands and where the

legitimate expectations of those concerned are duly respected. The provisions of the regulation may not be accorded retroactive effect unless sufficiently clear indications lead to such conclusion."

In that case they found that far from indicating any retroactive effect --

THE CHAIRMAN: Which legislation are you saying has retrospective effect here?

MR. THOMPSON: My Lord, I will come to that in due course.

THE CHAIRMAN: You have cited an authority saying you cannot have retrospective legislation. What is the legislation here that you say is retrospective?

MR. THOMPSON: I am saying there is not any, there is no power.

THE CHAIRMAN: The power relied on derives from the statute. There has been no order that you make any repayment prior to the coming into force of the statute. I do not follow the relevance of what you have just told us.

MR. THOMPSON: The measure is the measure that is being taken by Ofcom. This is my second point. As with other general principles of EU law, the requirements of legal certainty by not only the EU legislator, but also national bodies adopting measures within a field governed by EU law. There is the case of *Gondrand*, which is at A5, tab 56, states this in terms:

"The principles of the protection of legitimate expectations and legal certainty form part of the Community Legal Order. They must accordingly be observed by the Community institutions but also by the Member States when they exercise the powers conferred on them by Community Directors."

So here we have Ofcom exercising a power conferred by a Community Directive, and so we say that it is equally bound by the same principles in relation to retroactivity.

THE CHAIRMAN: I think that is probably common ground.

MR. THOMPSON: Then the third principle I rely on is that measures imposing burdens on undertakings, particularly financial burdens, must be clear so that undertakings can understand and take into account of those burdens. That is the relative well known *Gondrand* case, which is bundle 1 of the authorities, tab 18, at 16-18, and then the quotation:

"The principle of legal certainty requires that rules imposing charges on the taxpayer must be clear and precise so that he may know without ambiguity what are his rights and obligations and may take steps accordingly."

This highly restrictive approach or retrospectivity in EU Regulation, particularly where financial burdens are imposed, is manifested in the CRF itself with only two very limited instances - Article 10 of the Authorisation Directive and Article 7.3 of the predecessor

Directive, 97/33 - making very specific and limited provision for NRAs to impose retrospective obligations. Neither of those cases provides any support for Ofcom's claim to jurisdiction.

I will look at the legislation in more detail in a moment, but these very well established principles of EU law demonstrate the grave difficulties facing Ofcom's case. Having failed to consider the matter at all in the Decision, it has had to dig about in the CRF to try and find provision for a retrospective power that is plainly not there, looking for a non-existent needle in a statutory haystack.

The original source of Ofcom's difficulties is not difficult to locate. In the Decision there is, revealingly, no analysis at all of the source of Ofcom's asserted powers to impose retrospective payment obligations in the provisions of the CRF.

THE CHAIRMAN: You said that you accepted that Ofcom's has power to order repayment from the time Ofcom received the dispute.

MR. THOMPSON: Yes.

THE CHAIRMAN: Could you just help me, in your Notice of Appeal under Ground 5, which you are now addressing, at para.3.22 you put it differently. You say that repayments relating to services supplied and paid for without dispute, which you say is without raising any formal challenge to their validity, for example, by means of a letter or email formally raising the issue of cost orientation of the charges in question on a specific basis. A letter or email formally raising the issue is clearly some time considerably before Ofcom receiving the dispute. Are you now departing from that and urging a later stage?

MR. THOMPSON: Yes, we are, candidly. We have been put under pressure in the pleading. The matter was dealt with in the pleadings and the skeleton argument and we can see that there is a question about how exactly it should be put. In the end, it seemed to us that the clearest guide to this was the 30 second recital to the Framework Directive and the wording of the Framework Directive itself, both of which suggest that the power of the NRA is triggered by the dispute being referred after a period of negotiation. I will come to the 30 second recital in a moment.

Mr. Read refers me to para.409 of the Notice of Appeal.

THE CHAIRMAN: That put it slightly differently, I think.

MR. THOMPSON: I think what he is saying is we reserved our position and we have effectively exercised that reserved position.

THE CHAIRMAN: You have made clear what your position is, and it is no longer that in footnote 214. You are saying there is no retrospective power in the CRF?

MR. THOMPSON: Yes, but I am also saying that in the Decision or the Determination there is no analysis at all of the source of Ofcom's powers to impose retrospective payment obligations. There is simply a bare reference to s.190(2)(d) of the 2003 Act, which one finds at paras.2.6 to 2.8 of the Determination.

If and in so far as it thought about the matter, it appears that Ofcom simply reverse engineered or assumed the existence of relevant CRF powers by reference to a broad and, in BT's submission, erroneous construction of s.190(2)(d).

As a matter of EU law, like any other case of conditions imposed under a detailed statutory regime, we say that this is to consider the matter from the wrong end of the telescope, an approach that not surprisingly leads to a distorted view. It should be elementary that the starting point for a proper understanding of Ofcom's powers and obligations is a proper understanding of the EU statutory regime that is the sole legitimate source of those powers and obligations and not the other way round. Before looking at the EU regime, I also note that the starting point for Ofcom's claims to jurisdiction to order retrospective money payments, its reading of s.190(2)(d), in fact rests on relatively weak foundations even as a matter of fact of domestic construction. I refer here to the finding of the Tribunal itself in *TRD*, a case that the Chairman will at least be familiar with, para.169, where the Tribunal found that there is a simple and obvious construction of 190(2)(d) that avoids all these complications and historic investigations and which is, in fact, the construction for which BT contends, and I quote here - I do not know if the Tribunal wants to look at this, it is at CBE 6 ----

THE CHAIRMAN: Just one moment. Paragraph 169, which is p.72, I think. Yes.

MR. THOMPSON: The Tribunal states that s.190(2)(d) of the 2003 Act is a straightforward provision designed to ensure that Ofcom's determination of what is a reasonable rate is backdated to the time at which that rate would have come into effect had the OCCM been accepted. It should ordinarily follow on from determination that this kind of readjustment takes place. Otherwise the party which has wrongly resisted the proposed OCCM is in a better position than they would have been in had they accepted it without challenge. In my submission, on this straightforward, s.190(2)(d) is simply a backdating power enabling Ofcom to hold the ring pending the outcome of a dispute so as to avoid perverse incentives for actual and potential parties to disputes. There is nothing in the CRF to suggest that the United Kingdom was under any obligation, or indeed entitlement, to confer any wider power. We say that construed in this straightforward way ----

THE CHAIRMAN: It has got to be entitlement, has it not?

MR. THOMPSON: Yes.

THE CHAIRMAN: Obligation does not matter, does it? If they are not precluded from doing it, then they are entitled to do it?

MR. THOMPSON: I am not sure that is right, Sir, because the CRF itself precludes obligations being provided for ----

THE CHAIRMAN: If they are not precluded. Your case has to be that they are precluded.

MR. THOMPSON: It is indeed that, because this is effectively a Swiss regime, everything that is not allowed is prohibited. That is how this regime works, Sir. Indeed that is the main point. I will come to it in a moment.

We say that construed in this straightforward way suggested by the Tribunal in *TRD*, s.190(2)(d) is a manifestation of the well known discretion of the Member States in the implementation of a Directive, whereas the construction for which Ofcom and the disputing CPs contend has created a monster that has no true ancestry in either UK or EU law.

I will now come to the core issue of whether the CRF does indeed provide for such a power. As I have already indicated, despite its obvious importance, the Decision has no analysis at all of the source in the CRF of the asserted power to order retrospective payments. Under the heading of Ofcom's powers when determining a dispute, Ofcom simply sets out s.190(2) without any explanation of how these powers are said to derive from the CRF.

In order to remedy this omission and thereby to address this issue properly, the best place to begin is with the central economic freedoms guaranteed by the EU Treaties, and in this instance the freedom to provide services set out in Articles 52 and 56 of the Treaty on the function of the European Union, formerly Articles 46 and 49 of the Treaty. I think it is worth just looking at those, although I am sure the Chair at least is very familiar with them. That is tab 14 of authorities bundle 1, p.70 of the Official Journal. Article 56, which used to be 49 states:

> "Within the framework of the provisions set out below, restrictions on freedom to provide services within the Union shall be prohibited in respect of nationals of Member States who are established in a Member State other than that of the person for whom the services are intended."

Then Article 52 on the other page:

> "The provisions of this Chapter and measures taken in pursuance thereof shall not prejudice the applicability of provisions laid down by law, regulation or administrative action providing for special treatment for foreign nationals on grounds of public policy, public security or public health."

Then over the page at p.71, you will see at Article 62:

> "The provisions of Articles 51 to 54 shall apply to the matters covered by this Chapter."

So effectively there is a sort of dog leg arrangement whereby Article 52 is incorporated into the Services Chapter.

The significance of this provision was the subject of a recent judgment by the Court of Justice, *The Number* case which is referred to various places in the pleading and appears at Tab 8 of the Core Bundle. It is para.29 and 31 of that judgment. I do not whether the Tribunal needs to look at it. I think it is in the pleadings. I will read out the relevant passage.

> "Article 3(2) of the Authorisation Directive provides that the provision of electronic communications networks or the provision of electronic communications services may, without prejudice to the specific obligations referred to in Article 6(2) of that directive … only be subject to a general authorisation…".

This is the important passage:

> "Accordingly, Member States are entitled to impose specific obligations on one or more individual undertakings only in so far as such obligations fall within the cases contemplated in Article 6(2) of the Authorisation Directive…
>
> As an exception to the prohibition on imposing specific obligations on operators individually, the obligations which may be imposed…are to be interpreted strictly".

So it is a prohibitory regime and it is a strict prohibitory regime. I turn now to the CRF itself. As in other regulated sectors there are essentially two stages of regulation, initial authorisation by means of licence conditions and monitoring and enforcement of those conditions by the relevant national regulator, here Ofcom. In relation to the first stage, of authorisation, the effect of the Authorisation Directive regime is that the conditions that can be imposed by the NRAs on the provision of telecom services are not limited to two specific categories, general obligations under Article 6(1) and Annex A of the Authorisation Directive and specific obligations under Article 6(2) and the specified provisions of the Access Directive and Universal Services Directive. We are here clearly concerned with specific SMP obligations and, in particular, with cost orientation obligations. So if we look briefly at the Authorisation Directive, that is the first item in the core bundle E.

THE CHAIRMAN: No, it is the second. The authorisation directive.

MR. THOMPSON: I am sorry, I have got that the wrong way round in my reference. I am grateful, sir. I have gone straight to the amended version. I thought that was probably the fuller version and so I was going to use it. I do not think a great deal turns on it although some reference is made to the amended version by Ofcom in its skeleton. The first passage I was going to refer the Tribunal to was recital (3) which is on p.2 of the amended text. You will see that the objective of the Directive is to create a legal framework to control the freedom to provide electronic communications, networks and services and then express reference to Article 46, the passage we have just looked at. Then in passing, at recital (7) "The least onerous authorisation system possible should be used". Then recital (27) on p.5, we will come to that in a moment, but it relates to enforcement. I will come back to that when we get to enforcement. I think we can then go to Article 3 on p.8. So Article 3(1) gives the general statement by reference to Article 46 and then Article 3(2):

> "The provision of electronic communications networks or the provision of electronic communications services may, without prejudice to the specific obligations referred to in Article 6(2) …only be subject to a general authorisation".

So that is the core provision that was interpreted in *The Number*. Then you turn to pp.10 and 11 and we find Article 6(2) which sets out the provisions in relation to specific obligations. Sir, it is a restricted list.

> "Specific obligations which may be imposed on providers of electronic communications, networks and services under Articles 5(1), 5(2), 6 and 8 of Directive 2002/19/EC (Access Directive)…".

Then there is a reference to the Universal Service Directive but there is obviously no reference to any powers relating to the Framework Directive. The powers are only in the Access Directive or Universal Service Directive. So those are all the specific obligation powers that the NRAs are to enjoy.

In the field of SMP regulation, as it says there, specific conditions may be imposed only in accordance with Article 8 of the Access Directive which then in due course incorporates Articles 9 to 13 of that Directive. If one turns back to Tab 1 one can see how that works, and again I have used the amended version and Article 8 starts on p.12.

THE CHAIRMAN: Yes, Article 8.

MR. THOMPSON: So Article 8 confers powers on the Members States to impose the specified 9 to 13 obligations. 8(2) makes that subject to a designation of significant market power on a specific market and 8(4) imposes restricted terms on how those obligations are imposed.

"Obligations imposed in accordance with the Article shall be based on the nature of the problem identified, proportionate and justified in the light of the objectives laid down in Article 8 of Directive 2002 (Framework Directive)…".

In passing, that is one of the best illustrations of how any suggestion that Article 8 is a source of power is obviously a nonsense because if it were right then this whole regime would make no sense at all because you would suddenly have a trumping power with a new extra power under Article 8 and the Framework Directives, which clearly is not referred to in Article 6(2) of the Authorisation Directive.

Sir, I have said there are two stages. There is the imposition of conditions and then the stage of monitoring enforcement. If you turn back to the Authorisation Directive, Articles 10 and 11 provide for extensive powers of information gathering and a procedure to be followed by an NRA where it finds there are undertakings in breach of either a general or a specific obligation imposed under the Directive. You see in Article 10 repeated reference to, for example, in (1) and (2) to the specific obligations referred to in Article 6(2) and in the second paragraph and the third. So that is obviously the scope of the enforcement power.

THE CHAIRMAN: I am sorry, one moment. This is Article 10(2), yes.

MR. THOMPSON: Yes. 10(1) is the monitoring power and then 10(2) is the enforcement power.

10(2) you notify a breach of the obligation and then 10(3):

"The relevant authority shall have the power to require the cessation of the breach".

So that is clearly a retrospective power.

"… referred to in paragraph 2 either immediately or within a reasonable time and shall take appropriate and proportionate measures aimed at ensuring compliance".

Then I believe, I may be corrected, that the only provision for retrospective powers are in 10(3)(a), which provides for dissuasive financial penalties where appropriate, which may include periodic penalties having retroactive effect. So that is to propel cessation so it is a limited retroactivity to compel respective cessation. Then at 10(5) you will see that there is a more intensive regime in the cases of serious or repeated breaches under the conditions of the general authorisation, and again reference to specific obligations referred to in Article 6(2). Then the last sentence:

"Sanctions and penalties which are effective, proportionate and dissuasive may be applied to cover the period of any breach, even if the breach has subsequently been rectified".

So again that appears to be a form of retroactive penal provision intended to require undertakings to comply with their regulatory obligation. Then I am not sure if we need to go to it, in parallel to this general enforcement power there is a specific enforcement power in relation to access disputes provided for in Article 5(3) of the Access Directive, enabling an NRA to intervene where necessary to ensure adequate access in accordance with Article 5(1).

So our submission is that it is apparent that none of these powers of enforcement provide for the imposition of retrospective payment obligations. Although Article 10 of the Authorisation Directive does provide for administrative penalties, including to a limited degree on a retrospective basis, it is clearly not concerned with imposing payment obligations to third parties. On the contrary, the 27th recital specifically provides that the penal provisions of Article 10 are without prejudice to civil actions for damages, and one can see that when we glanced at it, but if one goes back to it, the 27th recital is on p.5 and then there is provision for penalties, and then the last sentence:

> "This Directive should also be without prejudice to any claims that have been undertaken for the compensation for damages under national law".

So there is a conventional reference to damages actions. I note in this respect that there is no reference in the 27th recital to any alternative form of retrospective payment obligation arising under dispute resolution. On Ofcom's case that is a very surprising omission. If the CRF impliedly makes provision for an additional and highly exceptional, if not unique, form of regulation in addition to conventional actions for damages, then it is very surprising no mention is made of that interesting fact. As the present case vividly illustrates, actions for damages under s.104 of the 2003 Act are likely to be redundant if disgruntled customers can obtain administrative orders for payments from Ofcom without having to incur the time or effort of proving their case; without having to bear the cost risk of civil litigation, and without being required to make their complaint within any specified period. If a regime with such notable qualities is indeed provided for in the CRF imposing such exceptionally onerous regulatory obligations on undertakings found to be in breach of conditions imposed under the CRF, it is truly remarkable that no mention of it is made in the 27th recital of the Authorisation Directive. No specific provision for it has been made in the CRF at all, for example an applicable limitation period, and indeed no reference to it can be found anywhere in the recitals or operative provisions of any of the CRF directives.

THE CHAIRMAN: What is the effect of Article 13, para.3 of the Access Directive?

MR. THOMPSON: I am going to come to that in due course, sir, if I may.
THE CHAIRMAN: Sooner rather than later, please, because time is moving on.
MR. THOMPSON: Yes.
THE CHAIRMAN: That says that where appropriate a regulator can require prices to be adjusted. Do you say that is only prospective?
MR. THOMPSON: I do, sir.
THE CHAIRMAN: Then what is the source of the power which you accept? What enables the regulator to order repayment from the time it received the dispute?
MR. THOMPSON: I have said already, it is a straightforward provision for holding ----
THE CHAIRMAN: That is logic but where in the Directive does it come from?
MR. THOMPSON: It arises when a dispute arises.
THE CHAIRMAN: But where is the power to order repayment? You have made a big point of saying it can only be obligations which are expressly set out in the framework, so where is the power to order repayment which you accept? Where do we find it?
MR. THOMPSON: We find it in Article 20 of the Framework Directive.
THE CHAIRMAN: The Framework Directive?

End of Turn 5 11:34:10
THE CHAIRMAN: In that sense that where appropriate the Regulator can require prices to be adjusted. You say that is only prospective.
MR. THOMPSON: I do, Sir.
THE CHAIRMAN: Then what is the source of the power which you accept that enables the Regulator to order repayment from the time it received the dispute.
MR. THOMPSON: I have said already it is a straightforward provision for holding the ring pending the dispute.
THE CHAIRMAN: Well, that is logic, but where in the Directive does it come from.
MR. THOMPSON: It arises when the dispute arises.
THE CHAIRMAN: But where is the power to order repayment. You have made a big point of saying it can only be obligations which are expressly set out in the Framework. Where is the power to order repayment which you accept? Where do we find it?
MR. THOMPSON: We find it in Article 20 of the Framework Directive.
THE CHAIRMAN: The Framework Directive. So Article 20 of the Framework Directive, para. 3 I assume is what you refer to, is it?
MR. THOMPSON: Yes.

THE CHAIRMAN: Your case is that gives a free-standing power not found elsewhere in the other Directives to order repayment in resolving a dispute.

MR. THOMPSON: Yes, Sir.

THE CHAIRMAN: But you say that power is limited to repayment from the date the dispute was lodged?

MR. THOMPSON: If we jump ahead to Article 20: "In the event of a dispute arising in connection with existing obligations under this Directive" there is an interesting question about how the position in 2004 and 2008 is consistent with that provision, that the basic power is to resolve the dispute within four months. Then in 23: "In resolving the dispute the national regulatory authority shall take decisions aimed at achieving the objectives set out in Article 8." We say that there is no provision for Article 8 itself to confer any powers on the national regulatory authority, indeed, that is expressly precluded by Article 3(2) and 6(2) of the Authorisation Directive and the Judgment of the Court of Justice in *The Number*. It then goes on: "Any obligations imposed on an undertaking by the national regulatory authority in resolving a dispute shall respect the provisions" of the specific Directives, and we have made the point in our reply, paras. 301 to 303 that in the French version and the German version any obligations imposed, it says: "any obligations which can be imposed on an undertaking" so it makes it clear that it is a matter of its power, shall respect the provisions of this Directive, of the specific Directives" so we say that there is no wider power to impose obligations under Article 20 than there is under the Directives themselves, and so you have to go back to Article 6(2) and the provisions of the Access Directive and, if necessary, the Universal Service Directive, to see what the scope of those powers is.

THE CHAIRMAN: Then that takes me back to my question: where is the power to order repayment with the limited retrospective effect which you accept. I hear you said it is Article 23, but you now say actually that goes no further than Article 6(2). So if we look at Article 6(2) I thought you were saying that does not give any power to order repayment. I am lost, I am sorry, Mr. Thompson.

MR. THOMPSON: I made a relatively formal presentation in the hope that I was going to get through it in the limited time I have got.

THE CHAIRMAN: I appreciate that, but it is very important. I am not trying to derail it at all, I am just trying to understand the point, which is an important point, because clearly you make the point that Ofcom has not gone into the source of its power, which has to be consistent with the Framework. I think that is common ground. But I am now just trying to understand how you apply the Framework to reach the power which you accept exists.

MR. THOMPSON: Yes, Sir. I think we have to go straight to Article 13(3) because I have taken a slightly circuitous route because, as I understood it, Ofcom said: "Oh no, it has all been a mistake, there are powers in 10(5) of the Authorisation Directive which look retrospective, but they have nothing to do with it. Article 8 of the Framework Directive has nothing to do with it. Article 20 is not referred to in the Authorisation Directive, so indeed I would accept that you come to Article 13(3) as the only possible source of the power and there you find - and we would say this was primarily a power that would be exercised in a conventional own initiative enforcement process, so Ofcom is not satisfied with BT's pricing and comes a long and says: "Come and justify your pricing". 13(3) provides that the burden of proof that charges are derived from costs to lie with operator concerned.

> "For the purpose of calculating the cost of efficient provision of services, national regulatory authorities may use cost accounting methods independent of those used by the undertaking."

So the NRA is not bound by BT's own approach, even though BT has got the burden of proof. Then thirdly:

"National regulatory authorities may require an operator to provide full justification for its prices, and may, where appropriate, require prices to be adjusted."

We say that in an own initiative case, supposing BT is proposing to charge a particular price on 1st January 2014 and Ofcom is not satisfied with that. Ofcom asks for justification and BT provides a justification but this process takes a period of months, so you get to 1st May 2014 and then the question is if they are not justified is Ofcom entitled to backdate that finding to 1st January 2014 or is it limited to the date on which it makes its determination. What we accept in a regulatory context is that Ofcom is entitled to backdate the finding to the relevant date. It is not limited to the date on which it makes its determination, and that is why we say it is straightforward because we say that in the same way in a dispute resolution context somebody comes along and says: "We do not like the prices that BT are going to charge from 1st January 2014, Ofcom come and investigate", Ofcom investigates within its four months or, if necessary, in an exceptional period over a period of two years, and by exact analogy with the own initiative case, Ofcom can then backdate the finding to the date on which the dispute related, and we say that makes perfectly good sense of the provision and avoids all these issues about retrospectivity.

THE CHAIRMAN: And if they come and say: "We are unhappy about the price Ofcom has been charging for the past three years, you have accepted that Ofcom is entitled, indeed, it may be bound to determine the dispute, that is right, is it not?

MR. THOMPSON: Yes.

THE CHAIRMAN: So it is bound to make a ruling ----

MR. THOMPSON: Sir, for the purposes of this litigation I have accepted it.

THE CHAIRMAN: It has been conceded in other litigation.

MR. THOMPSON: I have said in terms in my notice of appeal that I consider that the Judgment of the Tribunal in PPC, it is the ... preliminary issues Judgement is wrongly decided.

THE CHAIRMAN: That was appealed, that point.

MR. THOMPSON: No, it was not.

THE CHAIRMAN: Was it not? I thought the historic disputes point was appealed. Was that not ground 1 of the appeal?

MR. THOMPSON: No, it was not. There was an appeal about whether or not the dispute had to be resolved within four months.

THE CHAIRMAN: I do not think so. It is in this bundle is it not, tab 11.

MR. THOMPSON: It is para. 39, p.7.

THE CHAIRMAN: I was looking at para. 65.

> "The argument before the Tribunal was that references to Ofcom are confined to current or prospective disputes and do not extend to historic, that is to say retrospective disputes. BT's argument on jurisdiction before this court was that it is necessarily implicit in the Act but Parliament tended to limit Ofcom's dispute resolution to those disputes which are likely to be completed within four months."

MR. THOMPSON: Yes.

THE CHAIRMAN: So BT did not pursue, it changed - is that not right? BT did not pursue the full breadth of its submission before the Tribunal, it narrowed it on appeal.

MR. THOMPSON: This is a different point, Sir, with respect. It is quoted in para. 39:

> "Mr. Vajda for BT submitted that there is to be implied in s.185 a prohibition against Ofcom accepting a dispute which is likely to take more than four months to resolve."

That point I respectfully disassociate myself from.

THE CHAIRMAN: Yes, but it was an appeal, it was a challenge to what the Tribunal had held, and it was now put in these narrower terms.

MR. THOMPSON: That is really, in my submission, nothing to do with it is historic or not, that was just a question of how long it was going to take for the matter to be resolved. It was basically saying complicated disputes are outside the scope of the dispute resolution.

THE CHAIRMAN: You say it is a complete different point that had never been argued below?

MR. THOMPSON: Yes. (After a pause) Sir, I do accept and put in our notice of appeal that the

purpose of this hearing we do not challenge the preliminary issues Judgment of the Tribunal. We give no guarantees at all that should this matter go the Court of Appeal or the Court of Justice that would be same position, for myself I think it is clearly wrong.

THE CHAIRMAN: Therefore, for the purpose of present argument, do you accept that Ofcom was right to determine whether there was an overcharge going back to whenever it was, 2004, it could decide that there was an overcharge and I do not think, indeed, it is any part of your appeal to say that there was no overcharge at all, you say it was put too high, but you do not suggest it should be nil, they can make that determination but you say Article 13(3) does not allow them then to adjust the price going back over the period of the determination. Is that right?

MR. THOMPSON: Yes. I see the time is travelling on. If I could make a series of submission about the problems for 13(3). First, we say that under consistent and long established case law, the Court of Justice going back over 30 years, retroactivity is wholly exceptional and has consistently been held to be contrary to the principle of legal certainty unless expressly provided for and specifically justified.

Secondly, the imposition of financial burdens on undertakings must be clearly stated if they are to satisfy the requirements of legal certainty. Here, there is no express provision for retrospectivity and no attempt at justification. On the contrary the 27th Recital of the Authorisation Directive suggests the regime is an entirely conventional one in which civil liability for historic claims is a matter for the ordinary courts.

That is also the natural reading of the UK Implementing Measure for Article 13(3) s.87(9)(d), and also s.104 of the 2003 Act in relation to civil liability. We say the lack of any express provision for retrospectivity in Article 13.3 is in marked contrast to the express provision for limited and specific and retrospective penalties in Article 10.3 and 10.5 of the Authorisation Directive. We also say that the wording of Article 13(3) clearly derives from virtually identical wording in Article 7.2 of Directive 97/33. In that Directive there is an even more direct contrast between this predecessor provision which makes no reference to retroactivity and the very next provision in the Directive, Article 7(3) which makes a specific and limited provision for the NRAs to impose a degree of retroactivity in relation to reference offers. Given the time, I will not go to it. It is a pleaded point and it is at tab 8 of authorities bundle 1.

However, looking at Article 13(3) more generally, we see that there is a serious difficulty in relation to Article 13(3) viewed retrospectively from the perspective of legal certainty. This arises from the fact that the first sentence of the paragraph on which Ofcom relies at various

places in the Decision, clearly places the burden of proof on an undertaking subject to a cost orientation condition to demonstrate compliance with that condition. However, the second sentence makes it no less clear that it is open to the NRA to alter the basis on which such justification takes place by using cost accounting methods independent of those used by the undertaking. The consequence is that if this provision is construed retrospectively, and in particular in relation to repayments, then the undertaking is in the impossible position of being placed under a legally binding obligation to justify its historic prices by reference to a test that it cannot know in advance.

The construction of the Tribunal in PPCs at para.249 (core bundle E tab 9) followed by Ofcom and the Decision is that the NRA is only permitted to substitute its own costs standard if it is not satisfied by the approach adopted by the undertaking. But in any event, the Tribunal's analysis merely complicates the matter; it does not address the fundamental difficulty from the perspective of legal certainty. Whatever the approach that may be adopted by the NRA, the undertaking cannot know, when it sets its prices, whether the costs standard that it adopts will subsequently be found to be acceptable to the NRA, nor can it know what alternative costs standard may be substituted by the NRA if the NRA is not satisfied with the approach that has actually been adopted.

On the present facts, whereby BT and Ofcom are still debating the correct approach to a number of costs issues in late 2013 – almost a year after the Decision was made and over three years after Sky and TTG had brought their disputes, and over nine years after the earliest date on which charges are challenged in the disputes – illustrates the hopeless legal uncertainty to which Ofcom's approach give rise. BT could not possibly have anticipated the costs standards that are now being debated when it set prices, for example in 2006 or 2007. Likewise, when it sets its prices now it cannot possibly know whether the approach that it adopts will turn out to be acceptable to Ofcom if a dispute is raised in 2017, or what alternative costs standards Ofcom might ultimately impose while it subsequently determines the dispute.

Ofcom's repeated changes of position, set out in BT's pleadings, illustrate the reality of this difficulty. That difficulty is, of course, compounded by the changes in the substantive legal provisions in the case law of the UK and EU courts since 2006, none of which could have been known when BT originally set its prices.

Overall, therefore, as in the leading case of *Salumi,* this is a case where a retrospective reading of the powers of the NRAs is not only striking by its absence, but the express terms of the legislation are actually entirely inconsistent with retrospective reading. By contrast,

viewed prospectively, the terms of Article 13(3) make good sense. If an NRA is not satisfied by the justification advanced for an undertaking subject to cost orientation obligations, then it can substitute its own methodology and require the undertaking to adjust its current and future pricing to reflect those requirements.

Overall, therefore, the Decision must be set aside on the fundamental ground that there is no legal basis for Ofcom's asserted power to impose retrospective payment obligations, and that its claimed powers are contrary to the EU principle of legal certainty.

I see the time so I will turn briefly to the issues under Condition HH3.1 and possibly connections and reference.

THE CHAIRMAN: Yes.

MR. THOMPSON: In relation to Condition HH3.1 we say the starting point is and must be Article 8 of the Access Directive, which we have looked at briefly. It is p.12 of tab 1 in the amended version.

THE CHAIRMAN: Yes.

MR. THOMPSON: What the Tribunal will see is that the first step is the designation of Significant Market Power on a specific market as a result of a market analysis carried out in accordance with Article 16 of the Framework Directive. 8.4 states that obligations imposed in accordance with its articles should be based on the nature of the problem identified, proportionate and justified in the light of the objectives laid down in Article 8.

If one then looks at 13(1) which is the basis for the power at p.15: the power is to impose obligations relating to cost recovery of price controls --

THE CHAIRMAN: You do not need to take time reading it out to us. We have looked at it and it is quoted in --

MR. THOMPSON: I think it is important to read the words that come after that: "for the provision of specific types of interconnection and/or access in situations where a market analysis indicates a lack of effective competition means the operator concerned may sustain prices in excessively high level or may apply a price squeeze to the detriment of end users".

So if you put Articles 8(2) and 8(4) together you see that there must be a specific market analysis; it must relate to a specific type of interconnection or access; and the theories of harm (if I may put it that way) have to be either excessive pricing or a margin squeeze.

8(4) says that is how the obligation must be imposed. There is no leeway. The Tribunal will recall that this has to be construed strictly.

So the basic point is that conduct, or potential conduct, on a different market – whether wider or narrower - and referenced to a different theory of harm would not be the basis for

a condition under this legislation. That is specifically carried through, as one would expect, into the 2003 Act in the provisions in relation to market definition, which are at ss.78 and 87 of the Act – 78(1) and 87(1) and the provisions in relation to the imposition of cost orientation at 87(7) and 88 of that Act.

We say that the 2004 and 2008 market reviews are entirely consistent with this approach. Given the time, perhaps we can look just at the 2004 market review at tab 12 of core bundle E. Given the indication from the Tribunal, I will not take you to the provision HH3 itself, as I imagine that is familiar. You will recall that each and every charge must be for network access covered by Condition HH1. So if one starts with the basis for the condition under HH1, that is at pp.12 and 13 of this tab, pp.162 to 163.

THE CHAIRMAN: Sorry, HH1? I think it is at the end, is it not, p.42 of the tab?

MR. THOMPSON: It is. I am grateful. What I was passing the Tribunal to was the basis for that condition which is at pp.112 to 13, and in particular para.7.20, so the obligation as explained by Ofcom is to "supply on fair and reasonable terms any products falling within the market for the provision of AISBO, upon reasonable request. 7.21 BT has been found to have SMP in this market."

Then at 7.25 the first sentence: The scope of the general access obligation is defined by reference to the scope of the wholesale markets." So it makes it quite clear that in accordance with the CRF the obligation under HH1 reflects the market definition that Ofcom has spent so much time going through.

Likewise, at 7.54 and 56 pp.17 and 18 Ofcom says this: "As BT has been identified as having SMP in this market, the availability of wholesale AISBO services at cost oriented prices would help to ensure …" Then at 7.56 the charges, the basis for it is again either excess pricing or --

THE CHAIRMAN: It is now services within the market, is it not?

MR. THOMPSON: For wholesale AISBO services.

THE CHAIRMAN: Yes.

MR. THOMPSON: In my submission, it would be totally perverse to say it was some other form of services. It must be the whole AISBO services that Ofcom has taken so much time to define.

Then when one looks at the conditions themselves, p.40 of the tab (p.490), unsurprisingly the heading says that it is as a result of the analysis of the market for, and then this is the longhand version of wholesale AISBO services. Then the definitions provisions says: "These conditions shall apply to the market for the provision of alternative interface

symmetric broadband origination at all bandwidths within the United Kingdom", so again it is the same scope.

HH1 says: "Where a Third Party reasonably requests in writing Network Access, the Dominant Provider shall provide that Network Access.", which again, in my submission, is a unitary thing; it is not other forms of things; it is the very same. That is wholesale AISBO services.

THE CHAIRMAN: It is not all, it is particular AISBO service. If you wanted a WES mb that is the sense.

MR. THOMPSON: That is the point. Again, the other point, it is perfectly true that we made a shift between our Notice of Appeal and our Reply, on reflection it seemed to us that realistically the request was for a specific service; it was not for all services. That is why we accepted that the correct construction is "of a specific service".

Likewise, at HH4.2(a) "a description of the Network Access to be provided". In my submission that can only sensibly be the wholesale AISBO services to be provided.

Likewise at HH5.3(a) "a description of the Network Access in question". Then repeatedly in HH7 there are references to a description of "the Network Access" and at HH8, 8.6(a)(i) and (ii) "the new Network Access"; "the new Network Access". Likewise HH8.9(a)(i) and (ii); HH12(a)(i) and (ii).

THE CHAIRMAN: Yes.

MR. THOMPSON: So, in my submission, that only really makes sense if it is a specific form of network access. So we say there is nothing in the terms of the LLMR that would have put anyone on notice that sub-components or elements of network access were caught.

THE CHAIRMAN: It depends what network access means, does it not?

MR. THOMPSON: We will come to that in just a second by maybe giving an extra five minutes to the ----

THE CHAIRMAN: That is a matter between you and Mr. Read. We are quite neutral on that.

MR. THOMPSON: I think I should deal with the four points that Ofcom takes, just to summarise our positive case. We say that, for example, a service ordered to commence on 1st January 2014, so that is the date which that specific service would have to be cost orientated, so in principle that charge could be challenged, and we say that is not a particularly aggregated approach. No doubt one would actually aggregate to try and work out what the relevant charges and costs were, but it is not in any way a particularly strange or aggregating version. We say it is a perfectly normal and practical reading of the condition. Against that, Ofcom effectively puts forward four arguments. First of all, we should have appealed against the

original imposition; secondly, that each and every charge, the wording used in Condition HH3.1 is determinative in their favour; thirdly, that the broad definition of network access is determinative in their favour, and then, fourthly, although I think they are a bit less enthusiastic about this than they once were, they say that the judgment in *PPCs* is decided in their favour.

Just taking them briefly, we say the appeal point is manifestly hopeless. If we are right in our construction of ----

THE CHAIRMAN: I think you can take that as read. If you are right in your construction, but if you are wrong in your construction then the appeal point is a very good one, is it not? If you are wrong in your construction, you are wrong in your construction and it does not mean what you say it means. Whether you should have appealed or not is irrelevant.

MR. THOMPSON: Indeed. In relation to the each and every charge, we say it obviously begs the question because the wording is not just "each and every charge", it is "in each and every charge for a network access covered by condition HH1".

THE CHAIRMAN: Offered, payable or proposed for network access.

MR. THOMPSON: Yes, for network access.

THE CHAIRMAN: Yes.

MR. THOMPSON: I do not think "offered, payable or proposed" makes anything more or less disaggregated. If we are correct that network access covered by condition HH1 refers to a wholesale AISBO service reasonably requested by one of its customers, then individual charges for parts of that service are not caught by ----

THE CHAIRMAN: Can you help me on that? As I understand it, the minimum contract period you had was a year. Is that right?

MR. THOMPSON: Yes.

THE CHAIRMAN: So a CP says, "I want the particular service", and signs a contract for a year. You say you aggregate collection charge and rental because it has to pay both to get the service.

MR. THOMPSON: Yes.

THE CHAIRMAN: All right? So you look at them together. At the end of the year the contract comes to an end. Towards the end of the year the CP is considering whether to renew or continue for a further year. For that further year it will not have to pay a connection charge, will it? The charge that it has to pay for the further year is only a rental, is it not? It does not have to pay a connection charge again. That is my understanding of the evidence.

MR. THOMPSON: That is correct.
THE CHAIRMAN: Yes, so when it is in Year 2 the only charge payable by that CP, and the only charge it has to consider when it is deciding whether to make a new contract for a further year, is a rental charge. That is the only charge it has to pay for network access in Year 2. So why is the charge payable for network access in Year 2, assuming this is a new contract because the first one was only a one year contract, why is that any more than the rental charge?
MR. THOMPSON: There will be witnesses.
THE CHAIRMAN: As I understand the evidence, the evidence is very clear that you only pay a connection charge once and you have just confirmed your minimum contract is a year. I was trying to understand the language on the basis of what, as I follow, is common ground in the evidence. It does not depend on the witness. It is just a reading of the wording of the condition which we have to interpret as a matter of law. What is the network charge payable when someone's one year contract comes to an end and they then want a contract for a second year?
MR. THOMPSON: Yes, sir, I see the point that is being put to me.
THE CHAIRMAN: I just do not follow how one can say, "Oh, although you do not have to pay a connection charge, the charge payable for the purpose of HH3.1", indeed offered, payable or proposed, because that is what BT will ask them to pay, includes the connection charge. To me it does not make sense.
MR. THOMPSON: Yes, the point that is being made to me, and it is a point that you will have seen, is that it clearly made sense to Ofcom in 2009 because otherwise ----
THE CHAIRMAN: We are not bound by whatever Ofcom thought. I am trying to interpret the language.
MR. THOMPSON: Indeed, sir. My basic submission is that it is for the service reasons we have requested and at the time of request ----
THE CHAIRMAN: But the only service being requested, as the CP comes to the end of Year 1, is deciding, "Should I extend this now and make another one year contract?" The only service they are requesting is, "Please can we continue to rent this Ethernet provision?" That is all they are asking for.
MR. THOMPSON: Yes, sir. I think I have to think about it. I do not think that point has exactly been put in the pleadings as it is put and I have to think about what the implications are. I could equally say that some very minor charge, which would not really make any sense on its own, could be said to be ----

THE CHAIRMAN: I know it was not said. It is sort of ignored *de minimis* charges ----

MR. THOMPSON: Yes, but I am not quite sure what the implication ----

THE CHAIRMAN: -- practicality, but this is a … one

MR. THOMPSON: Yes. I think I will have to think about that because I suspect this issue will recur, so I will not try and answer it entirely now, sir.

THE CHAIRMAN: Okay.

MR. THOMPSON: But our basic submission is that the obligation imposed by condition HH3.1 applies to each and every charge for a reasonably requested wholesale AISBO service not to each and every charge for each and every element of a requested AISBO service. We say that essentially the same problems arise under the definition of "network access". Although it is broad, the plain and natural reading of the provision -- I do not know if the Tribunal wants to look at the wording. I think it may be worth just looking at it for a moment. It is in Tab 5 of core bundle E. It is p.51 of the manuscript and p.235 of the printed transcript.

THE CHAIRMAN: I am sorry, I think we are slightly at cross-purposes.

MR. THOMPSON: Core bundle E5.

THE CHAIRMAN: Is the Communications Act.

MR. THOMPSON: Yes, sir. The definition of network access is at p.235, p.51 of the manuscript numbering. I am sorry, sir, I am in the amended text.

THE CHAIRMAN: I am sorry, something has gone slightly wrong.

MR. THOMPSON: I see what I have done. I have used the amended text.

THE CHAIRMAN: I think I am missing that.

MR. THOMPSON: Alternatively I can go to the un-amended text.

THE CHAIRMAN: No, that is fine. You go where you want to go.

MR. THOMPSON: There is a complicated basic definition of "network access" at 151(3) and then at (3)(b) it says:

> "Any services, facilities or arrangements which -
>
> (i) are not comprised in interconnection; but
>
> (ii) are services, facilities or arrangements by means of which [a person] is able, for the purposes of the provision of an electronic communications service … to make use of anything mentioned in subsection (4)".

(4):

> "The things referred to in subsection (3)(b) are -
>
> (a) any electronic communications network or electronic communications service provided by another communications provider;

(d) any other services or facilities which are provided or made available by another person and are capable of being used for the provision of electronic communications service".

We say that wholesale AISBO services, as defined, falls squarely within 151(4)(a) and that there is no basis to go any further just because the network access definition could cover other things, for example TISBO services and various other things. There is no reason to go any wider than the market definition which is actually set out in the LLMR 2004. In particular we say that neither a connection service nor a rental service would fall within (4)(d) because they are not something which are capable of being used because they do not have an independent existence. For good measure, in relation to ----

THE CHAIRMAN: Is capable of being used means it must have an independent existence or is one of the things that you use?

MR. THOMPSON: We would say that simply two aspects of the charge is not good enough. It has to be something.

THE CHAIRMAN: A connection is something. It is a distinct concept.

MR. THOMPSON: It is a distinct concept so it turns on whether that is actually capable of being within (4)(d).

THE CHAIRMAN: You say capable of being used on its own?

MR. THOMPSON: Yes. Our main submission is ----

THE CHAIRMAN: Is that right? We have put in the language "capable of being used on its own" for the provision? Is that right?

MR. THOMPSON: Yes, I suppose, or "independently" or something like that.

THE CHAIRMAN: Yes, independently or on its own.

MR. THOMPSON: Our main submission is ----

THE CHAIRMAN: You say that.

MR. THOMPSON: -- simply that is not the market definition. There is no consideration of connection services or rental services in the LLMR 2004 or BCMR 2008, so the mere fact that there are other things which potentially fall within the scope of network access has got nothing to do with it. The question is what was the scope of the condition set out in LLMR 2004? That is back to that network access or the network access. It does not say "any old bag of network accesses". It says the particular ones as defined.

THE CHAIRMAN: The definition in LLMR 2004 is by reference to the statute, is it not?

MR. THOMPSON: It is under the statute. The statute requires it to define a market an SMP on that market.

THE CHAIRMAN: Yes, I see that. I thought there was actually a reference back to the statute. You took us to the imposition of the conditions on p.40 in manuscript and at tab 12. In para.3 on p.41 Part 1 incorporates the definitions in the Act.

MR. THOMPSON: Yes, and the definition of network access.

THE CHAIRMAN: Yes. So the reference in HH3.1 and indeed all the others that you have outlined for us to network access has the meaning of s.151(3) and (4)?

MR. THOMPSON: Yes, but it also has the meaning given to it under the Market Definition provisions and SMP provisions.

THE CHAIRMAN: When you say it also has the meaning, it is defined, it is very specifically defined, is it not?

MR. THOMPSON: Yes, sir.

THE CHAIRMAN: It is a legal instrument and that is the meaning.

MR. THOMPSON: Yes, but network access as defined would include a large number of service markets.

THE CHAIRMAN: Yes, but these provisions only apply to the market as set out in para.1.

MR. THOMPSON: Exactly so, sir. That is the point I am making, that although the network access definition is wide, the scope of these conditions is narrow, specified by the market definition which Ofcom itself made, and the SMP finding that it made. It had nothing to do with connections or rentals; it was a specific market definition and a specific SMP finding on the market for wholesale AISBO services. And for good measure, it was not also a Market Definition finding of SMP in relation to mainlink which is the third component considered in the Determination.

Then, I think given the time I will skip over connections and rentals, but I will make the fourth point in relation to *PPCs* which is that in the Decision Ofcom made extensive reference to the judgment in *PPCs* on the apparent basis that it gave it a very broad power to apply a highly disaggregated approach under Condition HH3.1. It makes much less reference to that judgment in the pleaded case and the skeleton argument. We submit that Ofcom plainly misconstrued paras.215 to 228 of that judgment. I think one can make the point very shortly just by looking at para.215.

THE CHAIRMAN: Why do we not save that until when we hear from Ofcom. You made the point in your written submissions and I think we understand the point made, given that it is 12.20. Otherwise you are cutting Mr. Read down very much.

MR. THOMPSON: Yes. I apologise not to have covered the interesting topic of connections and rental but to some extent we have touched on that.

THE CHAIRMAN: It comes into the discussion on 3.1, does it not?

MR. THOMPSON: I suspect it will come up on a number of occasions in due course.

MS ROSE: Sir, can I just ask. There is one point that I do not fully understand what BT's case is and would appreciate to know. On their interpretation of HH3.1 is it their case that only connections and rentals should be aggregated, or is it their case that the whole circuit should be aggregated including mainlink where mainlink is purchased? I would just like to know what their position is on that.

THE CHAIRMAN: My understanding is that it does not include mainlink. That is not the way you put forward your figures in your Notice of Appeal. Is that right?

MR. THOMPSON: In relation to ground 2, we have aggregated only connections and rentals on an economic basis. In relation to ground 1 we have sought to make it clear that there is a difference, because although we accept that mainlink could be seen as a separate form of network access, in reality there was no finding by Ofcom either in 2004 or 2008 that mainlink was a separate market. Therefore, for the purposes of ground 1 it was part of the wholesale AISBO market. Indeed, in 2008 Ofcom specifically considered the scope of it and decided not to make any wider findings, or rather any narrower findings, in relation to the market.

THE CHAIRMAN: So on the interpretation of HH3.1, which is all we are concerned with, I am not now quite clear. Ground 1 is put, at least initially, as the primary interpretation ground. Are you saying mainlink should be included?

MR. THOMPSON: Yes, because it is within the scope of the market definition.

THE CHAIRMAN: You have not, I think, given figures in your Notice of Appeal, have you? Or do they include mainlink, the adjusted figures that you put forward?

MR. THOMPSON: It is set out at 468.1.

THE CHAIRMAN: 468.1 of what?

MR. THOMPSON: I am sorry, of the Notice of Appeal.

THE CHAIRMAN: Paragraph 468.1. I see. So you say it goes back to Ofcom to work it out?

MR. THOMPSON: Yes, and also 471.1: "there have been some preliminary calculations done".

THE CHAIRMAN: So you say it does include mainlink, because in your reply I thought you said that ground 2 is a construction argument, in part, on ground 1 and only aggregates rentals and connections, not mainlink?

MR. THOMPSON: Ground 2, sir.

THE CHAIRMAN: When you call it ground 1 or ground 2, the first question is what is the proper construction of condition HH3.1? That is the question we have got to answer?

MR. THOMPSON: Yes.

THE CHAIRMAN: In your reply at para.93 on p.36 tab 8 bundle A: "Condition HH can only properly be construed as requiring that connections and rentals are aggregated for this purpose."

MR. THOMPSON: Yes.

THE CHAIRMAN: So that does not appear to include mainlink.

MR. THOMPSON: This is on the basis of the economic and factual considerations I set out.

THE CHAIRMAN: Whatever the justification, there are various arguments one can deploy in favour of justification. Paragraph 93 is introduced as being an additional argument, not an alternative argument: "In addition to the arguments in ground 1" which, as has been pointed out, seems a slight shift from the Notice of Appeal. Nothing necessarily wrong with that, but the point raised by Ms Rose is: what actually is the position now (wherever you may have started) on mainlink? Are you now saying that the proper construction of condition HH3.1 is that it includes mainlink, or it is just aggregation of connections and rentals?

MR. THOMPSON: For the purposes of ground 1, which essentially turns on the scope of the market definition and the basis on which the condition was imposed, we say that mainlink was within the market definition and therefore is subject to the condition as part of the wholesale AISBO service.

In ground 2 we advance a number of economic and factual considerations which are relevant not only to construction of HH3.1 but also to the way in which connections and rentals are treated generally, both for the purposes of compliance and repayment. We say that connections and rentals must be aggregated, both for the purposes of the scope of the power and for the purposes of assessing compliance, and for the purposes of considering repayment.

THE CHAIRMAN: Leave repayment out for the moment, for the purpose of construction is it then an alternative that you say the proper construction (because of market definition) includes mainlink, and if you are wrong about that then you say (even if that is wrong) then for reasons of the economic and factual aspects it must at least include connections and rentals together?

MR. THOMPSON: Yes. Another way of putting it would be to say that mainlink could have been, but was not, identified as a separate form of network access whereas connections and rentals could not have been because they do not make sense, they are part of a single entity.

THE CHAIRMAN: Yes, I think I understand.

MR. THOMPSON: I am referred to the fact that at para.51 of the reply we did expressly refer to

mainlink. I will be corrected if I am wrong, but I think we also made the point in our skeleton argument. Since it is a point of concern and I am aware of the time, can we gather the references to sort this one out?

THE CHAIRMAN: Yes. I think you have explained what your position is, what your submission is. Thank you.

MR. THOMPSON: I think I should now pass over to Mr. Read with an apology that we have cut into his time.

MR. READ: Sir, as you know, I am dealing with grounds 3 and 4. I will, in light of the time, try to be as brief as possible. Can I start with ground 3. There is quite a lot of detail concerned with ground 3 which I simply will not have a chance to address you on in opening. But it is plain that in order to understand ground 3 properly one needs to understand the issues that BT has developed at some length in its Notice of Appeal and skeleton argument.

You will appreciate, sir, from the way it is being put in various places in the skeleton argument and the reply and so on and so forth, that essentially BT is saying that there are two issues in respect of ground 3 that undermine effectively the whole of Ofcom's approach which manifests itself in the three specific illustrations that we have actually given. Those are the two central errors, we say. (1) The lack of certainty about the way that condition HH3.1 was to be applied; and (2) that contrary to the assertions that Ofcom have made in the Decision and at various places in their pleadings, in fact what Ofcom did was apply this in a rigid and automated way in the form of an accounting exercise.

The three illustrations, as you know from the pleadings, are, firstly, the treatment of connections and rentals, which is primarily centred on the issue that that treatment would not make certain before. Secondly, there is Ofcom's approach to compliance for the years 2006/2007. That is centred on certainty and on the automated approach. Then are the four specific items, the rentals for 2008 base 10, 100 connection for 2006/2007 and 2007/2008, base rental 2009/10, and base 1000 connection of 2006.

I just want to explore two points very briefly in connection with that. Firstly, can I ask you to take the Determination itself, the Decision itself, core bundle B, and ask you to go p.127, para.9.220. You can see that in 9.220 Ofcom sets out what its stance was in the PPC Determinations, and just picking it up at (ii) in the quotation:

"Average charges compared to DSAC across the whole period …"

In other words, in 2009 one of the express things that Ofcom was actually looking at was averaging the DSACs over the whole period.

At 9.221 you can see quite clearly that Ofcom has changed its stance:

" For the purposes of resolving these Disputes we do not consider average charges compared to average DSAC across the whole period, as we suggested might be relevant in the 2009 PPC Determinations."

We say that is an illustration of the lack of certainty. I could go at some length through the authorities. I could go at some length through the background to all of this. There one can see if one likes a clear battle line that Ofcom has changed since its 2009 approach.

On that point I would just like to make four very quick points. Firstly, HH3.1, and I will not take you to that, does not indicate any time period over which the assessment has to be made. There is nothing within the wording of HH3.1 that suggests otherwise.

The second point is that when you actually look at the terms of HH3.1 it does not lay down a strict and absolute rule as to the costs that must be considered. You will have seen it has got words like "reasonably derived from the cost of provision", and "no appropriate mark-up for the recovery of common costs", and "an appropriate return on capital employed". Again, those are suggesting that far from excluding averaging over a period, if you want to look at what is being reasonably derived, if you want to see what is an appropriate mark-up then it is necessary to look at the broader picture. What we say Ofcom has done is look at a single year's picture, and that is wrong and inconsistent with legal certainty.

Indeed, I would make this point, that when you actually look, for example, at Ground 4 on transmission costs, the very reason why Ofcom make this adjustment originally is because they want to compare one year's revenue for connections against one year's costs for connections. That is why they end up in this process of stripping out the costs because they have been spread over five years. In fact, this has a knock-on process, not only in respect of the actual approach that Ofcom took to applying this mechanism, but also in what it had to do elsewhere in the Decision as well.

Can I also make two further points on that. The first is that Ofcom has itself accepted in the past that some costs might be expenses in the year in which they are incurred, but also yield benefits in other years. In such circumstances, revenues might look lower relative to costs in the years in which the costs are expensed but higher in other years. That is what they said in the Draft Determination in the PPC case. It is a good valid point, we say, but one which Ofcom has now excluded. You can pick up the references for that from para.228 of BT's Notice of Appeal.

THE CHAIRMAN: That was the Draft Determination?

MR. READ: That was the Draft Determination in PPC.

THE CHAIRMAN: But not in the final one?

MR. READ: Which led them, Sir, to the conclusion that I have just taken you in para.9.220 of the Decision, that would in the PPC case average over years. In other words, there was a consistent logic back in 2009 that because you could not always guarantee that costs for one year would be applied, it would reduce effectively the calls revenues for that particular year, it would be spread over a period. That is one reason why we looked at averaging.

It is not BT's case to say that you have to exclusively look at averaging. BT's case is to say that Ofcom has done the reverse, it has actually excluded data that would help it and assist it in actually working out what the correct assessment would be. It is not BT saying that you have to concentrate just on the average, it is BT saying that Ofcom were wrong to exclude a piece of relevant information in weighing up whether there was a breach or not. We say that that is an inherent problem because what effectively Ofcom has moved its way towards over the years is effectively a rather automated and rigid accounting process, which may be very useful for a regulator when a regulator is coming to make these assessments, but is not actually the correct way of dealing with the matter. You will have seen the evidence, for example, of Dr. Maldoom, which of course deals with the issues around DSAC, and we say averaging is one of these instances.

Can I make a couple of other points before I move on to a specific example. The first of these is that obviously, when dealing with telecoms, you are dealing with large infrastructure costs which necessarily will not be balanced against the revenue in a particular year. We would suggest that no sensible business person would ever assess how something is related to costs without looking at how those costs operate over the product life, or indeed the contract period. It is fair to say that Ofcom, itself, assumed that the average contractual term was three years, and that was in the ----

THE CHAIRMAN: Yes, that is average, but there will be quite a wide disparity.

MR. READ: Absolutely, but my point is that it is spread over a number of years. It is not confined to the single year where the minimum contract term may be a possibility ----

THE CHAIRMAN: For some CPs it will. If the minimum contract term means that, that is the contract term.

MR. READ: Tucked away in the wider and far flung elements of this case there is, of course, some evidence as to the circuit duration spread across all the CPs. It is contained in Mr. Coulson's first report. It may be that we have to look at that, but I will not get into that at this stage.

Can I just deal very briefly with Ofcom's justifications for saying that that there should not be an averaging over the period. Firstly, they rely upon the importance placed on it by the

Tribunal in the PPC case - I am looking now at para.9.221 of the Decision -, because of the words used that charges above DSAC are intrinsically excessive. In the PPC case the issue of averaging was never relevant because the 2 Mbit trunk that was involved in that case was over every DSAC every single year, and indeed, as you have seen from 9.220, the 2 Mbit trunk failed completely the average charges being above DSAC for that period. So it was not something that the Tribunal was ever really considering in the PPC case.

Secondly, they say:

> "Further, the use of the dispute period as a whole as the basis for calculating the averages is largely arbitrary, particularly in this case where services are in dispute for different periods."

It is certainly true that you might get instances where, if you do not look at a wider period but just confine yourself to the dispute period itself, then you might get a distortion. We do not say that that is the right way of doing it. We say the right way of doing it is to actually look at the five year period, or whatever, and consider it based against the RFS - one would be able to do that if one wanted it. In any event, Ofcom actually had, in respect of a number of the alleged overcharges, five years' worth of data in any event, so they could have done it regardless of the dispute period that was actually raised in that case.

You can also see in para.9.223 that they say:

> "… Ofcom had never given any indication that there could be a breach of the cost orientation obligation in respect of a single year, we would expect BT to be compliant with its regulatory obligations at all times."

That is a slightly problematic issue, because does that mean each day BT puts its prices on the website? Compliance, in our respectful submission, has to be considered, particularly when there is nothing specific it in HH3, over a timeframe consistent with the product life, with the contract period.

THE CHAIRMAN: Just a minute, you say over a timeframe consistent with the product life, and then you said "contract period".

MR. READ: And/or the contract period.

THE CHAIRMAN: They could be rather different.

MR. READ: They could be different. This has to be the basis on which BT should have priced.

You make a great point of this. BT must know how it can price. If it is either the contract period or the product life, which are they supposed to use?

MR. READ: The starting point is that DSAC has an inherent amount of flexibility within it.

Everyone, I think, accepts that in this case. If you know that, if you know that there is no

time limit upon HH3 and HH3 talks not in the absolute terms but uses things like "reasonably derived", and so on and so forth, "appropriate mark-up", then in those circumstances what is wrong is to say, "We are going to give no consideration to longer periods". That is the point I was making earlier, that BT is not saying Ofcom were completely wrong to focus on single years, but what we are saying is that they were wrong to then ignore other material, other evidence, other information, spread over a longer period. As part of the justification for that I say we will look at the product life and the period involved.

I am extremely conscious of the time I am taking on this.

THE CHAIRMAN: Can you give me just a moment. We will give you until ten past one.

MR. READ: The final point I should have made on 9.223 is that they then say that it ought to be done by reference to BT's RFS, which is contained in the end part. Our point on that is that Ofcom have this habit of relying on the RFS for some purposes and then discarding it for others. One sees that particularly when, for example, one is looking at the accounting obligations which, as you will have seen, Sir, forms annex 1 to our Notice of Appeal, the background to those. Certainly when BT says, "Look, let us see what is in the accounting obligations", it would not be right or fair for Ofcom to assess BT on something that it did not actually specify in the accounting obligations and the reporting obligations at the time. Ofcom then say, and one can see this in para. 134 of the defence, directions given in the statements on BT's financial reporting obligations make no representation that Ofcom would refrain from assessing charges by reference to connection and rental charges separately considered.

So I do not need you, Sir, to necessarily look at that in any detail but I do make the point that for these purposes Ofcom says: "Look at the RFS, the RFS are single years", but for other purposes it says: "Do not look at the RFS, actually you needed to have kept better material." We say Ofcom cannot have it both ways. Ofcom cannot rely on the RFS for some purposes and then ignore it on others, and in this particular case what they did in the 2009 PPC we say was entirely correct.

Can I ask you to go on in the determination which you have before you in bundle B, to table 14.14 which is at p.385. This is in connection to Ofcom's finding in respect of WES 10 rental charges. They held BT to have breached its cost orientation obligation in respect of one single year, 2008/2009, and one can see from the table the basis upon which they actually made this finding. If one looks one can see highlighted for 2008/2009 with the grey underlining the external revenue as a percentage of DSAC given at 129 per cent. Ofcom

says that single year excess, even though you look at the rest of the five years actually within that table you see was below the DSAC, even though that to be the position we still think that for that single year it ought to be judged to have breached its cost orientation obligation.

One only has to look at the figures to see that if one actually applied an averaging basis BT over the five year period would be below the DSAC on an average basis. I think it is 81 per cent over the five years and then even if you took out 2010/2011 as a potential outlier, BT would still, for the period 2006/2010 (i.e. excluding 2010/2011) still be on average but well below DSAC.

Why then does Ofcom say that it has not applied the DSAC test mechanistically? Essentially, it gives four reasons which it follows through on and you can see those from para. 14.213 on p.383 in the determination. First, it says: "Revenues exceeded DSAC", we have seen that for the single year. Secondly, "Revenues substantially exceeded FAC" - we will come back to that in a moment. "BT's ROCE substantially exceeded its WACC", and

> "BT's charges exceeded DSAC as a result of BT increasing its charges three times for the standard variant … in June 2007, December 2007 and June 2008"

If I can ask you to go back to the page we were looking at before, which is p.385. Looking first at the FAC, one of the problems with a number of instances in this case is that the DSAC to FAC ratio was, in fact, quite small, and there is evidence which you may have come across as to what might be an appropriate DSAC/FAC relationship. Mr. Coulson deals with that in his first expert's report, it is called his "Ex Ante DSAC Analysis" of trying to estimate what DSACs would have been from the information available at the time BT actually dealt with the matter. But you can see here, for example, that Ofcom has on the penultimate row in 14.14 got a FAC/DSAC ratio of 172 per cent for 2008, and 132 per cent for 2011, but that is based on a DSAC/FAC ratio of approximately 1.3. If you look at the figure of 4,431 for the DSAC in 2010/2011 and then look at the external unit FAC, which is 2100, you can see that in fact the FAC/DSAC ratio is substantially different for that year, it is around about the 211 per cent ratio.

The problem with all of this is it illustrates one of the underlying issues with all of this analysis that the figures shift around very markedly from year to year and, indeed, you can actually see that from fig.14.13 below, where, in fact, you can see that the average DSAC, which is marked by the red lines in 14.13. First of all it is above the 2000 mark in 2006/07, drops down to about the 1500 mark in 2007/08, goes up again in April 2009 and then shoots up even further in 2010/11.

This actually is one of the more stable instances - I could take you to ones where they go up and down much, much more, but the point about it is that the figures do vary considerably from year to year in all these instances. It makes it very difficult, no matter how religiously BT would try to work out what DSACs are likely to be, very difficult for them to know in advance what is actually going to happen, and it also makes looking at single years extremely problematic because the actual ratios move around significantly, and that in a sense is one of the core gripes that BT has about this, that what Ofcom seem to have done is to have adopted what is essentially an automated accounting methodology saying single year excess is intrinsically excessive, we will look at it again but, in effect, what Ofcom has done throughout the decision is to apply a fairly rigid formula.

If one looks at one of the principal justifications here that Ofcom give, it is the three price changes, and so, for example, on 4.221on p.385 it makes a play about BT increasing its charges three times, and that if it actually had not changed them there would not have been a problem.

The first point which, of course, just does not feature, but is a point that Ofcom knew well, is that actually those three price changes were all agreed in 2006/early 2007 as a method for ensuring that there was not too much of a price hike immediately in the market for WES 10 rental. There is quite a bit of evidence about what actually happened on this and it was done in the context of quite a lot of discussion with Ofcom at the time precisely because BT wanted to rebalance its prices, but it knew that there would be serious complaints from CPs about the shock of having a major price increase and, indeed, in respect of WES 10 - surprise, surprise - you will see that in May 2007 thus objected very strongly about this three phase price increase. I could take you through the documents - obviously I will not, but it is there. Ofcom completely ignore this in making their assessment on WES 10.

The only other points that I would make is that even if one is looking at the ROCEs, which is one of the other points that Ofcom rely upon, if one looks at the external ROCE, which is the bottom line of Table 14.14, one sees there that, in fact, for 2006/07 BT earned a nought return on capital expenditure, 10 per cent 2007/08, and nought per cent in 2010/11. This is not, we say, a rate of return regulation. Cost orientation is not a rate of return regulation. Therefore, ROCEs of 25 per cent, 23 per cent are not necessarily *per se* bad. There could well be justifications within the cost orientation mechanism for certain products in certain years for the ROCEs to be higher. But, if you look at the ROCEs over a five year period again you see that they are not excessive, so again because Ofcom excludes in what we say is this rigid accounting process, all reference to averaging the fact that in earlier years the

product was actually at a much lower level is ignored and completely rejected in what we say is the mechanistic approach that Ofcom took.

Sir, I am conscious of the time, I will say that is all I will say on Ground 3 - there is a lot more but no doubt that will be picked up in the rest of the case.

Can I turn very briefly then to Ground 4? Can I make the observation that although this perhaps does not have the attention that it might have done on the other elements, it is still quite a significant sum, it is about a £15 million effect on the overall allegation of overcharging.

THE CHAIRMAN: It really breaks down into a number of sub-grounds, does it not, Ground 4?

MR. READ: There are only three. There is the excess construction costs, the transmission equipment costs and there is the provisioning costs.

THE CHAIRMAN: The provisioning cost, if I have understood it rightly, in itself breaks down in to two parts.

MR. READ: That does break down into three different periods.

THE CHAIRMAN: I thought two different points, one about allocation, one about level? Perhaps I have misunderstood it.

MR. READ: They both come from the same central problem which is that BT made quite a serious error when it was collating the data in that it did not capture the provisioning costs for the AISBO services. What happens is that in 2008/09 some or more of those costs do get put across but they are still not the correct capturing of the proper amounts that are involved. What then happens in 2009/10 is that BT sets up a specific component to capture the provisioning costs.

I think it might be instrumental in illustrating this just to ask you to very briefly look at bundle D of the core bundle, and to go to tab 14, which is the first report of Mr. Coulson, whose evidence you will have seen has formed something of a batting to and fro between Ofcom and BT. But if I can ask you just to go to p.15, and there is confidential material on this page but it is marked, but I do not need to obviously mention the actual confidential information. It is p.15, para.3.28, and below that there is a figure, Table 3.1, which sets out how effectively BT failed to capture the costs in the first two years and how it failed to capture the costs in 2008/2009. Then if one goes over the page to Table 3.2, this is actually a table which Ofcom relied upon and it showing the total provisioning costs reported in the RFS. So that is on p.16, Table 3.2, the total provisioning costs reported in the RFS. You can see what happens in 2009/2010 2010/2011 is that the figures have jumped substantially, so it goes up (and these figures are not confidential) from around the 14 million mark in

2006/2007 through to 2008/2009 to the 100 million mark for the following two years. That is a direct result, we say, of BT in 2009/2010 having set up a system that actually allowed the provisioning costs to be properly captured within BT's RFS. One of those specific components that was set up to capture the provisioning costs for BT was the one specifically dedicated to the Ethernet services. As a result of that the problem is effectively sorted at that stage.

In reality we say that this is not anything to do with issues about methodology. It is a basic error in capturing the costs, and that is a question, one of fact, which the Tribunal is perfectly able to decide whether it is right or wrong. We thought that, having seen Mr. Coulson's report, Ofcom were not raising any matters about it. However, it now seems from the skeleton argument that they are and you see that we object to that approach, but we will probably have to see how that goes and plays out, Sir. Although it is unfortunate for Mr. Coulson because it is not quite clear how he is going to be dealt with come next week when he gives his evidence.

Obviously in addition to that, we accept that in para.11.39 of the Determination there is this methodology that Ofcom puts out for making adjustments to the RFS. In respect of provisioning costs we accept that that is a methodology that plainly the Tribunal has to have some form of regard to. But, and this is the "but", what drove Ofcom in its decision to reject this adjustment, in respect of 2008/2009, was simply that they were not satisfied that BT had not been correct in capturing the costs.

THE CHAIRMAN: Just give me a moment. So -- (after a pause):

MR. READ: What are you after, Sir, and I will try and ----

THE CHAIRMAN: I am just looking for their conclusions on the provisioning costs in the Decision. That is somewhere in 13.

MR. READ: It starts at p.308 in the Decision. That is the start of 2006 to 2008, and one sees at 13.358, and, in fact, actually if one looks at p.309 we see that there is a table there that I have actually taken you to already in Mr. Coulson's report. Mr. Coulson deals with why he says that that actually demonstrates BT was not capturing costs properly but, if need be, that is a matter that can be dealt with in the evidence. But the conclusion is at 13.358, which is:

> "Therefore we do not consider BT has provided us with sufficient evidence explaining how provisioning costs associated with the services were captured in 2006/2007 and 2007/2008 to enable us to determine whether the RFS treatment was obviously inappropriate… We therefore reject the adjustment on the basis that we are not in a position to conclude it corrects for an error in the RFS or a

methodology…".

Sir, we say that is a straightforward, simple, factual question. Was BT capturing it properly or was it not? Ofcom has not anywhere said that there were other factors that might have induced it not to make the adjustment. The reasons why Ofcom has rejected it are just what it says in 13.358 which is a straightforward factual question.

In respect of 13.359, the conclusion is the same that BT has not satisfied them about it, but in 13.363 they say:

"We note that even if we had found that the evidence suggested that the methodology for allocating the provisioning cost component in 2008/2009" ----

THE CHAIRMAN: Are there two points in 13.359, which is the allocation to connections arrangements, as between connections and arrangements, and, secondly, an amount, or is it the same point? That is what I am trying to ----

MR. READ: It is a slightly different point, is the short answer. It is quite complicated to explain it and I do not think even I could do it in four minutes.

THE CHAIRMAN: Mr. Coulson comes ----

MR. READ: There was an issue about whether or not these costs were being allocated somewhere else and whether therefor it was simply BT deciding to do it in a particular way rather than another. In other words, BT had known about the costs but decided that they were going to allocate them like this for some reason that was not explained. That is not BT's case here. BT's case here is solely, "Look, BT did not capture these costs properly. The full amount was not properly captured". That the Tribunal can decide on the facts and the only other question, therefore, is whether the other factor that Ofcom puts in 13.36 is something that prevents this Tribunal, having found factually the material was not captured, from reaching a decision on it. We say, no, that is not right because in fact when you look at the figures it is about £8 million, I think, effect it would have had on the WLR products market and in the context of that market, which runs to many, many, many millions in revenue, it would not actually have an enormous effect or virtually any effect at all on the figures there.

So in essence, Sir, even for provisioning costs we say that you pose the question at the outset, "Effectively this is some form of regulatory judgment being exercised here, can the Tribunal do it?", we say it is not. We say that this is Ofcom putting a fig leaf up to try and suggest why at this stage the change should not be made. We say it is a straightforward factual issue which this Tribunal is perfectly entitled to consider.

THE CHAIRMAN: And you say the same about ECC, it is a simple error.

MR. READ: Yes, a simple error and, in fact, I do not think Ofcom even doubt that it is a simple error.

THE CHAIRMAN: Transmission costs.

MR. READ: Transmission costs, the starting point with both excess construction costs and transmission costs is to recognise -- the trouble with using methodology is, of course, it can have two different meanings in this case. The first meaning is the methodology that Ofcom sets out in para.11.39 of the Decision for making an adjustment to the RFS. In other words, how should Ofcom balance up making the adjustment to the RFS? But that is not relevant at all in respect of excess construction costs and transmission equipment costs because Ofcom has already decided to make the adjustment. In other words, it has ticked the 11.39 criteria and decided to make the adjustment. The only question we say that this Tribunal has to decide is whether the method that Ofcom itself has used to make those adjustments is right or wrong. It is a simple black and white ----

THE CHAIRMAN: No, it goes beyond that because on this one they put their method forward in their provisional determination for BT and others to comment on, having ticked that box, so they come up with their own method. They put it to your clients. Your clients did not make any adverse comments. They did not put forward an alternative. Ofcom therefore adopts that method and now on appeal you seek to put forward an alternative method. Is that not right?

MR. READ: No, it is not, Sir, with the greatest respect. You have to actually understand what was going on in order to realise why that is not the case. Can I just very briefly explain it? I will try and do it in three minutes. The starting point about this adjustment is that Ofcom considers there is a timing mismatch between the revenue associated transmission costs and the costs which were incurred and, indeed, they probably would not have had to have done that if they had averaged costs in any event. The time period was a five year period that BT was effectively depreciating over the life of what it assumed to be the costs for these. So Ofcom takes out the depreciation and mean capital employed from the accounts but then obviously has to put something back in order to balance year against year. What they then did, when they were putting the costs back, was to look at BT's -- BT did not have the information to allow them to do what they wanted to do originally, which is to basically put back against each granular service the particular cost for transmission equipment costs because BT did not have that information. So what Ofcom had to do was take the overall figures for WES and BES products and then find a way for splitting those elements down to the individual granular service level product in order to put them back to make the

comparison against the costs. So that is what they are doing. In doing that what Ofcom did, it was in fact in a two-stage allocation process, and what they did was to effectively use rental volumes which by definition involved a number of years. So, in other word, when you are actually allocating you are looking at a number of years and because you are looking at a number of years you get back to the very vice that they have been trying to avoid, which is looking at costs or weighting volumes spread over a number of years in order to ascertain a single year's costs that has to go back. And that is the point that we criticise. What Ofcom say is, "Actually we said we were going to do it on an RFS allocation". That is what they are saying in their skeleton argument and so that was in the provisional determination, BT ought to have picked that up. BT says, "No, that certainly is not the case because, in fact, there is no specific references given to what exactly they are doing in the DAM, and this is a huge document, it runs to 1,000 pages or more; it is a complicated thing, and so it was only when BT interrogated the model that Ofcom gave it that it realised that it had in fact done the allocation by reference to this. That is BT's case and BT says that if you are trying to put back single year costs against single year revenues, because that is the whole reason why you have stripped out the transmission equipment costs in the first place, you cannot do that by a methodology that effectively looks at weighting over a number of years. That is effectively BT's case on it.

THE CHAIRMAN: Can you just help me, 13.130 in the Decision, the first sentence. Is that right?

MR. READ: The problem with this, and again it is the level of complication that is involved in all of these, the FRS are incredibly complicated and BT put forward a proposition to Ofcom, when Ofcom was initially making these adjustments, that it should be balanced against connections. That was rejected and that is not what BT is complaining about. It is complaining about the weightings that were used for splitting the figures back up. In other words, that is a very Delphic ----

THE CHAIRMAN: That may be but is it right that the adjustment that Ofcom did make, which you criticise for reasons you have explained in brief, was put in the provisional decision and that Ofcom did not comment or criticise that.

MR. READ: BT did not comment.

THE CHAIRMAN: No, BT. I keep making that mistake. BT did not comment or criticise that. That is said in 13.130 and repeated in 13.139. It may be because you say that the original decision was so long and complicated, and it took so long to analyse, you only got round to looking at the model later, but I am just trying to understand whether the statement is

correct or whether you are saying it is wrong.

MR. READ: In essence what BT is saying is that 13.130 is right in that we did not criticise the original provisional decision. We did not criticise it because at that stage it had not been worked out the method by which Ofcom had actually done the weightings.

THE CHAIRMAN: Not worked out by BT?

MR. READ: By BT, because we had to take get right down into the detail of the model in order to actually understand what Ofcom had done. Ofcom are now saying that in the provisional determination they indicated that they did these allocations according to the RFS, and they say that BT should have picked that point up, regardless of the model, they should have picked that point up and said at that stage, "You have got this wrong". BT's answer to that is simply, "Actually the particular sentence that you are now", and I emphasise the word "now" because it has only come out in the skeleton argument, you see nothing of this in the defence -- The reason why that point does not help them is because, in fact, the detailed attribution methodology for doing this is vastly complicated and without specific references as to which one you are actually looking at, it is not clear how the allocation has actually been done. BT only then found that out subsequently.

THE CHAIRMAN: Yes, I see.

MR. READ: But even if I was wrong on that, what BT says is, well, this is an appeal on the merits. We know that new and fresh evidence is admissible. No application has been made in this case to exclude it. It is all very unfortunate, the way that Ground 4 has come before the Tribunal, and it would not in those circumstances be right for the Tribunal to, if you like, not deal with this point (which we say is a straightforward, factual matter) now even if BT might previously have been criticised for not spotting the problem earlier. So there were good reasons why we did not but no one has actually sought to exclude the evidence from it. We have said we only found it as a result of the investigation into the model. That is BT's position.

THE CHAIRMAN: Yes, that is very clear. Thank you.

MR. READ: I trespassed. I am sorry, Sir.

THE CHAIRMAN: Thank you very much. We will return at 5 past 2. We will sit for 5 or 10 minutes later at the end.

(Adjourned for a short time)

THE CHAIRMAN: Yes, Mr. Pickford.

MR. PICKFORD: Sir, members of the Tribunal, we advance three grounds of appeal which, in broad terms, are as follows. Ground 1 is that Ofcom erred, by failing to adopt a costs test

under Condition HH3.1, capable of preventing multiple recovery by BT of its costs.

Ground 2 is that Ofcom erred in failing to make a RAV adjustment when assessing BT's actual costs incurred. And what is ground 4 in our Notice of Appeal: Ofcom erred by failing to award interest.

Given the time constraints I am not going to be able to go to all of the source material. What I hope to do is go to some of the key ones, but again like Mr. Thompson, for speed in some cases I will be giving you the reference and a direct quotation.

THE CHAIRMAN: Yes. Ground 4, of course, is also advanced by Ms Rose.

MR. PICKFORD: It is, and in the light of that what we have agreed is I am going to take approximately one hour and 45 minutes, until roughly ten to 4, and then Ms Rose is going to have 45 minutes thereafter. The scheme is that I am going to focus my submissions very much on ground 1 of our appeal, I am going to make some comments on ground 2, and I will make some very short comments on our ground 4, but in order to avoid duplication we have agreed between us that Ms Rose will take the majority of the points on that ground. So I will be adopting prospectively her points that she is going to make in relation to that.

Dealing very briefly with the legal framework and the standard of review, I can be extremely brief. The legal framework is set out in our Notice of Appeal at paras.12 to 14 and I do not propose to repeat it now. Our case on the standard of review is at para.5 of our skeleton. Again, I do not intend to go into that in any detail now. It is a very familiar debate that Ofcom and appellants have, in virtually every appeal in this Tribunal. The main point of contention is the classic one: it is the extent to which Ofcom's margin of appreciation in respect of value judgments is something that should be respected, or something that the Tribunal can, to some extent, intrude upon.

What we say in relation to that is that in an appeal on merits (as this is) if the Tribunal considers that there is a different approach proposed by an appellant to that adopted by Ofcom, but significantly better than that selected by Ofcom, and that the change would be likely to make a material difference to the outcome of a dispute, it is required to find that Ofcom erred in selecting the inferior solution. That, in a nutshell, is our case on the matter. The authorities that we rely upon in support of that proposition are in the footnotes to para.5 of our skeleton argument.

Importantly, however, in this case, the principal arguments under our grounds of appeal we say do not turn on Ofcom's value judgments. So the principal points on ground 1 are in fact issues of construction, where Ofcom has no margin of appreciation. Under ground 2 we say there was an error of approach by Ofcom when it failed to ask itself an obvious and relevant

question. Again, that is not an area for a margin of appreciation. On ground 4 there can be no question of any margin of discretion in favour of Ofcom in terms of its original decision because it has not sought to defend it. So in fact the debate about the margin of appreciation may well be, except in the case of *Albion* a rather sterile one.

May I turn then to our first ground, on which I intend to concentrate, the cost test. What I propose to do is introduce our point and get an overview of the essential points that we make. Then I will come back and go through various aspects of it in more detail.

Ground 1 is that Ofcom erred by failing to adopt a test, when it applied Condition HH3.1, that was capable of preventing substantial multiple recovery by BT of its costs over the relevant period of disputes. This is not an opportunistic punt. Notwithstanding Ofcom's attempts to resolve the disputes properly, we say this is one of those limited occasions where Ofcom has made a significant mistake and it needs to be corrected. It needs to be corrected not just because it affects my client's interests (although undoubtedly it does; that is obviously why we are here) it also needs to be corrected because it raises an important point of principle that will affect how other disputes are determined in the future.

I am assuming that the words of HH3.1 are relatively familiar, so certainly in this introduction I am not going to repeat them. It is common ground in these appeals that BT failed to demonstrate that it complied with its obligation to demonstrate that its prices satisfied the condition. Its prices were so excessive that even BT does not come before the Tribunal to argue that there was no overcharge at all. Instead, in its own appeal it seeks to limit the amount of that overcharge, or to say that even if there was an overcharge it should not have to pay it back.

We say in response to that that the proposition that a communications provider with significant market power, who has been found to have overcharged by around £100 million, in those circumstances to suggest that Ofcom would have no power to require, or should choose not to require, the communications provider to disgorge its ill-gotten gains and breaching its SMP obligations we say is, with the greatest respect, manifestly misconceived. It would wholly undermine the effectiveness of the very SMP condition that we are concerned with. I have only a very limited period for my submissions and I am not going to say anything more about BT's appeal than that. We have set out in writing why we say it is in substantial parts highly confused, and in its entirety without any merit.

Turning back to our appeal, what is common ground with Ofcom? First, we agree that the test in Condition HH3.1 applies in respect of each and every charge.

Second, we have no objection to Ofcom applying some kind of upper band of DSAC on the

price of an individual service, and we can see that it serves an obvious and useful purpose of limiting BT's pricing flexibility so there is only so much common cost that it can load on to any one single service. If one loads too much common cost on to one service, which some of BT's customers buy disproportionately compared to others, one can see how that could lead to competitive distortions.

In other words, allowing the price of an individual service to exceed DSAC would lead to a disproportionate loading of common costs on to that service and thereby fall foul of what we say is one aspect - one aspect - of the test for an appropriate mark-up for common costs. It is essentially an issue about the balance between different charges, and if the issue raised by a dispute is an allegation that a single charge is of itself excessive by reference to the costs of that specific service then in deciding what the outer band of that charge should be there needs to be some limit. Ofcom applied DSAC and we do not seek to challenge that, but it is then that we do depart company from Ofcom, because if the allegation raised on a dispute is that the charges for a group of individual services are inappropriate because the mark-up for common costs for each service, taken together with the charges for other services leads to multiple recovery of common costs, we say that engages a different aspect of condition HH3.1 and a DSAC test is not sufficient on its own.

The DSAC test may still have a role to play in terms of the structure of charges, ensuring that one charge does not have too much common cost allocated to it, but we say that one needs an additional test to deal with the issue of overall recovery by BT of its costs and that DSAC is not fit for that purpose, because DSAC permits the same common costs to be recovered multiple times, and so the overall level of charges it allows is too high.

Moreover, quite how many times DSAC allows over recovery depends ultimately on arbitrary decisions about how BT chooses to divide its services into different groups. As Dr. Maldoom, who is BT's expert says, at para. 59(d) of his first report DSACs clearly depend on the way in which services are formed into groups both in terms of what other services are in the same group, and also how many groups there are overall. The latter affects the number of times which costs that are common across all services are recovered.

What do we say is the right test on the issue of recovery of common costs? The first point to make is that under condition HH3.1 it, of course, falls upon BT in the first instance to demonstrate compliance. So to that extent it gives BT some discretion in the first instance, and what did it need to do? It needed to show what its long run incremental cost was for each charge. It needed to show how it had marked up that long run incremental cost (LRIC) appropriately to allow for the recovery of common costs - and I emphasise the word

"recovery" - and it needs to show that the resultant return on capital employed was appropriate. In this case BT failed in that task - it is not really clear that it really attempted it. So in resolving the disputes we are already in the second best world of finding some kind of pragmatic solution to enable us, who have been overcharged, a remedy. We say in that context, save in the case of limited exceptions to which I will come, in aggregate across the group of products to which condition HH3.1 applies prices should be no more than FAC (Fully allocated cost)

The appropriate grouping of products could technically be the subject of some discretion but Ofcom has provided us with an obvious answer to that question by deciding on the boundaries of the market against which condition HH3.1 applies, and that is namely the AISBO or, as we tend to call it the Ethernet market, principally made up of WES/WEES remaining.

I will deal with the exceptions to our essential test in due course, but the main one is this: even if BT's charges for this group of services considered in aggregate exceed FAC that is not necessarily in breach of condition HH3.1 if - and I stress "if" - BT can show that it is, in fact, under recovering its common costs across other relevant services, which share common costs. In that situation, subject to certain constraints to which I will come, we accept it would be open to BT to demonstrate that the over recovery on one group offset the under recovery on the other group and that therefore overall there was just recovery.

So our approach, we say, is extremely flexible. All that we actually ask at the end of the day is that BT does not get to recover its common costs multiple times. Why do we propose FAC? Because it is the best available, and we say best known proxy, for a price at which BT recovers its LRIC plus its common costs, plus its cost of capital in line with condition HH3.1. So that way BT can still adopt a flexible structure of prices, if it chooses to do so and subject to the outer bound of DSAC on each price, but the overall level of prices in aggregate is confined to avoid over recovery.

So that is a summary of our essential case under Ground 1. I would then like, if I may, to divide that up into four principal points which I am going to develop.

The first point on Ground 1 is as follows. As we said DSAC when applying to a group of products rather than a single product allows multiple recovery of common costs - that is essentially common ground, and we say that is inconsistent with the terms of condition HH3.1 when it is read in the light in particular of the 2004 LLMR statement which imposed it. It is also inconsistent, as it happens, with the PPC Judgment.

We say if we are right on that we win, because Ofcom contend that multiple recovery of

common costs is quite compatible with condition HH3.1, so that is the first fault line between us and Ofcom.

Our secondary case is this. Even if, contrary to my primary submission, the likelihood or the risk of over recovery of costs were potentially compatible with condition HH3.1 Ofcom still erred in the present case by believing it was compelled to allow such a likelihood or a risk. In the challenge statement Ofcom did not meaningfully investigate the relationship between charges and costs considered in aggregate. It says that if the relationship had been a concern it would have imposed a charge control and, since it did not impose a charge control, it would be wrong to assess, they say, when addressing the appropriateness of the recovery of common costs and whether it leads to their multiple recovery. We say again that is a misunderstanding of condition HH3.1 and the 2004 LLMR statement.

Our third point is that even if we are wrong on our secondary case none of the points that Ofcom advance support their approach. Retrospective imposition of a charge control, regulatory certainty and the effects of PPC demonstrate that their approach is an inappropriate one.

The fourth point is that there is no cogent analysis that has been advanced in these proceedings to justify a conclusion that considerations of economic efficiency justify applying a test based only on DSAC. We say: on the contrary, if one looks at the available evidence, efficiency considerations lead you to the view that our approach is superior.

If I could turn then, first, to the issue of construction. If we could start, please, by going to the statutory context which is at tab 5 of bundle E, and in particular p.19.

Section 87 deals with conditions about network access and, over the page on external p.20, we see subsection 9 deals with SMP conditions that include, under (a) price controls and under (b) "such rules as they may make in relation to those matters about recovery of costs and costs orientation".

Then one sees in s.88 that all conditions falling within s.87(9) have to satisfy the criteria set out in s.88 and they are that Ofcom are not to set an SMP condition falling with subsection 87(9) except where it appears to them from the market analysis carried out for the purpose of setting that condition there is a relevant risk of adverse effects arising from price distortion. Then it also appears to them that the setting of the condition is appropriate for the purposes of promoting efficiency, promoting stable competition and conferring the greatest possible benefit of end users of public electronic communication services.

Then subsection (3):

> "For the purposes of this section there is a relevant risk of adverse effects arising

from a price distortion. The dominant provider might:

(a) so fix or maintain some or all of its prices at an excessively high level, or

(b) so impose a price squeeze so as to have adverse consequences on end users public electronic communication services".

Then subsection (4):

"In considering the matters mentioned in subsection (1)(b) Ofcom may:

(a) have regard to the prices at which services are available in comparable competitive markets;

(b) determine what they consider to represent efficiency by using such cost accounting methods as they think fit."

Those provisions apply equally to price controls and cost orientation obligations. There is no distinction between the two in the statutory framework in relation to the essential conditions that must be satisfied.

Obviously, when it is imposing either Ofcom must have regard to its wider objectives as set out in s.88(1)(b). However, the prevention of the risk of adverse effects from a price distortion is the driving force behind this section, because Ofcom does not have any power simply to impose an SMP condition for the purposes of achieving the aims in s.88(1)(b). It can only do it in order to address the risk of a price distortion. If it is to impose a condition for that purpose we say it must address that risk effectively.

In the 2004 statement to which I will come we see that Ofcom directed itself to the very questions raised by s.88, considered what the pricing risk was, considered it was desirable to set prices that would exist in a competitive market, and it chose a cost rule in HH3.1 that it considered was appropriate for that purpose.

So if we could consider then the language of HH3.1 itself. We have the advantage here of the Tribunal's Judgment in PCC which has, to some extent, already considered a number of these points, and that is at tab 9 of core bundle E. If we go first to para. 5, in the PPC case Ofcom had determined that:

" (1) BT had overcharged the Altnets by £41.688 million in respect of 2 Mbit/s trunk services…"

And BT had appealed that determination. So what was in issue was overcharge in relation to a particular product, 2Mbit/s trunk services. The Tribunal went on to note, at para. 26 that various markets which had been defined in the 2004 LLMR statement, and they included:

"(1) The provision of traditional interface symmetric broadband origination with a

bandwidth capacity up to and including 8 Mbit/s …"

and the TISBO above 8Mbit/s and thirdly, wholesale trunk segments.

Then at para.47 the Tribunal notes the SMP conditions that were imposed in respect of each of those. There was:

"(1) A cost orientation obligation in relation to terminating segments:

(2) Charge control in relation to terminating segments:

(3) A cost orientation obligation in relation to trunk segments …"

Then at para. 75 the Tribunal identifies the over recovery of common costs is a concern and it leads to profits in excess of the costs of capital.

"… where a firm prices one of its products at SAC, then if the firm were to charge more than LRIC for any of the other products, it would over-recover its common costs, and so earn profits in excess of its cost of capital."

Then we see every more clearly at paras.82 to 83 a similar point being made, where the Tribunal says:

"Some method of ensuring that common costs are recovered - but not over-recovered - is clearly essential".

It goes on at 83:

"In short, whilst it is obvious that if a multi-product firm prices at LRIC it will make a loss (because there will be no recovery of common costs) and if it prices at SAC it will make an unreasonable profit (because there will be *multiple* recovery of common costs) it is much less obvious how common costs are to be treated".

So what the Tribunal is saying here, amongst other things, is that multiple recovery of common costs is over-recovery of common costs and leads to an unreasonable profit, in excess of an appropriate cost of capital. So we say the Tribunal was spot on here in that multiple recovery of common costs is not compatible with Condition HH3.1.

If we could continue then to para.197 and following, where the Tribunal begins its analysis of the construction, Condition HH3.1, one sees if one turns over the page to para.202 the Tribunal says this:

"In the case of a public law instrument, which (as in the case of an SMP condition) is promulgated to the world at large, the relevant factual material will only extend to the material reasonably available to the public at large".

It goes on in 203:

"In the present case we considered the relevant factual matrix to be quite limited and to be confined to the relevant statutory framework for the imposition of SMP

conditions (specifically the 2003 Act and the EU Directives comprising the common regulatory framework) and to the published documents that led up to the SMP conditions imposed in this case (including, in particular, the 2004 LLMR statement)".

We are entirely in agreement with that. One then goes to, please, para.242 there is then a section entitled "The nature of the cost orientation obligation contained in Condition H3.1". Of course H3.1 is in identical terms to HH3.1. They say:

"It is clear from the wording of Condition H3.1 that it is left to the dominant provider - that is, BT - to decide how and what to charge for its services, provided always these charges are [then it quotes] … reasonably derived from the costs of provision based on a forward looking long run incremental cost approach and allowing an appropriate mark up for the recovery of common costs including an appropriate return on capital employed

".

It then deconstructs that into its three constituent parts, the LRIC, recovery of common costs and the appropriate return of capital employed. Then it says at 244:

"We have considered the economic meaning of these terms in paragraphs 67 to 100 above. The concepts are very specific and clear. Given that the imposition of SMP conditions is fundamentally economically driven, being a response to a dominant provider having significant market power in an identified market, it is obvious that these economic concepts are central to the true construction of Condition H3.1".

So, firstly, we have got the long run incremental cost. Incremental cost is the cost of producing an additional unit, the service that we are concerned with, and it is long run in that includes an allowance for fixed costs, insofar as there are any, or incurred in producing the service in question. The concept is forward-looking in the sense that when it values assets it asks, "What are these assets worth today?" not "What did we have to pay for them in the past?", and it is also forward-looking in the sense that it is saying, "If we look forward and vary all of our costs what is the cost of producing an additional unit of service?" We say it is plainly right, it is obvious and it is not in dispute, that BT should at the very least recover it's LRIC otherwise if it did not every unit it supplies will be loss making. That is the first point.

We then have a mark-up for common costs, and plainly where there are a number of costs that are common to a number of different products there needs to be some method of

allocating these again so that they are recovered so that BT does not make a loss.

Finally we have an appropriate return on capital employed. Ofcom has studied the weighted average cost of capital of BT on a number of occasions and it typically leads to something in the region of about 9 to 12% depending on the relative riskiness of the business that it is concerned with. We see this constituent elements again reflected in para.245. There is a slight difference between us and the Tribunal in that the Tribunal refers to Stage 3 on the appropriate return of capital employed as a "cross-check". We would not really see it as a cross-check. We would see that as something further that can be allowed to BT in terms of its return. It has to be able to make a return on its capital employed. But nothing, I would suggest, turns on that slight difference of terminology between us and the Tribunal.

In its approach here the Tribunal adopts an implicit and, we say, entirely correct approach to what is meant by the requirement that charges must be "reasonably derived" from the cost of provision. What the Tribunal is saying is that it is the rest of the condition and explains how one assesses this. It specifies a particular and precise approach to the costs of provision and so once you have worked out the forward-looking LRIC, the appropriate mark-up for the recovery of common costs, and the appropriate return on capital employed. The Tribunal says implicitly, and we say, that dictates the boundary of a permissible price, because if you allow prices above that you would then be exceeding what was appropriate in your previous calculation of recovery of common costs and returns on capital employed.

In the *PPC* case the Tribunal went on to consider whether BT had demonstrated its charges for the 2 Mbit trunk services were cost orientated. One sees, if one turns over the page, that there were three approaches that were advanced by BT. We begin at 253 with combinatorial tests and they can be summed up by what is said at 256 by the Tribunal.

> "Had BT demonstrated an absence of over-recovery of common costs through a series of combinatorial tests, then this would have been an appropriate way of demonstrating the appropriate mark-up for the recovery of common costs. However at the end of the day it was common ground that such combinatorial tests as were conducted by BT during the course of the Dispute Resolution Process were insufficient to establish this".

It is important to note that a combinatorial test does not in fact prevent the loading of common costs onto one particular service. You could satisfy a combinatorial test if you priced one product at SAC and everything else at LRIC. So that would be a very extreme way of balancing prices. I will come back to the relevance of that in a moment.

The second approach that was advanced by BT was something called circuit analysis, which

is at para.262 and following. This involved analysing the sum of BT's charges for trunk services together with the charges for terminating segments. As we have seen, those services were in different economic markets and they had different regulatory treatment. The Tribunal at 264 refers back to its reasoning at para.228 for why it rejects this approach. It is convenient, I think, if we just pick it up at 227. So if I can momentarily turn you back, we see at 227 that:

> "Both OFCOM and the Altnets suggested that a strong point in favour of this disaggregated approach was that an aggregated approach (in particular, one aggregating between trunk and terminating segments) would have the effect of conflating distinct schemes of regulation. We agree with this submission. Such an approach could effectively undermine specific charge controls directed to particular services, for example, the charge control imposed in relation to terminating segments. Were BT permitted effectively to cross-subsidise a "low" price for one service (eg terminating segments). by charging more for another service (eg trunk segments), and by aggregation using the low price of the former to bring down the aggregate price of the two services, then plainly the charge control/cost orientation regime would be substantially undermined".

Then they go in para.228 to say that the condition has to be applied to each specific charge individually.

That is entirely fair enough and we agree with that, and that gives rise to the idea that there should be some outer bound on the degree of pricing flexibility that is permitted to BT. But there is also some tension here with what the Tribunal said in relation to combinatorial testing, when it suggested that that in theory, at least, if it could be done properly (and, of course, we know that BT did not do it) it could be a way of demonstrating compliance. As I said in relation to combinatorial testing, and this will be developed in evidence, that actually allows a very extreme rebalancing of prices. I would suggest that this apparent tension in the Tribunal's judgment flows from the fact that the requirement in the condition that the recovery of common costs be appropriate in fact imposes two different types of obligation. These were never fully explored in the *PPC* judgment, entirely understandably given the limited nature of the dispute and argument before the Tribunal in that case. We say that DSAC is a test which principally addresses the structure of charges. It puts limits on how much any one service can recover of common costs. Our aggregate FAC test steps in to provide an appropriate limit on the level of charges so that common costs are not recovered multiple times, which the DSAC test permits. We say that both of these are relevant to

determining what is an appropriate mark-up for common costs.

Turning then back to the *PPC* case and the third limb of BT's approach, we see that at para.265 and following. That is the "International benchmarking/comparisons". The Tribunal said in relation to this at 266, "This does not really help us very much because, of course, Condition H3.1 is concerned with BT's LRIC, BT's common costs and BT's cost capital, so it is not going to assist us greatly to look at international comparisons". So they rejected that as well.

Then at 278 the Tribunal goes on to deal with the DSAC test. The first point to note is that it says:

> "DSAC is not a generally well-known test".

It also notes that the evidence is that it was less well-known than a FAC. We say that passage undermines Ofcom's reliance on this case, at para.163.2 of their skeleton, the proposition that DSAC is the industry standard. That is not what the Tribunal says. At 282 the Tribunal goes on and it says:

> "One of the points about cost orientation provisions is that whilst prices so regulated are intended to be *orientated* to cost, the price is not dictated. The firm that is subject to the orientation obligation has a degree of flexibility in how it charges".

We do not argue with that and we say so does our proposed aggregate FAC test allow that flexibility. Again Ofcom rely on this passage to suggest that the Tribunal in *PPC* is recognising that a basis of charges control is a softer option than a charge control.

THE CHAIRMAN: I am sorry, my mistake, the passage you have just referred to is paragraph?

MR. PICKFORD: It is para.282. I do apologise.

THE CHAIRMAN: I have got it. Thank you.

MR. PICKFORD: So what Ofcom says about this is they say, "Aha, here is the Tribunal in *PPC* saying that the basis of charges or cost orientation obligations are a softer option than the charge control". We say that is not what the paragraph says. It does not actually make a comparison with the charge controls. Secondly, in talking about flexibility, we say that is very different from being soft so as to allow multiple recovery of common costs. Indeed, as is clear from elsewhere, in particular paras.82 to 83, the Tribunal is clear that you should not have multiple recovery of common costs. The Tribunal at 285 then goes on to say that no-one suggested that DSAC was a conclusive indicator that common costs had been appropriately allocated. It was common ground that a charge for service could be cost oriented even though it was in excess of the DSAC ceiling, and equally, a charge below

DSAC might not be cost oriented. But then it goes on at 286 to say that effectively at the end of the hearing BT had given up arguing against DSAC. At 286(2) it notes the FAC could have been used as a means of fully allocating common costs but would have effectively imposed a single price on BT for its PPC services.

THE CHAIRMAN: I am sorry, you are at 286?

MR. PICKFORD: I am at 286 subparagraph 2. It is rejecting FAC in this particular context because that is applying to a single service, and it is saying that if you are applying FAC to 2Mbit trunk services you get an answer. We do not disagree with that. That does not, of course, tell you anything about whether it is appropriate to have an aggregate FAC test across all of the products in the market to ensure that overall they do not recover more than their common costs because within that you can have pricing flexibility, as long as if you have prices above FAC you have some that are below FAC, overall, our test is satisfied.

THE CHAIRMAN: Just a moment. Have I understood this? You are saying that the Tribunal's rejection of FAC as inappropriate is because it was only a single product and therefore would have led to inflexibility?

MR. PICKFORD: Yes, because it says FAC could have been used as a means of fully allocating common costs, but would have effectively imposed a single price on BT for its PPC services. FAC is a means of attributing common costs to different services, and if you are going to apply FAC just to one service (and we do not disagree with the Tribunal here) you effectively dictate the price. But that is not our case. Our case is that you apply a FAC test in aggregate across the whole of the relevant set of services. By that, when I said in aggregate I mean it does not apply to each individual service each time. You say that in aggregate you have to satisfy FAC.

PROFESSOR MAYER: Can you just clarify what you mean by the services in aggregate? What services are you then including, and should you include all of the services of the company in question?

MR. PICKFORD: We say in the first instance you look to the services to which Condition HH3.1 applies, which in this case is Ethernet services, or as it is also called AISBO. We use the terms effectively interchangeably. We accept that it would be possible for BT to say, just looking at Ethernet services, we are over-recovering relative to your aggregate FAC standard, but of course they share common costs with these other services over here; they share common costs, for instance, with ISDN services and certain other services. So they could come along to Ofcom and say: notwithstanding we are above FAC for these services;

we are below FAC for these other services and therefore what we are doing is still not inappropriate because overall we are still not over-recovering our common costs because the two net off; we simply recover our common costs once. We accept that it would be legitimate for BT to come before Ofcom and argue that point. That would be one means of satisfying the condition, if it were demonstrated.

PROFESSOR MAYER: But does that not then logically lead you to say you have to apply it across the whole of the company, and does that not then reduce essentially to being a charge control?

MR. PICKFORD: No, we say it does not. We say that in the first instance it applies to the services which are included in the market to which the condition applies. It is an exception to that that BT can then come along and say: actually, because we might be over-recovering here we can under-recover elsewhere. That is something which is not something that Ofcom necessarily have to do. It lies within BT's knowledge whether it is actually over-recovering or under-recovering elsewhere. Moreover, there are a number of reasons why we say that this test is not in fact equivalent to a charge control, albeit it does share one thing in common with the charge control which is that charge controls tend to, but are not necessarily, based on FAC, as is our test. But there are a whole range of reasons why it is not a charge control. I will come to those in due course.

THE CHAIRMAN: Suppose a CP wants only a base 100 service, it pays only for a base 100 service. The price it is charged has to meet the Condition HH3.1?

MR. PICKFORD: It does.

THE CHAIRMAN: So that price for that service then has to have an appropriate mark up for common costs?

MR. PICKFORD: It does.

THE CHAIRMAN: How would you then bring in what an aggregation with common costs allocated to a WES 100 service in assessing the compliance of the particular price for the WES 100 or the BES 100 service?

MR. PICKFORD: It comes in through what is an appropriate allocation of common costs. I will come on to develop this submission by reference to the documents, but we say that an appropriate allocation of common costs for the recovery of common costs cannot lead to multiple recovery of common costs. If the implication of the price for the WES 10 service is that combined with prices for other services in the market BT, on its face, is recovering more than its common costs then there is a problem.

THE CHAIRMAN: You are looking at it from the perspective of BT, but from the perspective of

a CP, one CP may be paying a much greater share of common costs, another one much less. From the point of view of BT there is no recovery, but as between the different CPs one is contributing much more than the other.

MR. PICKFORD: Indeed, and BT is allowed some flexibility. To be clear, we do not say that the DSAC test should not be applied; we are saying there are two elements to what is meant by appropriate. The DSAC test, that is Ofcom's test, picks up the concern, sir, that you have just articulated which is that to some extent some different CPs may face different prices. But DSAC allows still some flexibility in the way in which BT prices. It can still load some extra common costs on to particular services. So even DSAC does not eliminate the point that to some extent different CPs may face different relative contributions to common costs, but we say that is just one aspect of appropriateness.

THE CHAIRMAN: I understand that, but then in applying your second stage of an FAC, are you doing it in aggregate and therefore in a different way potentially as between different services within the market, because you are just looking at it in aggregate? So the adjustment, once you have met the ceiling of DSAC by reference to an aggregated FAC may be quite different, presumably at BT's option, as between different services?

MR. PICKFORD: Indeed.

THE CHAIRMAN: That can mean that you get a different impact on different CPs.

MR. PICKFORD: It can be, but it is always subject to – both constraints apply, so Ofcom's constraint applies.

THE CHAIRMAN: The second stage might bring certain prices down significantly.

MR. PICKFORD: It could bring further prices down. It is never going to allow other prices to go above the DSAC level.

THE CHAIRMAN: No, I see that.

MR. PICKFORD: But yes overall, and for reasons that I would like to develop, we say that what you cannot have is over-recovery altogether of your common costs.

THE CHAIRMAN: I understand that point. You could prevent that, of course, by applying an FAC to each service. But you say do not do that, and indeed that would be departing from what the Tribunal (you say correctly) held in 286(2) because then you get an inflexible price. So you say no, you are proposing something else, which is an aggregated FAC?

MR. PICKFORD: Yes.

THE CHAIRMAN: What I do not follow is how that then leads to what is an appropriate price in the individual case for the individual service, which is what the condition requires.

MR. PICKFORD: It allows BT some flexibility. It does not uniquely determine a particular price

cap on that service on its own without reference to the other services that are also included in the condition.

THE CHAIRMAN: Which that customer may not be purchasing?

MR. PICKFORD: Yes, and we accept that. But of course, it is an additional constraint, so the structure issue, the fact that one customer may be purchasing WES 10 but not WES 100, that structure issue is dealt with by DSAC. Our test comes along additionally and says: but there is also a level problem that if you allow DSAC for everything you are likely to get over-recovery of common costs. I will come on to develop that in a moment. And that is problematic.

MR HARRISON: Can I have a go? What you are saying is for, for example, like a BES 100 – I am going to make this absurd now – you could actually apply all the common costs to that one product and that would be fine as long as all the other prices reflected it, and the common costs therefore in aggregate were recovered. The condition that you were applying then was that that would not be allowed because the DSAC would stop that happening?

MR. PICKFORD: Exactly, because our test is additional to DSAC; it is not a replacement for it.

MR HARRISON: No, but that absurd example fits your analysis?

MR. PICKFORD: Exactly. That example would be prevented by the DSAC test. Our test is not trying to grapple with that problem; our test is trying to grapple with a different problem which is the fact that if you apply DSAC to everything, BT gets to over-recover its common costs altogether.

Leaving PPC there and returning to our case, we have just begun to develop the question of how one determines what is appropriate in the context of a recovery of common costs. My clients had squarely raised with Ofcom the fact that there was a problem with their DSAC test in that although they were happy for there to be some limits on individual prices, it was leading overall to BT recovering substantially more than its costs. The references for that are in our Notice of Appeal at paras.51 to 54. I am not going to take you to them now. We say Ofcom had to ask itself what therefore was an appropriate mark up for common costs, not merely taking account of the structure issue but also taking account of the fact that common costs should not be recovered more than once.

We say it can never be appropriate for a mark-up for common costs to lead to more than the recovery of common costs. That is the language of the condition: the mark up is for the recovery of common costs. To recover means to get something back. We say recovery of common costs means getting back what you have expended on common costs; it does not and cannot mean getting back what you never paid out for in the first place because that is

not recovery.

Moreover, we would add to that that it would make a nonsense of the provision if it did allow for more than recovery of common costs because Condition HH3.1 very carefully and precisely sets out three distinct elements for costing. They are forward looking long-run incremental costs, an appropriate mark-up for the recovery of common costs and appropriate return on capital employed. We say in relation to the middle element, you cannot suddenly let BT charge what it likes and not merely recover its common costs, but potentially recover those common costs multiple times - once, twice, as many times as it likes - because that makes a nonsense of the precision by which Ofcom has defined the other elements of the test, namely the forward looking long run incremental costs, and the appropriate return of capital employed. To read the three coherently together you can only recover your common costs.

Sir, we say just looking at the condition on its face, that is immediately supportive of our case, because Ofcom's case is that BT can recover multiple times, and condition HH3.1 was not concerned with that.

I would now like to go, please, to the 2004 LLMR statement, because it is highly important to see the background to the imposition of condition HH3.1 to understand properly how it is to be construed. It is in tab 12 of core bundle E. Could we start, please, para.7.10 on external p.10, where it says:

> "Regulation at the wholesale level is designed to address the problems which result from the existence of SMP in the relevant wholesale market. In particular it is designed to ensure that the SMP at the wholesale level does not restrict or distort competition in the relevant downstream markets …"

that is an important point there, "downstream markets" -

> "… or operate against the interests of consumers, for example through excessively high prices."

It goes on to discuss again that:

> "…the conditions imposed by Ofcom will promote competition in the provision of retail leased lines …"

Then 7.11:

> "The application of regulation at the wholesale level also fits with the requirements of the Framework Directive, that NRAs take measures which are proportionate to the objective of encouraging efficient investment in infrastructure and promoting innovation. The introduction of regulation in wholesale markets will encourage

communications providers to purchase wholesale products and combine them with their own networks where possible to create retail products in competition with BT's retail leased lines products and other services. This is preferable to retail regulation alone …"

7.12 explains how it is also consistent with another objective of the Framework Directive, namely to:

"… take measures which are proportionate to the objective of ensuring users "derive maximum benefit in terms of choice, price and quality". Regulation at the wholesale level will, as noted above, help to increase the number of retail products available, and by increasing competition …"

i.e. at the retail level -

"… will help to ensure that price and quality are optimised."

So here the aims of the obligation are all about promoting competition in downstream markets. Nowhere at all is Ofcom suggesting that it is about promoting competition in an upstream market. That is important for something I will come on to deal with later.

If one turns to p.17, this deals with the basis of charging obligations. If you start at 7.54:

"As BT has been identified as having SMP in this market, the availability of wholesale AISBO services at cost oriented prices would help to ensure that the resulting competition in the retail leased lines markets and other downstream markets should lead to lower prices.

It might be argued that the Competition Act should be used to avoid excessive or predatory pricing. However, Ofcom considers that sectoral tests are likely to be more stringent and more effective than the Competition Act, giving the SMP communications provider less latitude and providing greater certainty for access customers."

It then goes on at 7.59 to talk about the recovery of efficiently incurred costs. Then at 7.59 through to 7.60 Ofcom deals with the possibility of BT introducing new products and how it will deal with those not to stifle innovation, and effectively it says three things. It says at sub-para.(i) that the service may be so innovative that it falls outside the control altogether because it is in a different market, so that is fine.

Then, secondly, it might not be quite so innovative, but it might nonetheless be appropriate to adopt a different charging base, and of course one has to recall that condition HH3.1 says at the beginning "Unless Ofcom determines otherwise". So the possibility there is that they will say, "We are not going to apply the costs provisions in the rest of HH3.1".

Thirdly, they contemplate that it may allow a different return on capital employed than would otherwise be the case.

So what Ofcom is saying is that if there is something particularly risky about the new services then, as a third alternative, if they are still in the market and they are still going to apply condition HH3.1, they may nonetheless decide to flex the return on capital employed, but nowhere do they ever suggest that it might be appropriate to have multiple recovery of common costs.

We then come to paras.7.62 and 7.63. 7.63 is the essential paragraph relied upon by Ofcom to say, "We did not impose a charge control, therefore your case must be wrong". What is said here is:

> "Ofcom is of the view that it is not currently necessary to impose a price control on AISBO products. The AISBO market is in a relatively early stage of development and it is necessary to give time for the effects of the cost orientation obligation to impact on the competitiveness of the market before considering whether a price control is necessary. The need for a price control will be considered when the market is next reviewed."

When it is referring to the competitiveness of the market, I would suggest that they are referring there principally to the competitiveness of the downstream AISBO market, because that is what the rest of the aims of the regulation have all been about. In any event, even in so far as it talking about the wholesale AISBO market, it is talking about ensuring keen prices by BT, what they are not talking about is competitiveness in terms of new entrants to that market because there is no discussion anywhere in the aims of the regulation that it is about stimulating entry at the upstream level that compete with BT.

So what we say about these passages is that they show that the overriding aim of the obligation is to stimulate ----

THE CHAIRMAN: Just on that point, the AISBO market which is being considered here is that in which SMP found on BT's wholesale market, is it not?

MR. PICKFORD: There is also a retail AISBO market as well.

THE CHAIRMAN: But the SMP finding is for a wholesale market, is it not?

MR. PICKFORD: That is correct, yes.

THE CHAIRMAN: Are they not saying, "We are considering whether we should also put a price control on BT as well as cost orientation?"

MR. PICKFORD: Yes, they are.

THE CHAIRMAN: "But because the market which BT is in is at an early stage of development,

one aim of the SMP conditions is to increase competitiveness, we will wait and see how that market develops to see whether price control is necessary". It is the wholesale market that they are considering, is it not?

MR. PICKFORD: I would say it is not actually clear because there is reference to the AISBO products and the AISBO market is in a relatively early stage of development. Of course, there is a wholesale market and a retail market. We say it does not really matter which, because ultimately what it is certainly not saying ----

THE CHAIRMAN: They could not impose it on retail products without a finding of SMP.

MR. PICKFORD: They could not, but my point is that when they are talking about where they are going to impose the price control that does not necessarily map one to one on to when they say the AISBO market is in relatively early stages of development because both the retail and the wholesale AISBO markets are in early development. When it is talking about the competitiveness of the market, that can be talking about both parts of the AISBO market.

In any event, as I said, even if it is just talking about the wholesale market, what it is not saying is that they are trying to stimulate entry into that market. The whole point is that it is about constraining prices, BT's prices in that market.

PROFESSOR MAYER: But it does in 7.59 talk about encouraging innovation.

MR. PICKFORD: Yes.

PROFESSOR MAYER: I do not quite understand, if you are imposing an FAC cap, how do you allow the rate of return to exceed anything other than a normal return? Is it not the case that you are going to be essentially imposing a return?

MR. PICKFORD: It depends on how you define the FAC cap. If you say that FAC is the standard return that BT has allowed for other elements of its business, then you are effectively allowing a greater return than that. We say that what you can do in relation to FAC is flex the rate of return. You do not have to say it is FAC based on BT's normal rate of return, it can be FAC based on a higher return of return.

PROFESSOR MAYER: So you are saying that when you come to do the rate of return of analysis, you are not going to be concerned if the rate of return is above a normal return?

MR. PICKFORD: That is correct, if it can be justified. It is up to BT to come and say, "Here is our RFS, this is our normal rate of return, this is the normal FAC, but actually we can justify a higher return because of the particular riskiness, for example, for the investments that we are taking, or the need to stimulate investment in this particular market".

PROFESSOR MAYER: Then I am confused, because in a sense you are saying it is an

undetermined overall price cap, or undetermined overall recovery, because you are not then specifying what the allowed return is.

MR. PICKFORD: It has to be appropriate, because it has to be an appropriate return on capital employed. That is what the test is. We are not being prescriptive about what is necessarily appropriate. We say in the first instance it would be BT's normal WACC, but if BT can advance a convincing case that what is appropriate in a particular context is something higher, then we would permit that.

We also say that the purpose of this obligation is to allow BT to cover its costs but not recover more than its costs because if it recovers more than its costs it raises its competitors' costs. It does not actually raise its own costs because what it charges itself downstream it simply gets back upstream, and that will tend to undermine downstream competition which is precisely the thing that this obligation is supposed to be, we say, stimulating. Indeed, it is common ground amongst the experts that higher prices for WES and BES services as may arise under the Ofcom DSAC test, they reduce the promotion of downstream competition compared to Sky and TalkTalk's proposal. The references for that are at para.34 of our skeleton. I am not going to go to them now.

Moreover, when it comes to the objectives that Ofcom considers that it is pursuing in para.7.63 by imposing a cost orientation obligation where it is not necessary to impose charge control, what objectives are they? We say they are extremely similar to the objectives that it follows when it imposes a price control. We can see that if we go to para.6.130, which unfortunately has not made it into the core bundle. You will have to go to BT3.

THE CHAIRMAN: Sorry, what is the reference?

MR. PICKFORD: It is BT3 and it is para.6.130 on p.128. This is in the section, if one turns back, with the heading before 6.15 “Conclusions on the PPC price control”. It is the same statement, but this is where they did impose the price control. Then at 6.130, if you read 6.130 it is in virtually identical terms to the analysis of why a cost orientation condition was imposed on AISBO products contained at 7.67 and 7.68 of the part that we were referring to before.

THE CHAIRMAN: So we are comparing 6.130 which is the justification for price control, PPC, with 7.68?

MR. PICKFORD: That is correct, in particular with 7.68. I will ask the Tribunal to do a detailed textual comparison perhaps later, because obviously I am going to run out of time. But certainly my submission is that they are in very similar terms and the main difference

between them is what is referred to in 6.130 is that a price control encourages greater efficiency on the part of BT. That is not in dispute. It is common ground that price controls, by virtue of being *ex ante* regular, that set a defined limit that BT can then beat, have better incentives for productive efficiency than *ex post* imposition of a test after the event. That is a problem with the cost orientation obligation generally, that it only looks at things after the event rather than on an *ex ante* basis.

If one looks back at 6.107 (BT3) through to 6.109, in this section:

> "It might be argued that Ofcom's proposal for cost orientation in this market is sufficient and that it is therefore unnecessary to apply a price control in addition. [So we are again talking about PPC products] However, Ofcom does not consider that the obligations for cost orientation imposed on BT in the low bandwidth and high bandwidth TISBO markets provide sufficient constraint on PPC terminating segment charges and that it is necessary to apply a charge control. In the absence of charge controls, BT would have little incentive to reduce or constrain increases in its costs and hence in its PPC prices."

Then it goes on to explain the efficiency incentives given by a price control in 6.108. So the reason why Ofcom are adopting a charge control and not a cost orientation obligation in relation to PPC is because they want greater efficiency incentives to drive down prices. Otherwise they say there is no particular reason to drive down your prices if you can still recover them whatever they are, as you can under a cost orientation obligation.

Of course, the problem for a price control is it requires you to forecast out the efficient costs of the service approximately four years away from when you are talking about, because if you impose it for three years and there is about a year when you are actually doing the analysis you need to be able to guess or estimate what efficient costs are going to be in four years' time. That is a difficult exercise when a market is in its infancy, which may be one explanation of why no price control is imposed where it is a relatively new market, and a more flexible approach (as adopted in the cost orientation obligation) is what is adopted.

One also has to remember that the cost orientation obligations across each of the high bandwidth and low bandwidth TISBO markets, which are being referred to in para.6.107, whether on Ofcom's interpretation or ours, allow flexibility in terms of which products receive which allocation of common costs. What a price control specifically on PPCs does is it eliminates that flexibility. So a cost orientation obligation on either our approach or Ofcom's does still allow some flexibility in terms of how you balance prices, at least up to DSAC. A particular price control just on PPCs therefore is tighter also in that sense.

But what we say, having looked at these parts of the statement, is there is no suggestion anywhere that Ofcom wishes to allow BT the possibility of multiple recovery of common costs. Never suggested. Nowhere in the statement is there any suggestion that Ofcom wishes to impose a control which is less effective than the charge control in preventing BT from overcharging. Nowhere in the statement is there any suggestion that Ofcom is setting prices so as to incentivise upstream entry: high prices to incentivise entry. On the contrary, Ofcom is quite clear in the statement at Annex B (I do not have time to take you to it now but I will just give you the reference: B 418 to B 441) that it does not expect any significant upstream entry because of the structural barriers to entry in the wholesale market.

As regards stimulating innovation, I have already addressed that the way Ofcom deals with that is by saying: potentially if it is really innovative it falls outside the market; if it is moderately innovative we may disapply the strict cost provisions; or if it is still a bit less innovative than that, but there might be an argument, we will allow you potentially a higher cost of return on capital employed. That is how the condition is supposed to deal with innovation, not by allowing multiple recovery of common costs.

The final part of the 2004 statement that I would like to take you to is also in BT3. We say this confirms our analysis. It is chapter 10.

THE CHAIRMAN: Just a small point, the annex is in BT4, is it?

MR. PICKFORD: Sorry, it is in BT3 as well.

THE CHAIRMAN: It is also BT3?

MR. PICKFORD: It is also BT3. I am afraid I will have to allow the Tribunal to read that.

THE CHAIRMAN: No, you say B418?

MR. PICKFORD: The references at B418 to B441 p.393.

THE CHAIRMAN: Thank you.

MR. PICKFORD: The final part of the 2004 LLMR statement that I would like to take you to is chapter 10 on Cost Accounting and Accounting Separation Conditions. That is on p.251 BT3. Here we see at para.10.1 that the chapter:

> "… the financial reporting obligations that may be imposed on BT and Kingston, to ensure that a number of the obligations set out in Chapters 5 to 9 are met. In particular, obligations of cost orientation, price controls and non discrimination can require the imposition of financial reporting regimes to monitor dominant providers' compliance with these obligations."

At 10.6 it deals with cost accounting systems. It explains how the purpose of them is essentially to ensure compliance with the cost orientation obligations. It then goes on to

explain the obligations imposed in 10.7 both on BT and then in 10.8 on Kingston. Then in 10.10 it says:

> "Given the imposition of LRIC with an appropriate mark-up for the recovery of common costs on both BT and Kingston, and a charge control for BT, Ofcom is proposing that BT and Kingston should maintain appropriate cost accounting systems, that demonstrate that the obligations of cost orientation and (for BT) the charge control are being met. This will enable Ofcom to monitor compliance with those obligations."

It then sets out what the cost accounting obligations for BT will be and they include, at the third bullet, for the AISBO market. Similarly, it does the same thing at para.10.12 for Kingston. It then goes on to say:

> "In relation to the basis of charges, Ofcom has previously indicated elsewhere that CCA FAC can in certain cases be a good proxy for LRIC plus mark-ups. In terms of Kingston's charges, this matter will be considered further in the context of its financial reporting obligations."

I have relatively less time, as the clock ticks on, but those financial reporting obligations are what it is referring to at para.10.4 and 10.5 of the document: "The scope of *The regulatory financial reporting obligations on BT and Kingston*" which at that point was a consultation document.

I think for reasons of time I am not going to take you there, but they are to be found at BT10 tab 25. Essentially, what those obligations say is that BT has to comply fully with its financial reporting obligations, and it has to compile information on a LRIC basis. But Kingston, because it is small and the markets in which it operates are small, does not have to comply fully with LRIC accounting; it can simply provide CCA FAC accounting, and that CCA FAC accounting is sufficient for the purposes of demonstrating compliance with its cost orientation obligation. The references for that are in section 8 at 8.21, 8.22, 8.26 and 8.27. That is a consultation document.

The principles are then confirmed in the document at BT10 tab 26 para.3.22, but that confirmation actually came after this statement, because this statement is June 2004 and the confirmation then was July 2004.

Where that leaves us is that BT is required to demonstrate compliance with Condition HH3.1 on its terms, forward looking LRIC, mark up common costs, return on capital employed. Kingston, because of its small size, is given dispensation to report only on a FAC basis. Why? Because Ofcom says CCA FAC is a proxy for the test it has imposed,

namely LRIC plus an appropriate mark up for common costs and return on capital employed.

So having decided that BT should be held strictly to the reporting obligations but that Kingston can report so as to satisfy a test on the basis of CCA FAC, it would make no sense to then allow BT much greater leeway in terms of what it can satisfy by saying actually you can go way above that; you can satisfy DSAC when Kingston is being held to a CCA FAC test for LRIC plus EPMU.

THE CHAIRMAN: This is for the reporting obligation?

MR. PICKFORD: Yes, but the reporting obligation meshes, as you will see from the paragraphs that I referred you to, with the substantive test.

THE CHAIRMAN: They are used to support the substantive test. I do not know if we have any information for how the cost orientation obligation has been applied to Kingston and on what basis.

MR. PICKFORD: It may help, despite the short time, if we just simply then looked at para.8.27 of BT10 tab 25.

THE CHAIRMAN: We can look at it, Mr. Pickford, if you prefer in our own time.

MR. PICKFORD: What it says is that:

> " In considering the necessity of Kingston reporting on a LRIC basis, Ofcom assessed the relative impact of Kingston and BT in the UK communications sector. BT has an obligation to orient its costs on a LRIC+ basis in several markets where it has SMP. These markets are significant both in terms of revenues and the potential impact on competitors and indirectly end-users. Therefore, Ofcom considers that BT must report on a LRIC+ basis as it is the most apposite form of reporting. However, as the markets in which Kingston has SMP are less significant in comparison, and as Kingston is significantly smaller in scale and scope than BT, Ofcom considers that – as an exception – it is willing to accept Kingston reporting its cost orientation obligations on a Current Cost Accounting Fully Attributed Cost (CCA FAC) basis as a reasonable proxy. "

And, of course, as we saw in Chapter 10 at para. 10.12 it says that CCA FAC can in certain cases be a good proxy for LRIC+ mark-ups.

What we say there is Ofcom is explicitly drawing a relationship between CCA FAC and LRIC+ mark-ups and it is saying that notwithstanding that it is technically in terms of LRIC you, Kingston (in that report) you can get away with satisfying a CCA FAC test. We say it would be very odd and peculiar if, in that context BT, however, was allowed to price in a

way that entirely exceeded its FAC across the relevant services to which condition HH3.1 applies.

PROFESSOR MAYER: Could that not simply be because it is less concerned about innovation in the Kingston market than in BT?

MR. PICKFORD: It does not say that anywhere.

PROFESSOR MAYER: No, no, but you are saying it is inconsistent for it to suggest that FAC could be applied in Kingston but not BT.

MR. PICKFORD: It is inconsistent, and to meet your point, sir, about the innovation that is met by the considerations I have already dealt with in terms of how Ofcom deals with innovation, potentially exempting from the price controls. That is what it says on innovation and it is dealt with there.

THE CHAIRMAN: Though they regard it as a less appropriate form of reporting.

MR. PICKFORD: Yes.

THE CHAIRMAN: That is clear, is it not? Ofcom makes clear that it is a less appropriate form of reporting to do it on the basis of that.

MR. PICKFORD: Yes, and we accept that our test is a proxy. It is a proxy because, of course, the situation we are in is that the obligation was on BT in the first place to demonstrate compliance with the terms of condition HH3.1 and it did not do that. So we have to step in, or Ofcom has to step in and decide how to remedy that problem, and we have advanced our test as the best available proxy for a test which means that BT does not over recover its common costs. We do not say it is the only test that BT could ever have come up with. BT might have been able to find another way of demonstrating that it was not over recovering its common costs but it did not.

So that is my case on the construction of HH3.1. We say it is clear that double recovery, multiple recovery, over recovery of common costs is not what Ofcom was allowing when it imposed that condition.

As I said in opening, it is common ground that DSAC does not prevent BT from over recovery of common costs, and a reference for that is Mr. Myers' evidence at para. 127 - again, I am not going to take you to it now, but there is really no dispute that DSAC allows over recovery of costs.

Secondly, we know that that has the potential to be significant, and that is Dr. Houpis' evidence in 4th Houpis at 3.49 where he says that the additional revenues generated by DSAC above FAC could be in the region of £350 million, if all prices were set at DSAC instead of FAC.

The third point is that BT undoubtedly has the incentive so as to take advantage of flexibility and overcharge if it can because that was the very reason why we saw the price controls imposed in the first place. Mr. Robinson's evidence at para. 2.8 of his first amended report is that BT did over recover to the tune of £233.5 million more than its FAC in the present case.

So what is Ofcom's essential counter argument in relation to that over recovery? Ofcom says that the Houpis report fails to reliably establish that setting WES/WEES prices at DSAC would have given rise to over recovery of common costs. Its basis for saying that is an implicit suggestion that although BT recovered several hundred million pounds in excess of its FAC for Ethernet services, it is perhaps possible that this was offset by pricing substantially below FAC for other products which share significant common costs with those Ethernet services.

We say there were two problems with that submission. The first is that it is up to Ofcom or, of course, BT, if it is going to allow significant over recovery to the tune of several hundred million pounds on one group of products to demonstrate that there is, in fact, an offsetting under recovery elsewhere, and neither BT nor Ofcom have attempted to do that in this case.

The second point is that, insofar as there was evidence on the issue of what is happening in the other relevant markets we know that there is yet further over recovery. TalkTalk provided evidence to Ofcom during the administrative process that in relation to other products that were subject to a cost orientation obligation, other than the ones that they were complaining about in their dispute, BT was over recovering by around £450 million over the relevant period. The reference for that - again, I am not going to go to it - is para. 3.72 to 3.76 of TalkTalk's response of 20th April 2012 and that is at ST1 vol.3 tab 12.

£95 million of that £450 million was, in fact, over recovery on other AISBO services but Mr. Robinson also takes that into account in his calculation of over recovery, so we have to deduct that to avoid double counting. But, even if we deduct that, there is still around £600 million of over recovery on cost oriented services, and no one has demonstrated any under recovery elsewhere.

Moreover, there is a further point in relation to under recovery. There are only two other places where we could look for it. The first is products that are supplied in competitive markets, but not only is there no evidence that those products were priced at below FAC, Ofcom itself considered that it would be inappropriate to allow higher prices in the Ethernet market to be offset at below cost pricing in a competitive market, and we see that, I cannot take you to it now, but for your reference it is in the statement at para.9.114.3.

The only other place that you can look, apart from competitive products is products that have been sold subject to charge controls which are typically based on FAC, so it seems unlikely, given they were typically based on FAC, that there will be massive under recovery below FAC but, in any event, again Ofcom itself considered it would be inappropriate to allow offsetting above cost pricing where prices are subject to a cost orientation condition with below cost pricing in another market where there was a charge control, because that would upset the incentives in relation to the charge control, and that is at 9.114.2. That is also consistent with what the Tribunal said in the PPC case at para. 227.

Where that leaves us is that the only evidence before this Tribunal is that there was over recovery of common costs across all relevant markets in the region of £600 million, and no one has attempted to demonstrate otherwise. We say, therefore, where that leaves us is that Ofcom's test of DSAC, which permitted multiple recovery of common costs, was inadequate. There was overwhelming evidence of very, very large scale over recovery. That was put before Ofcom by my clients, it was one of the reasons for bringing their dispute. The condition HH3.1 is intended to prevent such over recovery of common costs, and therefore Ofcom's adoption of that test was unlawful in this case. That is the first point I make under Ground 1. There are three other points which in relation to Ground 1, which I can go over very shortly.

The second one is that, even if we are wrong about our construction of HH3.1 and that it was not intended to prevent multiple recovery of common costs and, suppose, in fact, that multiple recovery is compatible with it - so that is contrary to our first case - we say even if that is true Ofcom has still erred, because Ofcom took the view that it was compelled to allow over recovery of common costs because it said it had already struck a deliberate balance in the 2004 statement which effectively not only permitted but welcomed that over recovery. One sees that most starkly at para. 428 of its defence where it says that Ofcom decided in the 2004 LLMR statement that action in relation to Ethernet services to prevent over recovery across a group of services was not needed.

THE CHAIRMAN: What is the reference?

MR. PICKFORD: That is 428 of its defence. We say for the reasons that I have just developed that even if we are wrong in our primary case certainly you cannot read the 2004 LLMR statement to support Ofcom's view that it had already deliberately decided to allow over recovery of common costs, there is nothing there to support that submission.

Our third point on Ground 1, again in the alternative to the first two, is that Ofcom, in support of their approach, first in the statement and then in the defence, make a number of

essentially overlapping points which boil down to the following propositions. First, they say that we have misunderstood PPC. For the reasons I have explained to you we say our approach is entirely consistent with PPC and I am not going to go over that again.

They also say that they rejected a charge control in the 2004 LLMR statement and that therefore our approach is contrary to regulatory certainty. Again, I have taken you to the 2004 statement. We say just because they rejected a charge control does not demonstrate that they rejected our approach and I said that I would make good that submission and explain the differences between charge control and our cost orientation obligation.

They also say that a looser form of control was appropriate because higher charges might stimulate upstream entry. Again, I have taken you to the 2004 statement, and there is nothing there to suggest that that was the purpose of the charge control. They also make some points about efficiency, which I will deal with under my fourth point on Ground 1.

So, very briefly, on the test proposed by Sky and TalkTalk we say that our test is not equivalent to the imposition of a charge control for the following reasons: a charge control imposes a strict, unyielding, pre-determined limit on BT's prices based on forward looking estimates of its likely future efficient costs. That is not our test. First, under condition HH3.1, as construed by us and by Ofcom, it is BT that in the first instance gets to select its own methodology for the purpose of satisfying Ofcom that it has allocated its common costs appropriately. Ofcom only then has to step in if BT has failed, as it has in this case, to do that job.

The second point is that even in those cases where BT has been found to be in breach and it falls upon Ofcom to select a methodology, there is no hard edged and inflexible test for compliance under condition HH3.1, including on our approach. Our approach, as I have said, allows potentially above costs pricing in one market to be offset by below cost pricing in another if BT can demonstrate the evidence, but it has not done. Also, as I have explained, it allows a higher return on capital employed, again if that can be justified by BT. Again it was not in this case and Ofcom did not attempt to do that either.

The third difference is that the imposition of our test does not require BT's efficient costs to be estimated in advance, as would a price control. The comparison of prices and costs in our test relies, as does Ofcom's, on how to turn costs. That is obviously an advantage, as I have explained, in new markets where it is very difficult to estimate what those efficient costs might be four years out from the time when you are imposing the control.

So the only parallel that Ofcom has provided is that our test involved the use of FAC as does a charge control. We say it is a non-sequitur to say that simply because of that

commonality, because it rejected a charge control, therefore it rejected our test.

The fact that charge controls tend also to be based on FAC proves nothing more than that preventing over-recovery of costs is important when Ofcom imposes charge controls. It does not prove the opposite, but it is not important when Ofcom implements an alternative cost orientation obligation which may be self-administered by BT in the manner that we have just described. We say Ofcom's simply assumes what it seeks to prove.

Indeed, Ofcom itself ----

THE CHAIRMAN: When you say "alternative obligation", they are not necessarily alternatives, of course, because, as we know, they can both be imposed.

MR. PICKFORD: They can, that is true. When they are both imposed what is an appropriate recovery of common costs in terms that the level is then dictated by the price control. So the price control effectively steps in and fills out that aspect of condition HH3.1 or its equivalent.

THE CHAIRMAN: Condition HH3.1 - does that mean, and I think you allude to this in your skeleton, that the cost orientation obligation, if there is a charge control - when there is a charge control - does not have to limit recovery of common costs by the superimposition of a FAC averaged test?

MR. PICKFORD: Sorry, the cost?

THE CHAIRMAN: A cost orientation obligation of the kind we have here, if there is also a charge control, in those circumstances the cost orientation does not have to be subject to an FAC test?

MR. PICKFORD: That is correct, because in that case it is the same wording but what is appropriate as to level has been taken away, the discretion in relation to that has been taken away from BT because it has to comply in any event with a charge control. You then have to consider what residual discretion there is for BT that the cost orientation mops up, and effectively it mops up the structure point that we considered which is what Ofcom deals with when it imposes the DSAC test.

THE CHAIRMAN: That is the point you make, is it, at para.65 of your skeleton?

MR. PICKFORD: It may well be. I have not got para.65 open at the moment. (After a pause) Yes, it is. The way we put it there is how it applies is context dependent. I think it is important to make clear that we are not saying that it means anything different in either case. It is simply that the charge control effectively fills the space that is otherwise not filled in terms of preventing over-recovering of common costs. So it deals with that second aspect of what is appropriate in relation to the recovery of common costs.

THE CHAIRMAN: That still applies as regards the cost orientation obligation. You say it "fills the space".

MR. PICKFORD: The end result is the same. In both cases what you need to have is to ensure that ----

THE CHAIRMAN: I understand the end result will be, I see that. What I am concerned with is, does that mean that the meaning of the cost orientation obligation achieves a separate self-standing obligation changes?

MR. PICKFORD: No. We say that in all cases BT is required to demonstrate that there is an appropriate mark up for the recovery of common costs, but when that obligation is imposed simultaneously with the charge control, as regards the level of recovery the charge control is already dictating what an appropriate level of recovery of common costs is. So it effectively removes BT's discretion in that regard. The only thing that the cost orientation obligation then has left to do in that context is as regards the structure of prices. Indeed, Ofcom itself has recognised, it says in its costs orientation review at para.3.72 - this is BT32, tab 2:

"… there may be circumstances where the underlying objectives for the two types of remedy (i.e. a charge control and cost orientation) are similar – i.e. constraining prices as close as possible to a particular measure of cost such as FAC."

That is entirely consistent with that proposition. We say there is no support for the suggestion by Ofcom that cost orientation is somehow a soft option. I referred in my skeleton to recital 20 of the Access Directive, that an obligation that prices are cost orientated to provide full justification for those prices where competition is not sufficiently strong to prevent excessive pricing is at the "much heavier" end of the regulatory spectrum, and we say so it is. It is a tough obligation, just as a price control is a tough obligation.

As regards the alleged inconsistency of our approach to the 2004 Statement, I do not think I need to go over that again, we have effectively dealt with the 2004 Statement already, we also pointed out that our case is consistent with subsequent disputes by Ofcom, particularly the Energis dispute. That is addressed at 64.3 of my skeleton, and I am not going to address that again now.

There is also annex 14 of another dispute decision by Ofcom, which is contained at ST1- 6 tab 25, where Ofcom accepts, in common with acceptance in the June 2013 Statement, that it may be appropriate to interpret a cost orientation obligation consistently with the way that one would apply a price control. So again, entirely contrary to the case that Ofcom is advancing, that the two always necessarily mean different things. That if it chose not to impose a price control, therefore it must have chosen in relation to the cost orientation

obligation to do something very different.

Finally, in relation to the fourth point on Ground 1, we say our approach is consistent with economic efficiency and indeed superior in that respect. I am not going to develop that now because that will obviously be the subject of cross-examination and those, therefore, are points that it will be more appropriate to make in closing.

I have nearly reached my limit. I wonder if I might crave the indulgence of the Tribunal to make a few short remarks on the RAV adjustment, because we have entered into quite an involved debate over some points, and I can leave interest to be developed by Ms. Rose.

THE CHAIRMAN: We will go to 4.45 and you can have minutes. We started at 2.05, but you must not trespass on Ms. Rose's time, which is, after all, for your advantage as well because it is a ground of your appeal.

MR. PICKFORD: Indeed, I am very grateful. On the RAV adjustment, can we pick up the Statement which is in CBB, and go, please, to para.13.119. We begin with the heading, "Adjustments to ensure that revenues are compared against appropriate costs". Then the various adjustments are considered in the sub-paragraphs of 13.119, transmission equipment costs, 21CN costs and also further down the RAV adjustment. If we go to the first of those, the transmission equipment costs (just over the page), in terms of the analysis of that issue if one turns to para.13.135 we see that:

> "In 2006/07 to 2009/10 BT allocated transmission equipment costs to connections and in 2010/11 it changed its allocation policy so that transmission equipment costs were allocated to rentals."

If they have not have not got any problem with that the accounting treatment needs to catch up with the change in allocation policy. So they then make an adjustment. The adjustments go back to 2006/2007. There is no suggestion here that Ofcom had a new policy in 2006/07 about making such adjustments, but it decides that it is appropriate to make it to ensure that the costs in the RFS properly reflect BT's true costs. So that is an example of one adjustment that it makes.

Similarly, in relation to 21CN costs, over the page at 270, that Ofcom made a change going back to 2006. Again, there is no suggestion in any of this section that there is any policy that Ofcom had on 21CN costs then, but it goes on to explain in its analysis why it thinks it is appropriate to make an adjustment, nonetheless, to 21CN costs because, as it explains, during the relevant period costs associated with 21CN were allocated in the RFS to Ethernet, but was not delivered using BT's 21CN network, so again it makes an adjustment. Notwithstanding no particular policy in that, it is the right thing objectively to do.

Then we get to RAV, which is at 13.225, their analysis of it.

THE CHAIRMAN: When you say "no policy", are they not applying the framework for adjustments which they have set out earlier?

MR. PICKFORD: They are applying their general approach, which is ----

THE CHAIRMAN: "Policy" can mean lots of thing.

MR. PICKFORD: They had no specific policy in relation to making adjustments for 21CN costs or making adjustments for transmission equipment costs. Those are issues that arise in this dispute, and they say, "In order to make sure that costs properly reflect BT's actual costs, we are going to make these adjustments". They did not have a policy in particular in relation to transmission equipment costs.

THE CHAIRMAN: They have an overall policy which is their framework as to whether to make any adjustments.

MR. PICKFORD: They had an overall policy, that is correct.

THE CHAIRMAN: They are applying that in these particular cases?

MR. PICKFORD: That is correct, yes, in accordance with that. Yes, I do not dispute that at all.

So then we get to that and at 13.225 we then have Ofcom's analysis.

> "BT's RFS was prepared on a CCA basis, and do not include the RAV adjustment".

Then they say:

> "In line with the framework set out in Section 11 [that is what we have just referred to], in deciding whether or not to make the RAV adjustment for the purposes of assessing cost orientation, we need to consider whether BT's approach to calculating its DSACs in its accounts included an error or used an obviously inappropriate methodology".

Then they go on to conduct that analysis, and they base entirely, over the next paragraphs, from 13.226 to 13.232, on analysis of what BT subjectively could have understood as its policy in relation to making RAV adjustments. Nowhere in any of this section do they ask themselves what we say is the logically prior question, as they did for 21CN costs and as they did for transmission equipment costs, is it appropriate or is it not obviously inappropriate to make an adjustment for the RAV in order to bring BT's RFS into line with its actual costs? Their whole analysis is concerned with BT's subjective understanding of whether it was likely that they would require that. We say that is an error because they do not ask themselves the primary prior question as to whether objectively, by not making that adjustment, you are failing to represent BT's true costs.

The second error is that insofar as BT expectations about whether a RAV adjustment might

or might not be made are relevant, we say that they enter the picture effectively as an exception to whether it is objectively appropriate to make a change. So Ofcom might have said, "Well, there is a mismatch between BT's RFS and its actual costs if we do not make a RAV adjustment, but we are going to overlook that because we think that BT will have understood that we have never made adjustments so it would be unfair to make it now". But the thing is nowhere do they explain that BT could have had any expectation about making the RAV adjustment, or not making the RAV adjustment, between 2005 and 2009 because it did not have a policy on it until 2009. 2009 was the first time that they confronted it in relation to AISBO. In 2005 they had confronted the issue of a RAV adjustment in relation to copper access and, in particular, in relation to the use of ducts, and they made it in that context and so we say at the very least BT could have been alert to the possibility of there being a RAV adjustment but there was no policy on making a RAV adjustment in relation to AISBO until 2009. So there is no justification for not making it, even taking account of BT's expectations in the 2005 to 2009 period.

The third point, the final point on that, is this, that even if BT could not reasonably have expected a RAV adjustment to be made, and it would be unfair to hold BT in breach on the basis of making a RAV adjustment, of course Ofcom held BT in breach anyway because BT abjectly failed to demonstrate compliance with HH3.1. At that stage we say, when one turns to remedy, Ofcom needed to ask itself what price it should set on a retrospective basis in order to remove the effect of BT's charges having exceeded its costs. We say at that point, in relation to that question, Ofcom did need to ask itself objectively what are BT's actual costs in relation to the products in question. If a RAV adjustment is needed in order to correct an RFS because the RFS does not appropriately reflect BT's true costs, then it should have been made at that stage.

THE CHAIRMAN: So do you then quarrel with the framework that Ofcom would apply, which is not the test that you have just set out, not what are BT's actual costs but whether BT's methodology and the RFS was obviously inappropriate at the time it was issued?

MR. PICKFORD: We say in asking whether it was obviously inappropriate, what Ofcom actually does when it looks at other things, such as 21CN costs, is to determine what BT's actual costs were. That is what it is doing. "It is obviously inappropriate not to make this adjustment because if we do not make this adjustment then we are not reflecting BT's true costs". We say it is equally obviously inappropriate not to make a RAV adjustment for the same reason, that you are not reflecting BT's true costs.

THE CHAIRMAN: So any method that does not reflect true cost is obviously inappropriate? Is

that what you are saying?

MR. PICKFORD: If it is material and if it leads, as Ofcom explains in other contexts, to the overstatement of BT's costs then yes.

THE CHAIRMAN: That is not the normal meaning of "obviously inappropriate", is it?

MR. PICKFORD: We say that it is obviously inappropriate to allow an approach to BT's costs which does not reflect BT's true costs, insofar as it is a substantial and material consideration. Obviously it has to be material.

THE CHAIRMAN: Yes.

MR. PICKFORD: Particularly in the case where the issue that is under consideration is not a special pleading by BT. It is not BT saying, "We compiled our RFS on this basis but now we would like to play around with them". It is only that Ofcom itself was alerted to that BT compiled its RFS on a basis which did not include a RAV adjustment when it believes objectively, because it now has made clear in other statements, including in cost control that it subsequently has imposed, that a RAV adjustment should be made. So that is all I want to say on RAV adjustment.

On interest I am going to say about one minute, which is simply this. The essential point why we ask for interest is that if one does not award interest on the over-recovery by BT in breach of Condition HH3.1, one gives BT an incentive to breach its condition because you do not take account of the time value of money. Ofcom has chosen to advance no defence justifying its original decision and we say that speaks volumes. Moreover, in the *Gamma* dispute it now explains what the appropriate analysis is in relation to interest and it fully endorses the points we make on our appeal and that is the primary one, that if you do not allow interest to be included in the calculation of the overcharge then you give BT an incentive to breach a condition and that is contrary to the entire purpose of the regime.

If I could hand over to Ms. Rose in relation to the rest of that submission.

THE CHAIRMAN: Thank you.

MS. ROSE: Sir, before I deal with the interest point I would just like to pick up a point that was raised this morning which was in relation to the basis of BT's appeal to the Court of Appeal in the *PPC* case and, in particular, what BT's position was in relation to historic disputes and Ofcom's jurisdiction to resolve historic disputes on that appeal. We have obtained some copies of BT's skeleton argument for the Court of Appeal in that case, if I can just have them handed up. I would suggest that the best thing to do with this document is to file it at the back of the skeleton arguments bundle, which is one of the core bundles. Sir, this is BT's skeleton argument produced for the purposes of its appeal in the *PPC* case. If you go

first to para.41, p.14 at the bottom, you will see that BT refers to the fact that on 11th June 2010, as a preliminary issue, the CAT dismissed BT's arguments that Ofcom did not have legal power to deal with historic disputes under the dispute resolution procedure.

THE CHAIRMAN: I am so sorry, I did not ----

MS. ROSE: I am sorry, para.41, p.14 in the bottom right-hand corner.

THE CHAIRMAN: Yes, I misheard you. I am sorry. Yes.

MS. ROSE: They refer there to the preliminary issue decision of CAT dismissing BT's argument that Ofcom did not have legal power to deal with historic disputes. We can see at footnote 29 that they say: "For the purposes of this appeal the term 'historic dispute' is defined at paragraph 57 below". We then come to their first ground of appeal at p.16. Ground of appeal 1 "Jurisdiction/discretion in using the dispute resolution procedure". Ground 1A: "Ofcom erred in using the dispute resolution procedure to resolve the disputes in this case because it had no jurisdiction to do so and the CAT erred in finding to the contrary". You will then see at footnote 34 that they say, "This ground of appeal relates to the preliminary issues judgment and in part the main judgment because it was the preliminary issues judgment that dealt with jurisdiction and the main judgment that dealt with discretion". Then there are two sub-points that are identified. The first is the requirement that disputes be resolved in four months, as you can see at (a), and the footnote there acknowledges that this is a new point that has not previously been argued. Then if you move on in this document to p.19 you will see the heading: "B. Historic disputes". "BT asserts that the disputes in this case were historic disputes. A dispute is a historic dispute to the extent that it concerns a period of time prior to the date on which a clear disagreement has arisen between the parties and both parties know that such a dispute has arisen. No difficulty in ascertaining when a clear disagreement arose here". Then it sets out the dates. Then at 58: "It is implicit in the overall context and objectives pursued by the CRF and the various mechanisms for resolving disputes that historic disputes that are likely to take longer than four months to resolve fall outside the dispute resolution procedure".

What you can see there is that there was a fudging by BT of the two issues, whether historic disputes *per se* fell outside the jurisdiction of Ofcom or whether they fell outside the jurisdiction of Ofcom because it was said they were inherently more likely to be complex and to take more than four months to resolve. If you read the rest of para.58 you will see that that is the point that is being made. That was the basis on which BT pursued its appeal on Ground 1, that it was said that it was because disputes of this type were inherently likely to be more complex and take longer than four months to resolve that there was no

jurisdiction to do so. The argument that was abandoned by BT in that case was the argument that *per se* historic disputes were outside the jurisdiction of Ofcom.

You will have seen that in our skeleton argument we make the submission that given the history of the *PPC* appeal, the judgment of the CAT on the preliminary issue, and then the history of BT's appeal against that judgment and its abandonment of the *per se* historic disputes point, it would be an abuse of process for BT to be permitted to resurrect that argument.

So can I now turn to the appeal of Cable & Wireless, Virgin and Verizon which concerns only the refusal by Ofcom in its decision to make an award of interest on the repayment that BT has been ordered to make. I would like to go first to Ofcom's decision on the question of interest, which is at core bundle B starting at p.423. On p.423, just underneath the table, you see the heading in red "Interest on repayments". First of all, Ofcom recalls the provisional conclusions that were in its provisional decision. At 15.74:

> "The Disputing CPs requested that an appropriate level of interest be paid on any repayment. However, clause 12.3 of each of the contracts relevant to the services in dispute excludes interest on any repayments due to either party as a result of recalculation or adjustment of a charge with retrospective effect…"

An alternative 12.3 is set out.

> "In the Provisional Conclusions, Ofcom proposed to direct that interest should be paid on the repayments in accordance with the contractual provisions entered into by the Parties. We noted that this was consistent with our previous determinations. In this case, the relevant contractual provisions provide that interest will not be payable."

So Ofcom's position at the stage of the provisional determination, which was before the decision of the Court of Appeal in the O8O case, was effectively that the provisions of clause 12.3 were determinative of the question whether interest should be payable.

What then happened was that there were responses to the provisional conclusions. You can see in particular that there is reference to the responses made by Cable & Wireless if you go to p.426 para.15.89:

> "CWW also argues that if Ofcom '*simply let the contractual situation dictate whether interest is payable and did not carry out a proper assessment of what is fair as between the parties, and reasonable from the point of view of Ofcom's regulatory objectives*', it '*would be failing in its Section 3 duties*'. CWW also argues that '*following the relevant contractual term in any given dispute without*

> *consideration of what is fair and reasonable will lead to inconsistency of outcomes'* which would be '*contrary to the principles under which Ofcom's regulatory activity should be consistent'*."

You see over the page similar argument by Verizon at 15.91 and 15.92. Then at 15.95 there is the reference to the O8O judgment in the Court of Appeal. Then at 15.97 the contention that 12.3 should have very little, if any, weight attached to it and that the proper test is a proper assessment of what is fair and reasonable in the circumstances. Then at 15.98:

> "PPC Court of Appeal Judgment '*confirmed that "'it is not consistent with the regulatory regime and the objectives of the CRF to leave BT with the benefit of its excessive charging'"* '*absolutely leaves BT with the benefit of its excessive charging*'."

So it is clear that the argument that was being made after the production of the provisional decision by Ofcom by my clients was the contract is not the proper focus of this inquiry. This is a regulatory decision by Ofcom in which Ofcom is fulfilling its statutory duties in accordance with the Communications Act and the CRF, and the question for Ofcom is whether it is fair and reasonable for interest to be awarded on the repayment, having regard to the attainment of the statutory objectives, and the provision in the contract carries little, if any, weight in that regard. That was the argument being put forward.

There was also argument as to whether BT had effectively imposed the term on them. We see that at 15.101. The point was made that BT have SMP and that the position for the CPs was that effectively they had to accept the clause 12.3, there was no time to negotiate it. Then there was consideration of BT's incentives. You see that at 15.118. The argument that was developed by all of the disputing CPs was that if interest was not awarded there would be an incentive on BT to overcharge.

Then we come to Ofcom's decision in the light of those submissions that were made to it. It is worth looking at the reasoning of Ofcom on this. In its entirety it consists of only five paragraphs which start at p.435 para.15.139. At 15.140 Ofcom says:

> "In their responses to our Provisional Conclusions that BT's charges were not cost orientated and that BT should repay by way of adjustment of the overcharge a significant amount, the Disputing CPs provided extensive argument as to why Ofcom should set clause 12.3 aside as not fair and reasonable. They allege that the clause was imposed on them by BT in exercise of its significant market power; they state and have provided some evidence that they raised concerns about the clause with BT when the relevant contracts were originally negotiated and

subsequently on contract review. BT disputes their accounts. The Disputing CPs also argue that clause 12.3 permits BT to retain a benefit from overcharging and therefore acts as an incentive on BT to overcharge, in breach of its cost orientation obligations."

We submit that you can see there the first error that Ofcom is making because the submission that was being made was not: you should set aside 12.3 or 12.3 is not fair and reasonable as between the parties; the submission that was being made is: you, Ofcom as the regulator determining this dispute, should not be focused on the terms of the contract between the parties; you should be focused on what is the fair and reasonable resolution of the dispute, having regard to your statutory duties and objectives. That is the first flaw.

Then at 15.142 --

THE CHAIRMAN: I thought they did advance argument that it is not a fair and reasonable term?

MS ROSE: That was not the argument that was advanced by my clients. It may have been something that was said by Sky.

THE CHAIRMAN: Maybe they are --

MS ROSE: The paragraphs which I have shown to you, which summarise the submissions of my clients, what we were saying – we looked at it just a minute ago at 15.97.

THE CHAIRMAN: I see that. When you say an error, if the error is they should have said Sky/TalkTalk and not the disputing CPs, which is the collective term for everyone --

MS ROSE: It is more fundamental than that because Ofcom simply does not address the key question, which is whether or not the award of interest is necessary to have a fair and reasonable resolution of Ofcom's statutory objectives.

THE CHAIRMAN: That is a different point. I thought you were criticising that sentence saying it is not right to say there was an argument that Ofcom should set clause 12.3 aside as unfair and unreasonable. In the passage you asked us to look at briefly on the way there, they say exactly that.

MS ROSE: Sir, the problem is that Ofcom has approached this decision only through the lens of 12.3. What you are going to see from these paragraphs is that the only question Ofcom is asking itself is: should we set aside 12.3? Has there been evidence put forward that would justify or warrant setting aside 12.3? That was, we say simply the wrong question. We had in fact addressed the correct question but Ofcom never formulates it or seeks to deal with it in its analysis.

The reason I said that you see the error in this paragraph is that Ofcom identifies the sole question as being whether or not 12.3 should be set aside, and that in fact was not a

submission that was being made by my clients at all; we were saying that simply was not the right approach.

If you then go to 15.142 they say:

> "The question of whether clause 12.3 is fair and reasonable is not clearly within scope. In any event, Ofcom considers that interest is an ancillary issue in these Disputes to the primary issue of whether BT's charges were cost orientated. In order to determine whether clause 12.3 is not fair and reasonable we would need, critically, to understand why the Disputing CPs agreed to the inclusion of the clause. BT argues that it made concessions elsewhere. We would need to understand why this provision was agreed in the relevant contracts in the context of the contractual negotiations as a whole. We note in this context that the Disputing CPs did not bring a dispute or complaint to us in relation to this clause previously, even though it has been in place for some years during which the contract has been reviewed. We also note that BT's SIA and PPC Handover Agreement provide for interest at the Oftel rate on repayments due where a charge has retrospective effect."

We say that that passage, which is really the core of Ofcom's reasoning here, simply misses the point. The central issue for Ofcom in relation to interest was not: do the negotiations which led to the inclusion of 12.3 in the contract suggest that there was an inequality of bargaining power such that the clause should be set aside? The question for Ofcom was: in the resolution of this dispute is it fair and reasonable and is it a proportionate method of attaining our statutory objectives to award interest, regardless of what is in clause 12.3?

Then Ofcom say at 15.143:

> "The scope of these Disputes was to determine whether, during the Relevant Period, BT has overcharged for the services in dispute and to direct an adjustment to reflect any overcharge. We have determined that there was an overcharge and directed full repayment. Our decision on repayments was made in the light of our statutory duties and in particular with a view to incentivising BT to comply with its SMP obligations. We consider that we do not have sufficient evidence to decide whether we should also award interest, which would involve setting aside the contractual provision, in order to meet our regulatory objectives."

We say there is a serious confusion there because the question whether interest should be awarded depends centrally on first, whether the award of interest is necessary in order properly to adjust the overcharge – in other words, to remove from BT the full extent of the

benefit which it gained from overcharging which included not only the money which it received which it should not have received but also the time for which it held that money and was in a position to invest it rather than having to borrow, but secondly, whether the need to incentivise BT not to overcharge could be fully met without requiring BT to pay interest because of course if BT is permitted, following an overcharge, simply to repay the principal but not to pay interest, there is an obvious commercial incentive on BT to overcharge because even if it has to pay back the excess money (and that in itself is uncertain, because it depends on whether or not the dispute is called and is upheld) but even if a dispute is called and is upheld, BT still ends up with a benefit, effectively the benefit of free money for a period of time. That, we say, was the proper question which Ofcom should have been addressing in this section on interest which it never addressed, still less resolved. Instead, it became fixated on the question of whether it ought to set aside 12.3.

THE CHAIRMAN: They refer to it at the end of 15.140 simply as the argument but the subsequent paragraphs do not address it.

MS ROSE: They do not grapple with it, no. They do not address it, still less do they reach a conclusion as to whether or not they can fully remove the benefit from BT without it, and whether or not there remains an incentive on BT to overcharge without interest.

Then at 15.144:

> "In conclusion, we consider that the Disputing CPs have not provided strong and compelling evidence that clause 12.3 is not fair and reasonable such that we should intervene in the light of our regulatory objectives to set it aside."

You can see there again why I made the submission I did about the terms of 15.140. That, we say, is simply an inadequate reflection on the argument that was being made by my clients.

So we say it is clear from Ofcom's decision that that decision was seriously flawed. Ofcom did not address the arguments that had been put to it, and it did not address the correct questions that it ought to have addressed. What is significant is that when you look at Ofcom's defence there has been no attempt by Ofcom to justify the stance that it took in this decision. The defence is at core bundle A tab 4.

THE CHAIRMAN: Yes, I think we have seen that. They have taken the approach which I think the Court of Appeal said they can take, saying we will leave it to the disputing parties.

MS ROSE: It is a little more subtle than that, if we just look at what they say at para.551. This is the only paragraph that addresses my clients' appeal. You can see that it refers back to para.545. So if you go back to 545 Ofcom says:

"Ofcom notes that none of the Disputing CPs has identified any good reason why the Tribunal should admit this fresh evidence. [That is talking about the evidence that was submitted with the Notice of Appeal related to the negotiations for clause 12.3.]Nevertheless, Ofcom accepts that it would be appropriate for the Tribunal to have regard to it in considering whether interest should be awarded on any repayment it determines should have been ordered, given the potentially critical significance of this evidence both to Sky / TalkTalk's appeal, as well as to CWW, Virgin and Verizon, as Ofcom had pointed out in the Determinations."

Then they say they anticipate BT will wish to file evidence in response. Then they say:

"In these circumstances, recognising that ultimately it is now a matter for the Tribunal as to whether interest should be awarded, Ofcom does not propose to offer any view at this stage as to whether the facts now identified by Sky and TalkTalk and CWW, Virgin and Verizon provide a sufficient and appropriate basis on which to set aside clause 12.3 and award interest at anything other than the contractual rate, that is, 0%."

Then they say they do not consider it necessary to respond in detail to the individual arguments. So that is what they say in relation to Sky's appeal. If you then go back to 551 they say the same in relation to my clients' appeal. They say:

"… it is appropriate for the Tribunal to take that evidence into account in determining whether interest should be awarded on any repayment. Accordingly, Ofcom does not propose to respond at this stage to CWW, Virgin and Verizon's individual grounds …"

So you will note that Ofcom are not saying there: we are leaving this matter to BT and the disputing CPs, what Ofcom are saying is: because new evidence has been submitted of the negotiations that led up to the inclusion of 12.3 and that might be critical, for that reason we leave it to Tribunal.

The oddity of that stance is that the issue of the nature of the negotiations is very much only one of the challenges made by the disputing CPs to the failure to award interest on this appeal. Our primary complaint is that Ofcom failed to address the right legal test when it declined to award interest. You can see that if you just turn up our Notice of Appeal tab 3 in this same bundle. Our grounds of appeal are summarised at para.6. You will see that the first is that Ofcom erred in law and/or in the exercise of its discretion in failing to award interest. That is developed starting at para.49. You will see that at paras.49 down to 55 we develop the point that I have made to the Tribunal, which is that the task for Ofcom was the

task identified in the *TRD* case, requiring Ofcom to:

> "… determine what are reasonable terms and conditions as between the parties. The word 'reasonable' in this context means two things. First it requires a fair balance to be struck between the interests of the parties to the connectivity agreement. It therefore requires the same kind of adjudication that any arbitrator appointed by the parties to determine a dispute about the reasonable rate would carry out. But secondly, because OFCOM is a regulator bound by its statutory duties and the Community requirements it also means reasonable for the purposes of ensuring that those objectives and requirements are achieved.."

Then the Court of Appeal in the 080 case (I do not intend to read it out, but the crucial passage is set out at para.54). We say that was the right approach which Ofcom failed to apply. Of come has not responded at all to that complaint.

THE CHAIRMAN: I thought they have effectively accepted that that is the right approach.

MS ROSE: Yes, they have. That was my next point.

THE CHAIRMAN: It is at the end of their skeleton.

MS ROSE: Yes. They do not go so far as effectively to accept it; they are silent.

THE CHAIRMAN: I thought they say (looking at para.206 of their skeleton) on the final page:

> "In every case the issue under s.192(b) is how best to achieve the objectives of the Act and the CRF and if an award of interest is required in order best to achieve those objectives then Ofcom clearly has the power to make such an award, irrespective of its ability, otherwise the contractual."

That is your point, is it not?

MS ROSE: That is my point, sir. There is no difference between Ofcom and I as to what is the correct approach, but they do not make an express concession that our appeal should be allowed on the basis they erred in law.

We submit that it must follow from the paragraphs that we have just looked at in the Decision that Ofcom in fact do not dispute that they did approach the question of interest in the wrong way. In that situation the right course is for this Tribunal to consider for itself, on the basis of all the evidence, whether or not interest should be awarded, and if so, at a later hearing, what is the appropriate rate?

Ofcom's acceptance that it got it wrong in this decision is now explicit in the Decision that it produced on Friday in resolving the Gamma dispute. Since this is a brand new document --

THE CHAIRMAN: We know nothing about it.

MS ROSE: I am sure you know nothing about it, and it is terribly exciting. If you will just give me a few moments, we do need to take a little look at the Gamma dispute because it is of central importance now to the interest appeal. I hope you have an additional documents bundle, additional documents 2. It is a slim volume.

THE CHAIRMAN: I fear we have two additional documents bundles.

MS ROSE: So far – I am sure there will be more additional documents bundles before we finish. If you go to tab 16 in this bundle you will see a brand new fresh decision of Ofcom, warm from the presses, that came out on Friday in a dispute between Gamma and BT relating to the Ofttel interest rate in the SIA.

The position is that the standard interconnect agreement does provide for the payment of interest by BT if it is found to have overcharged, but it provides for the payment of interest at a very low interest rate. A dispute was referred by Gamma saying that that interest rate was not fair or reasonable. That was the question that Ofcom was considering.

May I just give you the key passages in this.

THE CHAIRMAN: Just to help us, this was not where an overcharge has actually been found, is it? It is relating to the terms of the agreement?

MS ROSE: It is the question of the terms of the agreement. If you go to the summary at 1.2 p.3:

> **"The dispute relates to the interest rate set out in the SIA, intended to apply, amongst other things, to any repayments required between parties as a result of a direction by Ofcom."

Then at 1.7 we have the scope of the dispute:

> **"The basis on which interest is or should be payable by the parties where Ofcom has directed one or other of them to make a repayment to the other as a consequence of a recalculation or redetermination of charges payable under BT's SIA, if appropriate, the level of interest which shall be payable in those circumstances."

So that was the issue.

Then the provisional conclusions are summarised at 1.8. I do not intend to go through those but draw them to your attention. The final conclusions and the Determination are summarised starting at 1.10. You can see at 1.12 that they determine that the relevant paragraphs are not fair and reasonable, that they do not consider it appropriate to exercise their discretion to amend the provisions; it is up to the parties to decide whether to amend or delete, but they then say:

**"We nevertheless consider that it is important that we provide both the parties and other CPs which are parties to the SIA with sufficient clarity as to the rights and obligations which should apply in this context. We therefore set out guidance in Annex 2 based on our conclusion in this determination which we would intend to follow when deciding whether interest should be payable and if so at what rate, in the context of a dispute determination relating to charges payable under the SIA."

So the key point is BT are not required to amend the SIA so the term may remain in the contract, but regardless of the fact that the term is in the contract, Ofcom is giving guidance as to the approach it will follow when deciding whether or not to award interest.

If you then go on in the guidance, if you look in the provisional conclusions at p.15, at the bottom of the page there is a section headed "Ofcom's jurisdiction to require interest to be paid in the context of resolving a dispute". These provisional conclusions are then adopted by Ofcom in its final conclusions, as we will see in a moment, and they constitute a summary of Ofcom's position as to the basis on which it has jurisdiction to award interest. We respectfully agree with and adopt this analysis. There is not time to take you through it paragraph by paragraph, but we say this is the correct analysis on jurisdiction.

Then Ofcom's statutory duties and regulatory principles are summarised at 3.10 and then their application to the facts of the dispute were considered. You will see that Ofcom, in its provisional determination, identified three objectives. The first of those at p.18 was avoiding communications providers having an incentive to set charges that are unduly high. The second was avoiding communications providers having an incentive to delay submitting disputes. The third at p.25 was avoiding distorting communications providers' incentives to invest. Each of those incentives was then analysed by Ofcom.

We come to Ofcom's final conclusions at s.4 p.46 para.4.3. You can see that Ofcom adopts its provisional conclusions on jurisdiction and at 4.7 it rejects BT's submission that it has no power to award interest. Then they come on to the application of the relevant legal and regulatory principles to the facts of this dispute, and at p.52 they say:

**"For the reasons set out at paras.3.57 to 3.61 of the provisional conclusions, we remain of the view that when exercising our powers under s.192(d) to make a direction requiring repayment of an overcharge following a dispute, objective one is the most important of the three potential objectives."

So that is the objective of avoiding there being an incentive on a communications provider to overcharge. Then they say:

> **"Therefore, we consider it is likely to be appropriate to award interest in the majority of cases in which a direction for repayment is considered appropriate. In the absence of evidence to the contrary, the appropriate interest rate should reflect the time value of the principal to the overcharging firm, i.e. the benefit the overcharging firm enjoys by virtue of the delay between its overcharging and the date on which it makes repayment."

So that is the conclusion on the actual dispute. Then Ofcom sets out its general guidance at Annex 2 at p.67. At para.1 they say:

> "When exercising our powers Ofcom will decide whether interest should be payable and, if so, at rate, taking account of all relevant considerations with a view to setting an amount of principle plus interest which would best meet our statutory duties and regulatory objectives. In particular, with a main objective of avoiding CPs having incentives to set unduly high charges".

We agree that that is the correct approach and it is plain that that is not the approach that Ofcom applied in this case. They then say at A2.3:

> "It is likely to be appropriate to award interest in the majority of cases to avoid the incentive to set charges that are unduly high".

Then the starting point is "the interest rate should generally reflect the time value of the principle". Then "Approach to the applicable contractual interest rate":

> "Where an applicable contractual interest rate is in place we shall have regard to the extent to which that rate would meet our regulatory objectives, in particular having regard to the need to foster commercial certainty and a stable and predictable regulatory environment".

Then they say they will consider whether the contractual evidence is what the parties have agreed will represent a fair and reasonable proxy for the benefit to the overcharging firm. Then at 2.7:

> "Where we have grounds to consider the contractual rate would not meet our statutory duties and regulatory objectives we may decide it is not appropriate to apply the contractual rate and we will need to consider what rate to apply to ensure that our statutory duties and regulatory objectives are met".

So that is a summary of the guidance that Ofcom sets out in the *Gamma* case. We submit that that is the approach that we were advocating for during the resolution of this dispute and is not the approach that Ofcom adopted in this dispute but it is the correct approach and it is the approach that we submit that this Tribunal should now take to the question of

interest.

Can I then turn very briefly to the question of the significance of the contract? Clause 12.3, that clause is at core bundle E, Tab 17. It is at p.11 of the manuscript pagination. Clause 12 starts right at the bottom on p.10 with the heading "Charges and deposits", and then at 12.1:

> "The Communications Provider agrees to pay all charges for the Service as shown in the Carrier Price List … and calculated using the details recorded by BT".

Then 12.2:

> "The Communications Provider agrees to pay the charges within 30 calendar days of the date of BT's invoice. BT may charge daily interest on late payments in accordance with the Late Payments of Commercial Debts (Interest) Act 1998 for the period beginning of the date on which payment is due and ending on the date the payment is actually made".

Then 12.3:

> "If a refund is due to the Communications Provider by BT, unless that overpayment results from information provided by the Communications Provider which is not attributable to information provided by BT, the Communications Provider may charge daily interest on late repayments in accordance with the Late Payments of Commercial Debts (Interest) Act for the period beginning on the date on which the parties agreed BT shall make the repayment and ending on the date BT actually makes payment".

So just pausing there, you can see that there is a reciprocation between 12.2 and the first sentence of 12.3. Essentially if each party is late in making a payment that is due to the other, interest is payable under the Late Payment of Commercial Debts Act. For an example of a situation where a refund would be due to a CP, if you go back to Clause 2.8 in this contract you will see that:

> "BT agrees to repay or credit the Communications Provider with the appropriate proportion of any rental paid in advance other than from any part of the minimum period are termination charges are payable under this contract".

So there is an example of a situation in which the first sentence of 12.3 would apply. Then the second sentence of 12.3:

> "If any charge is recalculated or adjusted with retrospective effect under an order, direction, determination or requirement of Ofcom, or any other regulatory authority or body of competent jurisdiction, the parties agree that interest will not be payable on any amount due to either party as a result of that recalculation or

adjustment".

There are a number of points to stress. We set out four reasons why this clause should carry minimal weight in our skeleton argument, which is in Tab 3 of the skeleton arguments bundle, at para.32-43. I do not have time to go to them now but I simply draw those to your attention. There are two points that I want to stress. The first is that the whole rationale for the regulation of BT in this market is that BT has significant market power, in other words it has dominance to such an extent that it is in a position to set prices that are excessive. The fact of BT's dominance means that contractual negotiations between BT and other communications providers do not take place on an equal footing. BT holds the pen and holds the cards, because if BT insists on the insertion of a particular clause in the agreement ultimately, if the communications providers do not agree to that clause, they will not get access to the service over which BT holds the monopoly. If they are going to be active at all in the AISBO market they have to agree to the terms that BT is offering. Their only recourse, if they are not prepared to agree to BT's terms, is recourse to Ofcom through the resolution of a dispute. In that situation we submit that it defeats the purpose of statutory regulation to say that when Ofcom is seeking to determine that dispute Ofcom will consider itself to be governed by the terms of the contract, because otherwise there would be no point in having a reference to the regulator. That is the whole purpose of the scheme.

THE CHAIRMAN: But you could have under the scheme have referred this clause at the time of the contract, as did *Gamma*.

MS. ROSE: They did not refer it at the time of the contract. They referred it ----

THE CHAIRMAN: They referred it before.

MS. ROSE: Of course, and we could refer it now, but there is no need for us to do that because the whole purpose -- and I do not have time to develop the legal framework here -- but you will see under the CRF and under the 2003 Act, that the essential function of the National Regulatory Authority is to impose a solution on the parties to the dispute; in other words, overriding their contractual rights is integral to the whole question of dispute resolution. It is about the imposition of a solution where either there is a deadlock or where the contract does not promote competition but restricts and distorts competition.

There is another point which is that in any event there was not any requirement to refer 12.3 because the interest payment that we are saying Ofcom should have made is not inconsistent with and does not override 12.3. What the second sentence of 12.3 says is that where Ofcom recalculates a payment with retrospective effect the parties agree interest will not be payable on any amount due as a result of that recalculation. In other words, if Ofcom says,

"We recalculate the payment as being X", contractual interest is not payable on that amount. But our argument is that when recalculating the payment Ofcom should have included an element for the time value of money in that repayment. So we are not seeking contractual interest on top of the payment as recalculated by Ofcom. What we are saying is that the recalculation itself should include an element for the time value of money, as Ofcom itself now accepts is generally the rule in its *Gamma* determination. So we say that for that reason as well there is no inconsistency between the remedy that we were seeking and 12.3. The real resistance to our appeal, of course, comes not from Ofcom at all but from BT in their statement of intervention. The first point that they make is they say that BT have no power to award interest. I do not have time to develop that now. We submit that the answer to it is that that is given in our skeleton argument and that is also summarised by Ofcom in the *Gamma* decision, that there is clear jurisdiction to award interest under s.190 of the Communications Act and that that reflects the powers that Ofcom has under Article 20 of the Framework Directive, Article 13 and Article 8. So we say that looking at the provisions of the CRF and of the 2003 Act, there is a clear power to award interest. Indeed, we say that it would be inconsistent with the obligations on the UK under the CRF for Ofcom not to have the power to award interest because if Ofcom could not award interest it would not be in a position fully to achieve its objectives under Article 8 of the Framework Directive to ensure that there is no distortion or restriction of competition. So that is the first point. The second argument in relation to the exercise of discretion is that BT say Ofcom's decision was right first because Ofcom was right to give significant weight to Clause 12.3, and you have my response to that.

THE CHAIRMAN: Can I just clarify, do you say you make your point on construction of Clause 12.3.

MS. ROSE: Yes.

THE CHAIRMAN: If you are right on that it just does not apply?

MS. ROSE: Yes.

THE CHAIRMAN: If you are wrong on that, do you say it is irrelevant, completely irrelevant? I appreciate your criticism that you made of the decision, saying that was the sole focus and that was wrong, but taking that point on board, do you say it is completely irrelevant or it is just a factor to be given some weight but perhaps little weight?

MS. ROSE: If you construed 12.3 as being a clause which purported to be an agreement between the parties that they would not invite Ofcom to recalculate the charge in such a way as to include the time element of money, you would have to construe it as meaning that there was

an agreement not to ask Ofcom to do that. If you construed it in that way then you would have to ask the question whether the application of that clause in this case was a proportionate way of Ofcom meeting its statutory objectives. We say that Ofcom's approach in the *Gamma* case is an appropriate approach, that you start with the statutory objectives and you might say, well, if the parties have agreed a contractual interest rate between them that is a reasonable proxy of what they think is the time value of money. That obviously cannot be the case here because it is zero, which is obviously not a reasonable proxy for the time value of money. So on the facts of this case we say it would be very difficult to see how the existence of 12.3, even construed in such a way that it was overridden by this decision, could be a significant factor. We say that that is even before you get onto the question of the circumstances in which it came to be included in the agreement. We rely on that as well but we say, regardless of that question, it is of minimal (if any) significance on the facts of this case. It might be very different if you had a clause in which the parties had agreed mutually the interest rate that should be payable on retrospective payments by Ofcom at what was a reasonable level. You might well say in that situation, "We are not going to second guess that. We are not going to seek to fine tune it", but that is obviously not this case.

So then, on the exercise of discretion, BT says first of all Ofcom was right to give significant weight to 12.3, and you have my submission on that. Secondly, they say there are no other considerations that warrant overriding 12.3. I just want to look very quickly, before I sit down, at the way that BT approaches this. This is in their statement of intervention at tab 5 of core bundle A. You can see their approach at para.187. Here they are addressing the expert report of Dr. Houpis in relation to incentives, and they say:

> " … neither point, when properly analysed, provides anywhere near enough a compelling a reason for Ofcom to have ignored contractual certainty …"

We say that indicates to you the wrong approach that BT are applying here. That is wholly the wrong approach in law.

Then they deal with the incentives on BT to overcharge at 189. They say that:

> "BT has already been ordered to pay a substantial principal sum (…). That in itself provides a large incentive against overcharging … "

We say that that misses the point. If a party overcharges, of course they are taking the risk that ----

THE CHAIRMAN: You have addressed that in your skeleton.

MS. ROSE: Yes, I have addressed that point. The second point is that they say there would then

be an incentive on the communications providers to delay bringing disputes (that is at 192), and we say that that is a wholly fanciful proposition. There is no evidence that any communications provider has ever sought to delay disputes, and in the real commercial world it is absurd to suggest that they would do so on the off-chance that they would be able to obtain a windfall at some indefinite future date rather than not having to pay too much for their services now. We address that in our skeleton argument at paras.24 to 31.

THE CHAIRMAN: Yes, we have seen that.

MS. ROSE: Those are the reasons why we submit our appeal should be allowed.

MR. READ: Sir, this is the first time you have seen the *Gamma* decision. Could I just ask you, when the Tribunal has a chance, to read the remedies section, which is at paras.4.77 to 4.88, so that the context of the dispute is put into the proper context.

THE CHAIRMAN: 4.77 to 4.88. Thank you. We will do that.

We start at ten o'clock tomorrow, and I think you have been told that we would like to start at 9.30 on Friday so that we can be sure to finish at 4.30. Ten o'clock tomorrow. Thank you.

(Adjourned until 10.00 am on Wednesday, 30th October 2013)