Neutral citation [2008] CAT 10

IN THE COMPETITION APPEAL TRIBUNAL

1083/3/3/07
1085/3/3/07

Victoria House
Bloomsbury Place
London WC1A 2EB

20 May 2008

Before:

VIVIEN ROSE
(Chairman)
PROFESSOR ANDREW BAIN OBE
ADAM SCOTT TD

Sitting as a Tribunal in England and Wales

BETWEEN:

HUTCHISON 3G UK LIMITED
BRITISH TELECOMMUNICATIONS PLC

Appellants

-v-

OFFICE OF COMMUNICATIONS

Respondent

supported by

O2 (UK) LIMITED

T-MOBILE (UK) LIMITED

VODAFONE LIMITED

ORANGE PERSONAL COMMUNICATIONS SERVICES LIMITED

Interveners

Heard at Victoria House on 21 April 2008

RULING ON ADMISSIBILITY OF HUTCHISON 3G UK'S PLEADINGS

APPEARANCES

Mr Brian Kennelly (instructed by Baker & McKenzie) appeared on behalf of Hutchison 3G (UK) Limited.

Mr Josh Holmes and Mr Ben Lask (instructed by the Office of Communications) appeared for the Respondent.

Miss Sarah Lee (instructed by BT Legal) appeared on behalf of British Telecommunications plc.

Miss Kelyn Bacon (instructed by SJ Berwin) appeared on behalf of O2 (UK) Limited.

Miss Marie Demetriou (instructed by Field Fisher Waterhouse) appeared on behalf of Orange Personal Communications Services Limited.

Mr Meredith Pickford (instructed by Miss Robyn Durie, Regulatory Counsel, T-Mobile) appeared on behalf of T-Mobile (UK) Limited.

Miss Elizabeth McKnight (Partner, of Herbert Smith) appeared on behalf of Vodafone Limited.

Mr Tom Sharpe and Mr David Caplan appeared on behalf of the Competition Commission.

I. INTRODUCTION

1. On 21 April 2008 the Tribunal held a Case Management Conference concerning challenges made by the parties in these appeals to pleadings and evidence served by Hutchison 3G UK ("H3G"). H3G is the appellant in its own appeal brought against the decision of the Respondent ("OFCOM") of 27 March 2007 ("the 2007 Statement") which set a price control for mobile call termination charges set by mobile network operators ("MNOs") including H3G. H3G is also an intervener in the appeal brought by British Telecommunications plc ("BT") against the 2007 Statement. OFCOM and some of the other interveners in both appeals submitted to the Tribunal that large parts of H3G's pleadings both in its own appeal and at its Statement of Intervention in the BT appeal are inadmissible. We will consider separately the challenges to the pleadings in the different appeals. In this ruling we set out the background to the appeals only so far as relevant to the issues discussed at the CMC.

2. The 2007 Statement concerns the prices that mobile network operators charge for mobile call termination ("MCT"). MCT is the process of connecting a voice call from the caller's network to the recipient's network. Consumers expect to be able to make calls from their fixed line or mobile phone to any other retail customer irrespective of the service provider (fixed or mobile) to which the receiving party subscribes. Network operators enter into contractual arrangements with each other for the provision of access to each other's networks. Under those arrangements the terminating network operator makes a charge for each call terminated on its network, known as a mobile call termination charge. The charge for mobile call termination is expressed in pence per minute or "ppm". Usually the mobile network operators set different prices for terminating day-time, evening and weekend minutes. There are tens of billions of minutes terminated on the networks of the MNOs each year so that changes of a fraction of a penny in the rates make a difference of many millions of pounds in the income and expenditure of these companies.

3. These appeals are the first to be brought in the Tribunal using the procedure set out in sections 193 to 195 of the Communications Act 2003 ("the 2003 Act"). Broadly speaking, that procedure requires the Tribunal to identify whether an appeal raises any "specified price control matters" as defined. If it does, then those matters are to be referred by the Tribunal to the Competition Commission for its determination. Matters raised by the appeal which are not price control matters are to be decided by the Tribunal. Once the Competition Commission has notified the Tribunal of its determination of the price control matters referred to it, the Tribunal must decide the whole of the appeal on the merits and, in relation to the price control matters, must decide those matters in accordance with the determination of the Competition Commission, unless the Tribunal decides, applying the principles applicable on an application for judicial review, that the Competition Commission's determination would fall to be set aside on such an application.

4. H3G's appeal against the 2007 Statement raises both non price control matters and specified price control matters. The BT appeal raises only specified price control matters. In the non price control matters raised in its appeal, H3G argues that OFCOM should not have set a price control at all for H3G either because H3G does not have significant market power (in which case OFCOM has no power to set a price control) or because OFCOM's approach to, and reasoning in, deciding to set a price control failed properly to take account of its statutory duties. The specified price control matters in H3G's appeal, therefore, only arise for decision if it is unsuccessful in relation to the non price control matters in its appeal. However, the Tribunal ordered at an early stage of the appeal that the reference of the price control matters to the Competition Commission should not be postponed pending judgment in the non price control matters. This was a course urged upon the Tribunal by H3G because H3G regarded it as urgent so far as its future business is concerned, to have a resolution of these issues as quickly as possible.

5. The hearing of the non price control matters raised by H3G's appeal took place before the Tribunal in January and February 2008. By a ruling dated 18 March 2008 the Tribunal referred the specified price control matters raised in H3G's appeal and BT's appeal to the Competition Commission. That ruling asked the Competition Commission to answer eight questions: see [2008] CAT 5.

II. THE H3G APPEAL

6. H3G's Notice of Appeal lodged on 23 May 2007 dealt separately with the price control and the non price control matters. The main body of the Notice set out the totality of the relief sought by H3G but then focused on the grounds of appeal in relation to the non-price control matters. In an Appendix to the Notice of Appeal H3G set out its pleaded case in relation to the specified price control matters ("the Price Control Appendix" or "PCA"). Attached to that Price Control Appendix was a paper called "Ofcom's LRIC Model, Economic Depreciation, Long run average cost pricing and perfect contestability".

7. In November 2007 H3G made an application to amend its Notice of Appeal and adduce further evidence, primarily in relation to non price control matters. That application succeeded in part and was dismissed in part: see [2007] CAT 33. References in this ruling to H3G's Notice of Appeal and Price Control Appendix are references to those pleadings as amended pursuant to that ruling.

8. It was also accepted at an early stage of these proceedings that once the price control matters had been referred to the Competition Commission in accordance with section 193 of the 2003 Act, the appellants in the two appeals would have an opportunity to supplement their cases by submission of a fuller version of their pleading and any additional evidence on which they wanted to rely before the Competition Commission. By an order dated 25 February 2008 the Tribunal therefore gave BT and H3G permission to file further supplementary material including statements, submissions or evidence in support of their existing notices of appeal. A deadline of 7 March 2008 was set. At the case management conference at which that timetable was discussed, the Tribunal said the following:

> "The supplemental material should not be raising any new issues. We have made it very clear, even in relation to outline pleadings that the fact that they may, or may not, have been in outline does not mean that new issues can be raised in the elaboration of those, or in the supplemental evidence. So, there should not be that much which will come as a surprise, and if there is something that comes as a surprise, no doubt [the Interveners] will draw that to our attention and ask us to deal with it."

9. H3G served its pleading pursuant to the Tribunal's order on 7 March 2008. The material served was:

(a) a document called a "Supplemental Submission" to which were attached a number of further documents comprising-

(b) "Appendix 1 – Legal Basis of NPZ". "NPZ" stands for "net payment zero" and refers to the remedy for which H3G contends in its appeal. The different meanings which H3G asserts this term bears are explained further below;

(c) "Schedule of Evidence". This provided a concordance between the evidence that H3G had lodged with the Tribunal in relation to non price control matters and the issues that the Competition Commission now had to consider in relation to the price control matters; the Tribunal having indicated that the parties were not required to re-serve such evidence for this purpose;

(d) 13 Annexes including:

i. witness statements from Kevin Russell (the Chief Executive Officer of H3G), David Dyson (the Chief Financial Officer of H3G) and James Westby (Head of Interconnect at H3G);

ii. An expert report prepared by Oxera Consulting Ltd;

iii. a LRIC calculation prepared by H3G, together with an explanatory document;

iv. a welfare model prepared by H3G showing gains from moving to NPZ; and

v. various academic papers, published reports and earlier submissions from H3G to OFCOM.

We refer to the bundle of material served on 7 March 2008 as "the Supplementary Material" and to the document described at (a) as the "Supplemental Submission".

Later in March H3G sought permission to adduce further material out of time. This material is discussed in paragraphs [113] to [116], below.

10. OFCOM and the Interveners in the H3G appeal (other than BT) have challenged the admissibility of much of this material on the grounds that it goes beyond what H3G had pleaded in the Notice of Appeal and Price Control Appendix. H3G argues that all the material falls within the scope of their original pleaded case and that the objections raised are unfounded. In the alternative, H3G has applied in effect for permission to treat the supplementary material as amending its original Notice of Appeal and Price Control Appendix, in so far as such permission is regarded as necessary by the Tribunal. We refer to the interveners who have joined with OFCOM in disputing the admissibility of the material as the "2G/3G MNOs". BT adopted a different stance: BT considered that the Supplementary Material did not go beyond the current Notice of Appeal read together with the Price Control Appendix. BT also considered that the questions referred to the Competition Commission were in sufficiently broad terms to encompass H3G's proposal as to the appropriate remedy which has now been more clearly articulated in the Supplementary Material submitted by H3G.

11. We should make clear at the outset that the arguments raised by OFCOM and the 2G/3G MNOs seeking to preclude H3G from, as they see it, raising new issues in this appeal have nothing to do with the merits or otherwise of H3G's case on those issues. No one has argued that H3G should be prohibited from raising these points because the points are frivolous or irrelevant or are bound to be rejected by the Competition Commission. Accordingly, nothing in this ruling should be taken as any indication of the views of the Tribunal on the merits of the points that H3G raises. The Tribunal has not needed to form any such views in order to decide the applications heard at the CMC. The only matters which the Tribunal has to consider are first, whether the points raised are, as H3G contends, within the scope of its original pleadings and, if not, whether it is appropriate for H3G to be granted permission to raise them. As regards the application in the alternative to amend, it is certainly the case that the Tribunal must have regard to the public interest as well as to the interest of the parties in determining that question. But the public interest in having the point investigated by the Competition Commission is, again,

to be assessed independently of any view about the merits of the point given, as we have said, that no one has argued that the points are bound to fail.

III. THE NOTICE OF APPEAL AND PRICE CONTROL APPENDIX IN THE H3G APPEAL

12. In support of its primary contention that all the points raised in the Supplementary Material fall within the scope of the Notice of Appeal and Price Control Appendix, H3G subjected the latter two documents to close textual analysis. In refuting this contention, the 2G/3G MNOs have done the same. It is necessary therefore to describe the original pleadings and the Supplemental Submission in some detail.

13. So far as the main body of the Notice of Appeal is concerned, the only passage which is relevant to this ruling is paragraph 3.2 where H3G sets out the relief it is seeking as that the Competition Commission should determine:

> "(a) the level of mobile-to-mobile MCT rates so that the MCT rate paid and received by H3G to and from other MNOs equals zero pence per minute or otherwise leads to a neutral net revenue position; or
>
> (b) in the alternative, the level of mobile-to-mobile MCT rates received by H3G and an appropriate glide path for the same that takes account of actual market circumstances including the availability or otherwise of effective MNP [i.e. mobile number portability]; and/or
>
> (c) the level of fixed-to-mobile MCT rates so that-
>
> (i) the level of the MCT rate paid by fixed operators to all UK MNOs is based on long-run average cost, with separate controls for 2G and 3G call termination; and/or
>
> (ii) the level of the MCT rate for 2G call termination paid by fixed operators is at a rate based on long-run average cost, reduced so as to reflect the lower risk that attaches to the investment in 2G networks; and
>
> (iii) the level of the MCT rate for 3G call termination paid by fixed operators is at a rate based on long-run average cost (combined with an appropriate glide path which takes account of actual market circumstances), increased so as to reflect the higher risk that attaches to the investment in 3G networks and the fact that H3G as a later entrant needs to recover efficiently incurred CARS costs."

14. The Price Control Appendix comprises 12 sections. The first section headed "Introduction" contains paragraph 1.2 on which H3G places heavy reliance:

"As explained below, H3G considers that a more appropriate package of remedies would:

(a) eliminate or mitigate the distortionary effect on competition by producing a result that is or is at least equivalent to a "net payment zero" outcome between the MNOs. That is, no actual wholesale payments would be made by H3G to the 2G/3G MNOs or vice versa. This would eliminate an artificial cost floor on competition in the mobile sector at the retail level.

(b) reduce the average MCT rates payable regarding fixed-to-mobile calls through applying an appropriate methodology for assessing costs."

15. Section 4 is headed "Alternative Approach to Remedy". H3G submits that there is "an alternative approach to a price control remedy regarding mobile-to-mobile calls" which is to set call termination rates so as to ensure that payments made by H3G to the 2G/3G MNOs are wholly off-set by payments it receives for call termination on its network. In other words, the Competition Commission is urged to adopt a "net wholesale payments zero" approach or "NPZ". H3G sets out the arguments in favour of this, as we discuss further below.

16. Section 5 sets out H3G's challenge to the path of cost recovery incorporated into the OFCOM cost model. H3G objects to the fact that OFCOM's model, based on the Economic Depreciation (ED) approach to calculating charges, gives rise to a unit charge which does not change with the annual utilisation of the network. In the early years of a network, when utilisation is low, that charge is less than would be obtained using a LRAC approach to calculating charges, in which unit costs fall as network utilisation increases. H3G complains that the ED approach favours the 2G/3G MNOs, whose 2G utilisation is relatively high, in comparison with H3G, whose 3G utilisation is still relatively low.

17. Section 6 comprises a single paragraph which indicates that as an alternative to the NPZ approach, H3G argues that OFCOM's estimate of the appropriate cost benchmark for call termination on H3G's 3G network is too low not only because of the inappropriate path of cost recovery adopted (as pleaded in section 5) but for reasons set out in subsequent sections. In other words, H3G argues that if the Competition Commission rejects the NPZ remedy, then H3G's alternative case is that the OFCOM cost model used to set the price control is inappropriate for the reasons set out in the other sections of the Price Control Appendix.

18. Sections 7 to 10 concern errors which H3G allege affect the MCT rate set for H3G. The upshot of these errors is that the MCT rate set for H3G is too low. Section 7 alleges errors in relation to the glide path set by OFCOM, that is the stages in the reductions in price which H3G has to implement between the start of the price control in 1 April 2007 until it achieves the ultimate target average charge in 2011. Section 8 argues that the price control set for H3G should be adjusted to make an allowance for H3G's "CARS" costs, that is Customer Acquisition, Retention and Service. H3G estimates that the appropriate additional amount that should be included in the MCT rate to take account of CARS costs is in the order of 5.0 ppm. Section 9 alleges that the price control set fails to take account of a distortion which arises because of how MCT rates are applied in a case where the recipient subscriber has ported their number, that is has moved to a new network and taken their phone number with them.

19. Section 10 criticises the OFCOM for lack of reasoning as regards the choices it makes of the charges it includes in the different scenarios used. H3G alleges that the 2007 Statement lacks transparency and sufficient reasoning and indicates that OFCOM did not take proper account of the risks involved in setting either the glide path or the end point.

20. Sections 11 and 12 turn to considering the rates set for the 2G/3G MNOs rather than for H3G. Section 11 argues that the TAC imposed on the 2G/3G MNOs is "far too high" and "should have been significantly lower". There are a number of reasons given for this. The first is the error in the path of cost recovery methodology already described in section 5. Secondly H3G alleges that OFCOM erred in its assumptions about the market shares that the MNOs were likely to achieve by 2016/2017, its estimate of H3G's likely market share being too high and the market shares of the MNOs consequently being too low. This results in an overstated MCT rate for the 2G/3G MNOs. Thirdly, the target average charge set for the 2G/3G MNOs fails to take account of the lower risk attaching to the forecasts around the 2G investments compared to the 3G investments.

21. Finally in section 12, H3G argues that setting a blended 2G/3G rate for the other MNOs was inappropriate because it created a disincentive for the 2G/3G MNOs to migrate their call traffic from 2G to 3G networks.

IV. H3G'S CASE ON NPZ

22. The main complaint that OFCOM and the 2G/3G MNOs level at the Supplementary Material is that it represents a fundamental change to H3G's primary case in favour of the NPZ remedy in the form referred to in the Price Control Appendix.

23. In the Introduction section of the Supplemental Submission H3G reiterates the importance it attaches to the central issue of its appeal, namely that the appropriate price control is the NPZ approach. It then refers to the annexed witness statement of Mr Russell as explaining "why H3G is advocating NPZ as the most appropriate remedy to address the existing market distortions in the mobile sector, including both mobile-to-mobile ("M2M") and fixed-to-mobile ("F2M") issues." This would require, H3G goes on to state, M2M ppm rates being set "at or (pragmatically) close to zero" and F2M MCT rates "being an order of magnitude lower than at present". The figure put forward by H3G for both M2M and F2M rates is "less than 0.4 ppm". This figure is used because 0.4 ppm is effectively the average charge that BT collects for mobile to fixed ("M2F") termination, that is, it is the amount that the MNOs pay to BT when BT terminates calls from their subscribers on BT's fixed network.

24. Section 3 of the Supplemental Submission sets out H3G's case as follows:

> "3.1 NPZ can take various forms. To the extent that the [Competition Commission] feels it will be able to recommend a precise remedy, or at least suggest one as guidance for OFCOM, H3G proposes that prices for M2M and F2M calls should fall to the level of fixed call termination".

25. H3G then lists the advantages of such an approach and goes on:

> "3.3 Theory suggests that optimal F2M rates are marginal cost less a network externality (see Harbord and Pagnozzi's analysis of "optimal" prices …). As a practical matter, H3G proposes that MCT payments between H3G and the 2G/3G MNOs (and between the 2G/3G MNOs themselves) *and* average F2M charges are

> reduced to an amount around the charges by BT for mobile-to-fixed and fixed-to-fixed termination.
>
> 3.4 The practical and quick implementation of such a remedy is achieveable: see the witness statement of James Westby…. The MNOs (and other network operators) would agree to terminate each others' calls on their respective networks. The originating and terminating networks would bill their own subscribers for the cost of calls[16] (constrained, of course, by retail market conditions). Arbitrage opportunities would be minimised. …"

Footnote 16 to this passage reads:

> "NPZ does not mean that network resources are not renumerated: rather, origination and/or termination payments (which are either set at zero ppm or very close to this) net out between networks in the same circumstances and remuneration instead takes the form of the right to terminate calls on the networks of similar operators at no charge."

26. Mr Russell's witness statement expands on these points. He explains that he is making the statement to explain to the Competition Commission why he believes that the wholesale interconnection regime is "not pro-consumer and is anti-competitive" and why H3G's proposed alternative to the current interconnection charging regime, NPZ, would better serve the industry in future. He states:

> "To clarify, H3G's definition of NPZ is any regime whereby "*payments made by H3G to the 2G/3G MNOs in relation to call termination on their respective networks are wholly off-set by the payments it receives from the 2G/3G MNOs for call termination on its network"*. This would also be applicable as between each of the 2G/3G MNOs." (emphasis in the original)

27. After setting out various arguments in favour of NPZ, Mr Russell comes to describe H3G's proposed solution. He refers to a commercial proposal H3G made previously to the 2G/3G MNOs to move to a zero pence per minute interconnection rate. But, he says, having considered the implementation and commercial issues raised by Mr Westby:

> "my pragmatic proposal is to achieve something approximating to NPZ through steep reductions in interconnection rates so that they are close to zero but not actually zero. I believe that such an approach could be easily implemented in the current industry framework, and for practical purposes, suggest that all interconnection rates (for calls originating on fixed or mobile networks) would be reduced to the same level as BT charges for terminating calls on its network[5] (i.e. less than 0.4 pence per minute), thus ensuring reciprocity between the interconnection rates for fixed and mobile calls".

Footnote 5 to that passage reads:

> "As the Competition Commission will be aware, BT actually charges a number of different termination rates depending on where a call is handed over and the time of day the call is made. For present purposes, though I doubt it makes any difference to what I say in this statement, I assume that the rates used would be that for Single Tandem Call Termination as per the BT Carrier Price List [web site address]"

28. He recognises that if the rate is not set at zero, this means that any network which has an imbalance of incoming and outgoing traffic will continue to have to make net outpayments to the other networks. However, in absolute terms, these outpayments will be much smaller than are generated applying the rates set in the price control under appeal. Thus setting rates at less than 0.4 ppm achieves many if not quite all of the benefits achievable from zero ppm without creating the difficulties of implementation to which Mr Westby refers in his witness statement. Mr Russell therefore recommends his proposal as a pragmatic approach that can be implemented in a short timescale.

29. Mr Westby, who is Head of Interconnect at H3G, states that he was asked by H3G to examine the practical implications of implementing zero rates for calls originated on MNO networks only and to assume a non-zero MCT rate still applies for other types of call. This would mean that each MNO would need to have at least two MCT rates: one zero rate and another non-zero rate for calls originating from operators who are not part of the zero ppm MCT arrangement. He says "It is this simultaneous use of two (or more) MCT rates that gives rise to most of the difficulties in implementation".

30. The problem he identifies is, in short, that in order to implement such a differential pricing tariff, the MNO needs to be able to tell from which network the call is originating so that it knows whether the call should be terminated at the zero rate or not. Mr Westby does not explain in so many words why this is a problem but the Tribunal is aware from evidence provided in respect of other aspects of this appeal that the problem derives from the use of transit operators for routing calls indirectly from one network to another. Of course, the terminating network knows who is introducing the call onto its network since it must invoice that network for the termination. What the terminating network ("network T") does not know,

however, is whether the call originates from a subscriber to that network (network A) or whether it originates from a subscriber on another network (network B) which is using network A as a transit service provider to route its calls to network T. Many billions of call minutes are routed by transit operators to MNOs each year. This does not matter provided network T's charge for termination of calls from network A's subscribers is the same as the charge for calls from network B's subscribers. But if the charge is different, network T may be unable to distinguish whether a call introduced by network A comes from a network A subscriber or from a network B subscriber.

31. Although these problems are not insuperable they would, Mr Westby says, at present "require at least some investment and thereby consequent delay". There is also an "arbitrage" problem in that operators who are not part of the zero ppm group will have an incentive to find ways to route their calls through an operator which is within that group. Thus in the above example, if network T offers network A a zero rate MCT but charges network B subscribers a non-zero rate, networks A and B will have an incentive to arrange for B's call traffic to route via network A so that network B gets the benefit of the zero rate. At present MNOs do not have the apparatus either to identify if this is happening or to stop it. Steps could be taken to minimise this but, Mr Westby says he is doubtful such measures could fully eliminate the risk.

32. These problems do not arise if all MNOs implement reciprocal low MCT rates as between all the networks. There would then be no additional need for caller identification and the arbitrage issues would be avoided. Although in the paragraphs headed "Reciprocal low MCT rates" Mr Westby appears to refer only to rates as between *mobile* network operators and service providers, in his conclusions he makes clear he is referring to rates as between all networks:

> "6. … As an alternative [to NPZ for MNOs only] I was asked to examine a situation close to NPZ in which all MCT rates for all MNOs (for calls originating on any network) were fixed at the same uniform level, being one of the rates that BT charges for terminating calls on its network. Using such an MCT rate would result in reciprocity with fixed line operators without any change in the termination rates they charge (…). I shall refer to this alternative MCT regime as "reciprocal low MCT rates". I concluded that reciprocal low MCT rates would be implemented without raising the same implementation considerations arising in

connection with zero ppm MCT and would also offer incidental benefits of, amongst other things, reduced arbitrage."

33. OFCOM and the 2G/3G MNOs complained to the Tribunal that it was apparent from the Supplementary Material that H3G's case was now significantly different from the case set out in the Price Control Appendix. The Tribunal asked for written submissions identifying the passages to which the other parties objected and the reasons for those objections. It was apparent from OFCOM's and the 2G/3G MNOs' submissions that they considered, taking the Supplemental Submission, Mr Russell's and Mr Westby's statements together, that H3G had "abandoned" its NPZ case in so far as it had argued that the rates as between the MNOs should be set at zero and replaced it with an NPZ case that all MCT charges covering fixed to mobile calls as well as mobile to mobile should be set at 0.4 ppm or less. They argued that the case was significantly different in two important ways: because the zero figure had been changed to a 0.4 ppm figure and because the scope of the NPZ remedy was now expanded to cover not only rates as between the MNOs but also rates for F2M calls.

34. At the CMC on 21 April 2008, H3G denied that this was how it now put its case. Specifically H3G denied that it had abandoned the original NPZ option – that is zero ppm among MNOs – as its primary argument as regards its challenge to the level of the price controls set in the 2007 Statement. H3G argues that it has always left some "flexibility" in its pleading to the effect that the figure itself does not necessarily have to be zero, it could be close to zero provided that the problems that H3G identified with the price control set by OFCOM were addressed in the ultimate figure set by the Competition Commission. As Mr Kennelly, appearing for H3G, put it "Zero was and is still H3G's best case, but it may not be possible, and H3G may have to make some concessions". He maintained that the NPZ case was still limited to the rates as between MNOs and the case was put on the basis that the rate should be "zero or close to zero".

35. As regards F2M rates, H3G points out that it has always pleaded that average MCT rates should be reduced "through applying an appropriate methodology for assessing costs". H3G accepted that it had not explained in its original pleadings what that "appropriate methodology" was. This was now made clear in the

Supplementary Material namely that the "appropriate methodology" was a methodology which produces a very low termination rate. H3G denied that their case was that F2M MCT should be set at 0.4 ppm – that being a price derived not from any modelling of *mobile* network operators's costs but rather from the BT termination rate. Mr Kenelly said:

> "Just to be clear, as we say in our submissions for the CMC, 0.4 may not ultimately be the figure which we will propose to the [Competition Commission]. 0.4 is, we think, close to the figure which it will ultimately arrive at, but that is a pragmatic choice. It is not clear to us at the moment what that figure should be. The basic point, the economic rationale, … is that because the marginal costs are so low the termination charge ought to be extremely low, as close to zero as good as, in our submission, for fixed-to-mobile, That is the costs methodology I have referred to. We have referred to LRIC or marginal costs. That is what we suggest is the appropriate costs methodology in determining the appropriate figure for fixed-to-mobile".

36. Mr Kenelley went on to explain that if the Competition Commission rejected the NPZ idea in principle and moved to consider the alternative M2M case set out in the later sections of the Price Control Appendix (in which case the 2G/3G MNOs' MCT rates would not be very far below, and H3G's rates would be above, the rates set in the OFCOM price control) then H3G would not persist in arguing that F2M should be set according to marginal costs and so at a rate less than 1 ppm. In that event, H3G would revert to arguing that F2M rates should be set at a rate which "should take into account the costs that Ofcom has suggested" and that this rate should be the same as the M2M rate.

37. OFCOM and the 2G/3G MNOs may be forgiven for having found this thoroughly confusing. The thrust of the Supplementary Material, in particular Mr Russell's statement and Mr Westby's statement, was that H3G had revisted its NPZ case because it realised that it was impractical to have different rates for M2M and F2M. This is because MNOs cannot tell whether a call which is delivered to the network originates with that network or is transiting from a different network and so would not know what rate to charge. To overcome this problem, Mr Westby says (and Mr Russell appears to agree) the pragmatic, or practical way to implement NPZ is to have a close to zero rate for both M2M and F2M. They appeared to be suggesting that this rate should be in the region of 0.4 ppm which is the BT M2F rate.

38. But according to Mr Kennelly's submissions at the hearing the way the NPZ case is now put does not necessarily result in M2M and F2M rates being the same. On the contrary, the preferred remedy is still that M2M rates should be set at zero ppm and F2M rates should be set at marginal cost which is something less than 1 ppm but clearly something more than zero. Given that it is clear from Mr Westby's evidence that the practical difficulties he refers to arise if there is *any* differential in price between different networks regardless of the scale of that difference, this preferred remedy does not, therefore, seem to overcome the difficulties to which Mr Westby's evidence is directed and which Mr Russell appears to suggest have prompted this revised approach.

39. This also leaves the justification put forward for the alternative non-zero ppm NPZ case for M2M entirely unclear. The Supplementary Material does not actually plead at any point that M2M rates should be set **at** 0.4 ppm though it does state in paragraph 3.1 that H3G proposes that prices for M2M and F2M calls should "fall to the level of fixed call termination". By contrast, H3G refers in parentheses in paragraph 1.2.(c)(i)(A) to the fact that Mr Russell "suggests **less than** 0.4 ppm for both, being one of BT's wholesale charges for fixed call termination" (emphasis added); there are references to M2M rates and F2M rates being at "significantly lower levels" (paragraph 2.7) and to LRICs of between 0.5 ppm and 1.9 ppm being "consistent with evidence from a number of sources". Now that H3G have indicated that they are not seeking to extend the NPZ remedy to F2M and given that they do not seem to accept that F2M and M2M rates must necessarily be the same, we do not know whether one of the alternative cases H3G is putting forward is that M2M rates should be set at 0.4 pence or whether it should be "less than 0.4 pence". In either event, it is also not clear whether the argument is that it should be less than 0.4 ppm in order to align it with M2F rates or because this accords with a rough estimate of the MNOs' marginal costs or for both or neither reason.

40. In fact none of the figures presented by H3G as representing the marginal costs of call termination by the MNOs is as low as 0.4 ppm and there is no explanation as to why MNOs should be required to provide this service at less than their marginal costs, unless this is because of the need to align the price with the M2F price.

41. It is against that background that we now turn to consider whether, to the extent that we understand what H3G's case is, it is the same as – or "falls within" - the case put forward in the original Notice of Appeal and Price Control Appendix.

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42. So far as concerns the argument that M2M rates should not be set at zero but at some other "close to zero" or "less than 0.4 ppm" rate, this is clearly not what was envisaged in the original pleading. The remedy or "more appropriate package of remedies" sought by H3G was stated to be "a result that is *or is at least equivalent to* a "net payment zero" outcome between the MNOs". Paragraph 4.2 of the PCA stated that the appropriate remedies "should ensure" that payments made by H3G to the 2G/3G MNOs should be "wholly offset" by the payments it receives so that the resulting position should be net payments zero. Paragraph 4.3 stated "*One way, and the simplest way*, of achieving this would be for all rates to be set to zero".

43. H3G argued that the words we have italicised mean that the pleading leaves open the possibility of arguing that NPZ encompasses a regime where rates are set at a number close to but not zero. The reciprocal low MCT rate is therefore part of this case.

44. The Tribunal rejects this for two reasons. First, it is not what any person reading the pleading would have understood it to mean. What the words indicate is that there are a number of ways that one could set rates so that the end effect was that the payments among the MNOs entirely cancel each other out. Clearly this is correct – one could set rates as between the MNOs, based on forecast or actual volumes of minutes terminated, in such a way that the payments completely cancel each other out. But a much simpler way, and therefore the way advocated by H3G, is to set all the rates to zero. Setting the rates at something other than zero without adjusting them to take account of traffic imbalances does not result in net payment zero but in net payments of substantial amounts of money. No one would have understood the words in italics as meaning that the principle of net payment zero encompassed a proposal which resulted in substantial net payments.

45. Secondly, even if one could read the words as a reference to other potential routes to NPZ, H3G clearly proposed one of those routes, and not the other routes, as the positive case it was putting forward. If an appellant states that there are a number ways it could achieve its aim and it is proposing one of those ways as the way to be adopted by the Competition Commission, that does not mean that all other ways are part of its pleaded case. On the contrary, the respondent and interveners are entitled to conclude that the positive case mounted is the case that they have to answer and that they do not have to answer a case based on the other ways. The other potential ways do not lie dormant in the pleading ready to be revived by the appellant at any future point in the proceedings.

46. It is clear to the Tribunal that the alternative case on which H3G now seeks to rely that M2M rates should be set at less than 0.4 ppm but more than zero is a new case and not part of its original case. Should then H3G be permitted in effect to amend its Notice of Appeal by serving the Supplementary Material incorporating the less than 0.4 ppm option?

47. Amendment of a notice of appeal in Tribunal proceedings is governed by Rule 11 of the Tribunal's Rules (S.I. 2003 no. 1372) which is in the following terms:

> "11(1). The appellant may amend the notice of appeal only with the permission of the Tribunal.
>
> (2) Where the Tribunal grants permission under paragraph (1) it may do so on such terms as it thinks fit, and shall give such further or consequential directions as may be necessary.
>
> (3) The Tribunal shall not grant permission to amend in order to add a new ground for contesting the decision unless—
>
> (a) such ground is based on matters of law or fact which have come to light since the appeal was made; or
>
> (b) it was not practicable to include such ground in the notice of appeal; or
>
> (c) the circumstances are exceptional."

48. The Tribunal's Guide to Proceedings provides further guidance on the circumstances in which an appellant may seek permission to amend its notice of appeal. In so far as material, it reads as follows:

"Amendment of pleadings

11.11 Rule 11 provides that a notice of appeal can be amended only with the permission of the Tribunal. Since the form of the notice of appeal is not that of a traditional pleading, such as a statement of case in High Court litigation, but rather a narrative presentation of factual and legal argument, the concept of 'amendment', as traditionally applied to civil proceedings, cannot be directly transposed to proceedings before the Tribunal. Thus it will not normally be necessary to apply formally to 'amend' simply to put into different words the written submissions made in support of a ground of appeal which is already set out in the notice of appeal. Permission to amend will however be necessary where the appellant seeks to raise a new ground of appeal that lies outside the four corners of the original appeal. In that event, the conditions of Rule 11(3) apply to the exercise of the Tribunal's discretion to permit the amendment – which will only be possible where the new ground:

(a) is based on matters of law or fact which have come to light since the appeal was made; or

(b) it was not practicable to include the new ground in the notice of appeal; or

(c) the circumstances are exceptional."

49. The Rule therefore distinguishes between amendments that raise new grounds and those that do not. Where an amendment raises a new ground, the Tribunal must be satisfied that one of the conditions in paragraph (3) is satisfied. Where the amendment falls within Rule 11(1), the Tribunal has a wide discretion as to whether to permit the amendment and will exercise that discretion in accordance with fairness and justice, having regard to all the circumstances.

50. In the Tribunal's judgment, this new case urging a rate of less than 0.4 ppm is a new ground and not simply an additional argument in support of the original NPZ case. The original NPZ case urged the setting of a rate (zero) that was independent of any assessment of the costs incurred by the MNOs in providing the service and was not linked in any way to the rates charged to the fixed network operators. We have said that it is not now clear whether the less than 0.4 ppm case is based on the need to align rates with the M2F rates or whether it is based on or at least justified by reference to the marginal costs of the MNOs. Whichever is now the way H3G wants to argue the point, the point clearly raises fundamentally different issues from the original NPZ case.

51. The Tribunal is also clear that none of the grounds in Rule 11(3) is made out here. No reason has been put forward by H3G as to why the less than 0.4 ppm case was

not pleaded in the original Price Control Appendix other than the fact that the academic literature in support of radical reductions in MCT rates has developed since the lodging of the Notice of Appeal. This is not sufficient to satisfy the test in either 11(3)(a) or (b).

52. Mr Westby does not say in his evidence *when* he "was asked by H3G to examine the practical implications of implementing" the NPZ remedy. No explanation was offered to the Tribunal as to why H3G, which has operated in the United Kingdom market for a number of years, should only now have appreciated the apparently simple point that a tariff setting different rates for different customers cannot easily be operated if the MNOs cannot distinguish which customer the call is originating from.

53. We have considered carefully whether there are "exceptional circumstances" in this case. H3G urged that the public interest lies in favour of allowing the Competition Commission to consider the alternative less than 0.4 ppm rate and that the interest of consumers clearly lies in a substantial reduction in the MCT rates set by the OFCOM price control.

54. As we indicated at the outset, the Tribunal has not formed any view as to the merits of H3G's proposed case. There may well be very powerful arguments in favour of a radically new way of approaching the question of MCT rates by not only reducing the rates as between MNOs but also aligning them with the very low rates set for M2F calls. It also appears from some of the Supplementary Material that there is a growing debate at the European level as to whether MCT rates are, in general, set much too high and whether the industry and the consumer would be better off if MCT charges were drastically reduced or disappeared.

55. But the question for the Tribunal is not whether a less than 0.4 ppm rate is a good idea. The question is whether it is appropriate to allow H3G at this stage to introduce it as a ground in its appeal given that the appeal was lodged 11 months ago and that the specified price control matters were referred to the Competition Commission in March 2008 with a tight timetable for its investigation. The Tribunal has stressed on a number of occasions to the parties that the role of the

Competition Commission in determining the specified price control matters is not to conduct a completely fresh investigation into all aspects of the price control set by OFCOM. Rather it is to consider the specified price control issues raised by the appellants and determine those issues. The time limits on the Competition Commission's deliberations and the limited scope of any consultation with third parties reflect this limited role.

56. The Tribunal also has regard to the fact that if H3G were allowed to introduce the less than 0.4 ppm ground, there would need to be a further round of pleadings to require H3G to clarify how the case set out in the Supplementary Material accords with the case as described by Mr Kennelly at the hearing. As well as causing further disruption to the timetable, this risks creating another round of argument and the need for further case management hearings.

57. The Tribunal therefore refuses permission for H3G to amend its pleaded case by introducing the less than 0.4 ppm remedy ground in relation to M2M termination. H3G must confine its arguments as regards rates for M2M, to arguments in favour **either** of setting the rate for MCT between MNOs to zero with the effect that no payments are made by one MNO for terminating calls on a different MNO **or** in favour of adjusting the price control set in the 2007 Statement to reflect one or more of the points made in sections 5 onwards of the Price Control Appendix. As regards F2M rates, H3G is confined to arguing that F2M rates set in the 2007 Statement should be adjusted to reflect one or more of the points made in sections 5 onwards of the Price Control Appendix and that, if the Competition Commission rejects the NPZ remedy, that F2M rates and M2M rates should be set at the same level.

IV. H3G'S CASE ON THE RATES FOR FIXED TO MOBILE TERMINATION

58. We have described above the way that the case was put by H3G at the hearing. From that it appears that H3G's case in relation to MCT charges for F2M calls is that-

(a) if the Competition Commission accepts H3G's case on the NPZ remedy for M2M termination, then it should set a rate for F2M which is based on the marginal costs incurred by the MNOs in providing call termination. H3G does not plead precisely what those rates would be – H3G estimates "using OFCOM's own cost model" that these costs "may be as low as 0.8 ppm for H3G and 0.6 ppm for each of the 2G/3G MNOs". Evidence from other sources indicates that long run incremental costs are between 0.5 ppm and 1.9 ppm.

(b) If the Competition Commission rejects H3G's case on the NPZ remedy and moves instead to consider whether to adjust the price control because of the grounds pleaded in sections 5 and 8 to 12 of the Price Control Appendix, then H3G accepts that those grounds apply equally to F2M rates and that F2M rates should be the same as M2M rates.

59. The Tribunal accepts that H3G can run various arguments in the alternative in its appeal. Indeed, as we described in the Introduction above, H3G's case challenging the price control is argued in the alternative to its assertion that it does not have significant market power and that OFCOM should not have set any price control for call termination by H3G. Although it might appear unusual for H3G to argue that F2M rates should be based on different cost methodologies depending on how M2M rates are set, there is nothing defective about a pleading that puts forward such alternative cases.

60. The question for this Tribunal is whether H3G's argument that F2M rates should, if NPZ succeeds, be based on marginal cost was something that falls within its current pleaded case and, if not, whether it should be allowed to amend. In order to consider this it is necessary to examine briefly the price control set by OFCOM.

61. In the 2007 Statement OFCOM decided to impose price controls on the supply of MCT by each of the five MNOs. There were two conditions set relating to mobile call termination rates, Condition MA3 relating to F2M interconnection charges and Condition MA4 relating to M2M interconnection charges. The two Conditions MA3 and MA4 are intended to set the same charges, the purpose of having two

charges being simply to ensure that, because MNOs have the scope within the average set by the price control to set different charges for mobile call termination they should not be able to charge relatively high charges for terminating F2M calls to offset low charges for M2M.

62. The charge control is set to apply for 4 years from 1 April 2007 to 31 March 2011. Average charges of the 2G/3G MNOs must be reduced to 5.1 ppm (2006/7 prices) by the final year of the charge control period (1 April 2010 to 31 March 2011). Average charges of H3G must be reduced to 5.9 ppm (2006/7 prices) by the final year of the charge control (1 April 2010 to 31 March 2011). This level reflected cost differences between H3G and the 2G/3G MNOs.

63. OFCOM also set out its conclusions as to the costs. It is important to note that the price control was not set on the basis of the actual costs incurred by any or all of the MNOs. Rather OFCOM's model calculates the costs which are incurred by a hypothetical efficient MNO. This is essential so that the price control is not set to reflect an inflated cost base thereby "rewarding" the actual MNOs if they incur costs above the efficient level. In the 2007 Statement, OFCOM estimated that the 2010/11 unit costs of termination for the 2G/3G MNOs were 4.8 ppm and the costs for H3G, being a 3G only MNO, were 5.6 ppm. These figures included an allowance for spectrum costs, network costs and non-network costs such as administration.

64. H3G accepted that in the Notice of Appeal and Price Control Appendix it did not set out by how much F2M rates should be reduced compared to the rate set by OFCOM in Condition MA3. Paragraph 1.2(b) of the Price Control Appendix stated only that H3G considers that an appropriate package of remedies would reduce those charges "through applying an appropriate methodology for assessing costs". Paragraph 4.7 of the Price Control Appendix coming at the end of the section relating to NPZ stated:

> "In relation to fixed-to-mobile calls, H3G submits that lower MCT rates generally would benefit consumers. In circumstances where the effects on competition between the MNOs has been addressed [i.e. by adopting NPZ], H3G submits that a suitable cost based price control (taking account of the differences between 2G and 3G costs) is appropriate for all fixed-to-mobile rates".

65. This, H3G says, left it open what that methodology would be and hence H3G is able now to set out what it meant by "an appropriate methodology" and to argue that "potentially, the true incremental costs of termination are no more than 10% of the MCT rates determined by OFCOM".

66. There was much reference in the oral and written submissions of the parties to different kinds of cost methodology: LRIC (long run incremental cost), LRAC (long run average cost), LRAIC (long run average incremental cost), FAC (fully allocated cost) and marginal cost. These should not, however, blind one to the fact that if OFCOM's model calculated efficiently incurred costs as being 5.6 ppm for a 3G-only MNO and 4.8 ppm for a 2G/3G MNO and H3G now urges a model which generates a calculation of costs as being between 0.5 ppm and 1.9 ppm, H3G's model must be based on some very different assumptions or methods or inputs from OFCOM's model, regardless of what LRIC, LRAC, FAC or LRAIC tag is attached to the methodologies.

67. The Tribunal does not accept that the wording of the original Price Control Appendix leaves it open to H3G to adopt any methodology it sees fit without amending its pleading. There was nothing in the pleading to suggest that H3G considered that there was anything wrong with OFCOM's cost methodology other than the points that were raised in the later sections of the Price Control Appendix which set out H3G's alternative case on M2M prices. There was certainly nothing in the pleading to suggest to the other parties that as regards F2M charges, the Competition Commission was going to be considering whether to reject OFCOM's cost model in its entirety and to adopt some very different method of assessing costs and hence target prices. A fair reading of the Price Control Appendix would clearly lead the parties to believe that H3G's case was that, whether or not M2M was reduced to NPZ, F2M rates should be based on OFCOM's cost model adjusted to take account of the criticisms levelled at it in the later sections of the Price Control Appendix. This reading is reinforced by the reference in paragraph 4.7 of the PCA in parentheses to the need to take account of the differences between 2G and 3G costs, since many of the points made in those later sections of the Price Control Appendix alleged that OFCOM had failed properly to take account of such differences.

68. The Tribunal therefore holds that the introduction in the Supplementary Material of arguments that F2M rates should be set according to a cost model which differs from the cost model used by OFCOM in ways other than those highlighted in the original Price Control Appendix goes beyond the current pleaded case.

69. The Tribunal also refuses H3G permission to amend to include these arguments. Assuming, without deciding, that this proposed amendment would fall within subparagraph (1) rather than (3) of Rule 11, the Tribunal's judgment is that it should exercise its discretion against allowing amendment. To allow H3G to launch at this stage such a fundamental challenge to the OFCOM cost methodology in order to argue that F2M prices should be set at a fraction of what was set in the price control would be most unfair to the other parties. They have understandably not prepared their own arguments on the basis of such a challenge. It would also risk lengthening the proceedings before the Competition Commission and hence delaying the resolution of these appeals.

70. The Tribunal accepts the argument of the 2G/3G MNOs that an investigation into what are the "true incremental costs of termination" (to adopt a phrase used by H3G) would require substantial extra work. For example, Miss McKnight on behalf of Vodafone made it clear that Vodafone disputed H3G's assessment of marginal costs. She also pointed out that the H3G argument calls into question how one decides what a marginal unit is because an increment of infrastructure is added to carry both incoming and outgoing traffic, leaving it open to debate how much of the actual cost should one allocate to the provision of call termination services.

71. The challenge to the OFCOM model which H3G seeks to mount thus causes a whole raft of new issues to be opened up for submission and determination. But there is a more fundamental point here which the Tribunal raised at the hearing. The regulation of the telecoms sector is based on the EC Directives, Recommendations and guidance which make up the totality of the Common Regulatory Framework as implemented in the Member States. There is a developing debate about all aspects of telecoms regulation including the proper approach to setting MCT rates. This debate is an iterative process involving the

EC Commission which has its own procedures for gathering ideas and opinions from a wide range of sources and the national regulatory authorities in the Member States who carry out their own consultations so that new ideas are thoroughly discussed before being adopted. It may well be that in the course of a future review of this market OFCOM, having regard to developments at the European level will propose a move to a strictly marginal cost alternative to the kind of price model that has been adopted in the 2007 Statement. But none of the MNOs supported such a proposal during the consultation process leading up to the 2007 Statement (despite some reference by OFCOM to possible moves to a radically different system). The Tribunal is concerned that the "less than 0.4 ppm rate" ground and the reduction of both M2M and F2M rates to rates which are a small fraction of what is currently charged is not a something that should be considered for the first time in the course of the appellate process.

72. We recognise that the same concern could be raised in relation to the NPZ argument and that H3G is clearly entitled to raise that argument since it was included in the Price Control Appendix. But in deciding whether to allow H3G greatly to expand this argument, the Tribunal must take into account not only the effect on the other parties to the proceedings but also the effect on other participants in the industry whose businesses would be seriously affected by a dramatic reduction in F2M rates.

73. Mr Kennelly argued that it has been well known since the start of these proceedings that the appropriate level of both M2M and F2M was going to be before the Competition Commission and that the progress of these appeals has been "very closely followed by the industry at large". He submitted that OFCOM is able to act as the guardian of all these interests. In the Tribunal's judgment this is most unsatisfactory. We have held that there was nothing in the way the case has been conducted thus far which put the industry in general on notice that H3G was going to invite the Competition Commission to reject OFCOM's cost methodology entirely and replace it with a marginal cost model leading to MCT charges of less than 1 ppm. To allow H3G to take this appeal in a substantially new direction risks derailing the whole process. In the Tribunal's judgment it is far too late in these proceedings for that to be allowed to happen.

V. ADDITIONAL ARGUMENTS IN SUPPORT OF NPZ

74. Some of the parties challenged arguments raised in the Supplementary Material on the basis that they comprised new arguments being introduced in support of the NPZ remedy for M2M rates. It was accepted that these points did not raise new grounds for the purposes of Rule 11 but it was submitted that they were not part of the original pleaded case and that H3G needed the Tribunal's permission under Rule 11(1) to raise them.

75. In section 4 of the original Price Control Appendix, H3G set out its case in support of the NPZ remedy. H3G introduced the NPZ idea as:

> "an alternative approach to a price control remedy regarding mobile-to-mobile calls which would have substantial benefits for consumers in general, promote competition and not have the detrimental effects of the current price controls which OFCOM has determined".

76. In paragraph 4.5 H3G stated that there are a number of reasons for preferring such a remedy and then listed in some detail six such reasons:

(a) NPZ would remedy the current situation in which H3G's traffic imbalance vis-à-vis the other MNOs arising from its status as a new entrant and the inadequacy of the current number portability arrangements results in H3G making material net outpayments to the other MNOs;

(b) it removes the risk of damage to competition and investment which would arise if OFCOM's cost benchmark forecasts and its forecasts of subscriber numbers and migration of subscribers to 3G services turn out to be wrong;

(c) it provides a practical solution to the uncertainties surrounding the weights to be attached to alternative sets of assumptions employed in assessing efficient costs;

(d) it prevents H3G having to make material net out payments to its competitors and hence allows H3G to use the extra revenue thereby saved to play the role of maverick competitor on the retail market;

(e) Ofcom has not adequately scrutinised whether its price control worsens the competitive dynamics of the market;

(f) NPZ will eliminate the problem that OFCOM has identified as to if and how the price control should accommodate the distortion caused by the current arrangements for MCT charges for ported numbers.

77. H3G then stated in paragraph 4.6 that OFCOM could and should have given more weight to (1) an assessment of a remedy that reflected H3G's special position as a new entrant and (2) the actual impact on competition of H3G's MCT rates being brought closer into line with those of the 2G/3G MNOs.

78. Section 2 of the Supplemental Submission is headed "NPZ - Overview". and comprises 22 paragraphs in support of the NPZ remedy. The arguments raised in these paragraphs are rather diffuse but we adopt in part the framework used by Vodafone in its submissions in which it argued that paragraphs 2.6 to 2.22 – in effect all the substantive paragraphs of the section – were inadmissible on the grounds that none of them was contained in the original pleading whether in support of NPZ or otherwise.

(a) OFCOM's cost allocation methodology was inappropriate or economically inefficient

79. In paragraph 2.11(a) of the Supplemental Submission H3G alleges that OFCOM has determined MCT rates on the basis of an inappropriate and economically inefficient cost allocation method. H3G submits that this plea is foreshadowed by the reference in paragraph 1.2 of the PCA to the need to adopt an appropriate cost methodology "the implication being, of course, that the current methodology adopted by OFCOM is not appropriate".

80. For the reasons we have already set out in relation to H3G's case on F2M rates, the Tribunal does not accept that the reference to the need to adopt an appropriate cost methodology enables H3G now to introduce additional ways in which the model was inappropriate or to put forward different models which would be more appropriate. Further, NPZ was never put forward as a remedy that was linked to

the MNOs' costs – it was a remedy that was proposed independently of any analysis of costs. We therefore agree that paragraph 2.11(a) raises a new argument in favour of NPZ and, for the reasons set out in relation to the plea surging the adoption of a radically different cost model for F2M rates, we refuse permission to amend under Rule 11(1) to add this as an argument in favour of NPZ.

(b) OFCOM's cost model has led to MCT rates being set significantly above marginal costs.

81. In paragraph 2.11(b) of the Supplemental Submission and elsewhere H3G alleges that the OFCOM cost model has led to MCT rates being significantly above marginal cost. H3G then goes on to indicate that it considers that the marginal costs of call termination range from between 0.5 ppm and 1.9 ppm. H3G argues that it has "generally" argued that the OFCOM cost model constitutes an error and refers to paragraph 4.2 of the PCA which asserts that NPZ would promote competition and not have detrimental effects. We have looked at these references and at the other paragraphs in the PCA which H3G submits support this argument. H3G's submissions rely on taking words or phrases out of context and arguing that they support some general submission of which this new argument forms a part. For example, H3G refers to paragraph 5.7 PCA as arguing that LRAC would be more appropriate than fully allocated costs and to a footnote in the Note on the LRIC model that was appended to the PCA in support of section 5 ("the LRIC Model Note"). But section 5 and the LRIC Model Note relate to an entirely different point, namely the path of cost recovery adopted by OFCOM which, H3G submits unduly favours 2G networks over 3G. References in paragraph 5.7 to LRAC in that context cannot then be used to found a much more general challenge to the OFCOM cost model. There is nothing in the PCA which indicates that H3G intended to argue that the OFCOM cost model should be replaced by a marginal cost model. Again, for the reasons we have set out in relation to F2M costs, we find that the points made in paragraph 2.11(b) and the proposed means of identifying marginal cost go beyond the current pleading and that permission to amend should be refused.

(c) The current MCT regime results in higher retail prices

82. Paragraph 2.11(c) of the Supplemental Submission states:

> "Retail prices are likely to be higher than they otherwise should be. See the third witness statement of Kevin Russell ("KRWS 3") attached hereto"

H3G justifies the inclusion of this argument by referring to paragraph 1.2(a) of the PCA where it states that the NPZ remedy "would eliminate an artificial cost floor on competition in the mobile sector at the retail level". This is a different argument from the one put forward by H3G in the Price Control Appendix that the financial liability imposed on H3G by the price control in the 2007 Statement would result in competition in the retail sector being less keen (and hence, presumably, in retail prices rising overall).

83. The argument as explained in Mr Russell's statement in fact is nothing to do with MCT charges creating cost floors for retail pricing. Rather it is to the effect that because MNOs cannot be certain about the level of incoming calls that a subscriber will receive, the risk that a customer may make a lot more calls than he or she receives must be factored in at the retail pricing level. Because it is prudent to account for this risk in setting retail prices, Mr Russell argues, outgoing retail prices are inflated.

84. The Tribunal holds that this argument is inadmissible. First we do not consider that the sentence in paragraph 1.2(a) of the PCA put the other parties on notice that H3G intended to argue that the NPZ remedy should be adopted because it would lead to a fall in retail prices by removing this uncertainty. We refer to what we said in our ruling on the BT application for permission to amend: [2007] CAT 35:

> "An appellant cannot, by including broadly worded summaries in the notice [of appeal], create an opening for a subsequent assertion that in fact that summary is a ground which goes wider than the later particular suggest and can encompass additional arguments which do not appear at all in those later particulars."

85. Similarly here, paragraph 1.2 is in the part of the PCA headed "Introduction" and is prefaced by "As explained below". In fact the section which explained why NPZ was the preferred remedy made no mention of the elimination of artificial

cost floors or to the allegation that retail prices are higher because of uncertainty about the levels of incoming calls.

86. Secondly, it is unsatisfactory for an appellant to plead an unparticularised statement such as paragraph 2.11(c) of the Supplemental Submission and simply cross refer to a witness statement as particulars. The witness statement is intended to provide evidence in support of matters pleaded, it is not the pleading itself. Mr Russell's statement contains the conventional introductory language confirming that the content is from his own knowledge unless otherwise identified and that where facts and matters are stated which are not from his own knowledge, they are true to the best of his information and belief. Yet his description in paragraph 8 of the pricing point contains statements to the effect that risks "must therefore be factored in at the retail pricing level"; that retail pricing "is typically adjusted" to take into consideration the contribution of MCT payments and that "prudence demands" that retail prices take account of the uncertainty of MCT revenues. It is not at all clear however what evidence Mr Russell is presenting to support these opinions. For example is his evidence that, based on his own knowledge, H3G deliberately includes an element in its retail pricing to take account of this risk? If so, no supporting contemporaneous internal documentation evidencing such pricing discussions has been attached. Is he saying that, to the best of his information and belief, he knows it to be true that one or more of the other MNOs also increases its retail prices by factoring in this risk? If so, there is nothing to indicate on which information or experience he has based this assertion.

87. The manner in which this point has been put forward makes it almost impossible for OFCOM and the other MNOs to understand the case that is being put or to counter it. We do not see how H3G could make good the point asserted by Mr Russell in paragraphs 8 – 11 of his witness statement without substantial and commercially sensitive new evidence and submission being required from the MNOs. For that reason also we would strike out paragraph 2.11(c) of the Supplemental Submission.

88. H3G also refers to other snippets from its pleaded case such as a reference to "consumer benefits" in one paragraph and a reference to the price control making

it "more difficult to compete" in the retail market. Again we have looked at all the references to which H3G has directed our attention and none of them can fairly be said to raise this argument.

89. We therefore do not agree that it is open to H3G now to mount this argument or that it would be appropriate to allow them to amend to put it forward.

(d) H3G's welfare model

90. In paragraphs 2.16 – 2.18 of the Supplemental Submission, H3G introduces a welfare model which estimates the likely welfare benefits from implementation of NPZ in the UK mobile market. On 29 April 2008 H3G provided OFCOM, the Competition Commission and the other parties with a detailed explanation of the model, making it clear that this explanation was not intended as a further submission on the admissibility issues raised at the hearing.

91. In the Tribunal's judgment H3G is entitled to produce a welfare model to demonstrate or quantify the benefits alleged to flow from the adoption of the version of the NPZ remedy that was set out in the Price Control Appendix provided those benefits are the ones that have been particularised in paragraph 4.5 of the Price Control Appendix. Any welfare model designed to quantify (a) the benefits of the less than 0.4 ppm version of the NPZ remedy or (b) the benefits of a move to a marginal cost basis for pricing F2M calls or (c) any benefits of the PCA version of the NPZ remedy which are not pleaded in paragraph 4.5 is irrelevant, given that those issues are excluded by this ruling from the scope of the appeal.

92. We have considered carefully the best way to proceed in relation to this model, bearing in mind that the Competition Commission has not yet had an opportunity to examine whether it regards the model as useful for the purposes we have outlined. We therefore rule that the model is admissible to the extent set out in the preceding paragraph but that OFCOM and the Interveners should not respond to it in their own pleadings unless and until the Competition Commission asks them specified questions about the model. OFCOM and the Interveners should not provide their own "counter-models" unless or until the Competition Commission asks them to do so.

93. As regards paragraphs 2.16 – 2.18 of the Supplemental Submission, these are largely directed at the marginal cost arguments which have been disallowed. Paragraphs 2.17 and 2.18 must be excluded from the pleading and paragraph 2.16 is allowed only in so far as it relates to the matters which have been ruled admissible.

(e) Consistency with economic analysis

94. Paragraph 2.20 of the Supplemental Submission purports to set out a fifth reason why it argues that OFCOM erred in failing to give proper consideration to NPZ. This paragraph contains the statement that "the proper economic framework for analysing MCT rates has identified a number of flaws in the economic theory behind OFCOM's price control". It is not at all clear what "proper economic framework" is being referred to here or what flaws are alleged. This lack of clarity is unacceptable in a pleading particularly if the intention is then to use this sentence as a spring board for introducing further as yet unidentified economic arguments against the price control.

95. The second sentence of this paragraph refers to academic analysis in support of NPZ and refers to a number of articles by economists on which H3G relies to support an NPZ solution.

96. The Tribunal makes the following comments as regards H3G's reliance on such articles. It is entirely proper for H3G to cite academic articles in support of the arguments that it has raised in its pleadings in support of NPZ. It is also open to it to commission economists or other external consultants to produce analysis and reports on which it then relies. Those articles or reports might, however, include material which makes other arguments in favour of NPZ which H3G has not raised or which it has been precluded from raising by the rulings of this Tribunal. H3G is not expected to redact material from the articles so as to exclude any content which goes beyond its grounds of appeal. But the content of the articles cannot be allowed informally to expand the scope of the appeal. Those parts of the articles which go beyond H3G's arguments are not to be relied on and, equally, the other parties are not required or expected to comment on them or counter them. In so far as the articles cited by H3G in paragraph 2.20 support points that H3G is permitted

to raise in support of NPZ then they may be relied on. In so far as they go beyond that, they are irrelevant and cannot be relied on.

(f) Practical problems with regulatory regime

97. In paragraph 2.21 of the Supplemental Submission, H3G argues that by choosing to regulate MCT rates in the way it has, OFCOM has "effectively committed itself to an ongoing costly, time consuming and highly intrusive regulatory regime". It is also difficult, H3G says, to adapt the OFCOM regime to deal with new entrants. NPZ removes these problems.

98. The Tribunal does not accept the arguments put forward by H3G in submitting that this is a point already raised by its pleading. On the contrary, the argument seems to be inconsistent with the way in which H3G put its case at the hearing, namely that it is not asking for the zero rate NPZ remedy to be extended to F2M. If, as H3G argue, F2M is still going to be based on some assessment of the MNOs' costs (whether their marginal costs or the 2007 Statement costs model with adjustments) it is difficult to see that simply applying zero rates as between MNOs results in the benefits indicated, at least on the same scale. Further, as H3G acknowledges, OFCOM, as a national regulatory authority, is obliged under the Common Regulatory Framework to conduct market reviews from time to time.

99. Again, when considering whether to grant permission to amend, the Tribunal has to have regard to what H3G would need to do to make good the point pleaded and what the other parties would have to do if they wanted to rebut the point. Issues concerning the efficient use of OFCOM's regulatory resources and questions about how OFCOM deals with new entrants have not formed any part of H3G's appeal thus far. One would also need to investigate the effect on economic efficiency and overall welfare of introducing a system that does not send any signal about termination costs by pricing MCT at zero. It is not right therefore to allow this new argument to be raised at this stage.

(g) The current level of MCT rates constrains the growth of the mobile internet

100. In paragraph 2.22 of the Supplemental Submission, H3G sets out a long quotation from a speech given in February 2008 by the EC Commissioner Viviane Reding,

Commissioner responsible for the Information Society. The speech makes the point that the current high cost of 3G services is inhibiting the use of internet via mobiles. The quotation closes with the exhortation "If Europe's mobile industry were to be serious about mobile convergence, you would certainly have to bring down mobile termination charges more aggressively".

101. We conclude that an argument that NPZ will encourage the use of mobile internet is a new point that is not raised in the Notice of Appeal. Clearly this would require substantial new submissions from the parties into an area of the sector that has not yet been explored. It is not appropriate to introduce this argument now.

(h) Additional arguments in Mr Russell's witness statement

102. A number of the 2G/3G MNOs also point out that in Mr Russell's witness statement which forms part of the Supplementary Material, he raises arguments in favour of NPZ. In paragraphs 12 and 13 of his statement he argues that the present interconnection regime distorts the pricing signals provided to customers who differ in terms of the balance between incoming and outgoing calls. This leads to inefficient network usage. This is not a point that appears any where in H3G Price Control Appendix or in the Supplemental Submission.

103. In paragraphs 17 and 18 Mr Russell asserts that H3G is disadvantaged by the aggressive pricing practices of the 2G/3G MNOs who are able to use information about the calling practices of their existing individual customers to devise bespoke retail packages for those customers in order to persuade them not to switch networks. This is a highly contentious point and has not been raised before in this appeal.

104. H3G argues that these are all part and parcel of general submission in paragraph 4.2 of the PCA that NPZ "would have substantial benefits for consumers in general, promote competition and not have the detrimental effects of the current price controls". As the Tribunal has already indicated, however, it is not permissible for H3G to rely on such a broadly worded sentence as allowing it, at any stage of the proceedings, to introduce new challenges on the grounds that they can broadly be described as "benefits for consumers" or as removing another

"distortionary effect on competition". Such an approach ignores the fact that H3G has particularised its case and is bound, unless and until its pleading is amended, to stick to those particulars. Mr Russell's evidence must be limited to supporting permissible pleaded paragraphs. It cannot raise new and unpleaded points.

VI. OTHER CHALLENGES TO THE ADMISSIBILITY OF THE SUPPLEMENTARY MATERIAL

105. The 2G/3G MNOs have provided the Tribunal with tables setting out the passages in the Supplementary Material to which they object and indicating the reasons for their objection. H3G helpfully provided the Tribunal with a schedule, running to some 40 pages, consolidating the points raised by the 2G/3G MNOs and OFCOM. Much of this material relates to the points already described in this Ruling and in so far as the material relates to grounds or arguments that the Tribunal has ruled cannot be relied on by H3G, then clearly the corresponding material in the rest of the Supplementary Material is also excluded. In this section we consider objections raised to the contents of the Supplementary Material which are independent of the points already considered.

(a) Reports, articles etc.

106. Some of the Supplementary Material contains academic papers and reports. As regards the content of those, the Tribunal repeats its guidance in paragraph [96] above. H3G is not required to redact the articles to remove argumentation which goes beyond the scope of its appeal. It is entitled to rely on those parts of the articles which support arguments it is able to raise in its appeal and to argue that the conclusions of the author hold good even ignoring the parts of the article that go beyond the scope of the appeal. The other parties are not required to address or rebut material in the articles which goes beyond the scope of the appeal and it is open to them to argue that the conclusions of the authors are undermined by the exclusion from consideration of the impermissible arguments. The Competition Commission is well able to make up its mind where the merits of such submissions lie.

107. The Tribunal notes that in its rebuttal of the objections made by the 2G/3G MNOs to the inclusion of certain evidence, H3G refers to the fact that the Tribunal said, during the 25 February 2008 case management conference, that evidence that has already been served on the parties in relation to the non-price control matters is to be regarded as evidence in the appeal generally. Such evidence is therefore available in the proceedings before the Competition Commission without it having to be reserved as part of the supplemental material. That indication does not detract from the point made in paragraph [96] above. The Tribunal was not thereby expanding the scope of the appeal to incorporate all arguments raised in witness statements or published papers, regardless of whether they are pleaded in the appeal. Such evidence is still only relevant and admissible if and in so far as it supports matters that are properly raised in the appeal by the pleadings.

(b) Traffic imbalance and on-net/off-net issues

108. The 2G/3G MNOs object to references in various places to the adverse effects on H3G of an alleged practice on the part of the 2G/3G MNOs of charging different retail prices to their subscribers depending on whether the call is made to another subscriber on the same network (on-net) or to a subscriber on a different network (off-net). This is a point that the Tribunal has addressed before first in refusing H3G permission to amend its Notice of Appeal to raise the point: see the ruling in [2007] CAT 33 and secondly in refusing H3G permission to appeal against the rejection of a subsequent application to raise the same point in the Price Control Appendix: see [2008] CAT 2. The Tribunal set out in those rulings the reasons why the point which H3G sought to raise – which was that the price differences between on-net and off-net hindered the growth of H3G's business because customers preferred to stay with a larger network in order to benefit from more, cheaper on-net calls – was excluded.

109. Clearly it is not open to H3G to reintroduce that same point in the Supplementary Material now. Further, if H3G wanted to raise a different point the success of which depended on H3G being able to establish that such a price differential in fact exists and that it in fact has a material influence on the choices that customers make about what network to join, H3G would have to apply for permission to amend.

110. This means also that where published materials are relied on by H3G in support of a part of its case and those materials include argumentation which presupposes the existence of a price differential or that such a differential influences customer choices, that argumentation cannot currently be relied on by H3G in this appeal and that conclusions of the authors of those reports and papers must be considered accordingly.

111. H3G is entitled to argue, however, that:

(a) a traffic imbalance exists between it and the other 2G/3G MNOs in that H3G terminates many more calls on its competitors' networks than those competitors terminate on H3G's network and consequently makes substantial net out-payments of MCT charges to the 2G/3G MNOs;

(b) this traffic imbalance stems in large part from the unsatisfactory nature of the mobile number portability arrangements in the United Kingdom;

(c) OFCOM wrongly rejected H3G's arguments that the traffic imbalance and its causes were factors that OFCOM should have investigated because they were relevant to the proper level of the price control.

112. OFCOM challenges the inclusion of paragraphs 2.9 to 2.15 of the Schedule of Evidence. It does not appear to the Tribunal that these paragraphs go beyond what is permitted. H3G draws attention to decisions of other national regulatory authorities who considered the existence of a traffic imbalance to be relevant to the setting of the rate. These comparisons support H3G's case that OFCOM erred in rejecting the relevance of this and that the decision should be remitted to OFCOM to investigate further what has caused H3G's traffic imbalance. Those points can fairly be made without any reference to on-net/off-net points, even if those points are raised in the documents to which H3G refers.

VII. MATERIAL SERVED BY H3G AFTER 7 MARCH 2008

113. The deadline set by the Tribunal's order for the service of supplementary material by H3G and BT was 7 March 2008. On 14 March 2008, H3G wrote to the

Tribunal stating that it wished to rely on two further documents. One document was a report by WIK-Consult called *The Future of IP Interconnection: Technical, Economic and public policy Aspects – Study for the European Commission.* The second document was the final version of a paper called *ERG's Common Position on symmetry of fixed call termination rates and symmetry of mobile call termination rates* produced by ERG – the European Regulators Group. An earlier draft version of this paper published for consultation had been included in H3G's evidence adduced at the hearing before the Tribunal of the non price control matters in this appeal in January/February 2008. At the end of March H3G sent the Tribunal two further documents, a report by Morgan Stanley about the Vodafone Group and a "Flash Message" from Cullen International.

114. Some of the other parties objected to the late submission of this material. H3G argued that the material had not been available in time to be included in the Supplementary Material served on 7 March. At the CMC on 21 April 2008 the Tribunal raised with the parties the best way of dealing not only with these documents but with other papers, reports, articles etc. that will inevitably be produced between now and the time that the Competition Commission sends its determination of the price control matters to the Tribunal. The purpose of referring price control matters to the Competition Commission is so that that body can bring to bear its experience and expertise in resolving complex economic problems such as are raised by this appeal. It does not make sense to try to stop the Competition Commission from having regard to published material which is relevant to the questions that have been referred to it. However, given the adversarial nature of these proceedings, there is a risk that each time one party comes across such an item it will apply to add it to its evidence and the other parties will contest its admissibility or produce lengthy arguments to the effect that the article is irrelevant or wrong. This effort and expense may all be unnecessary if the Competition Commission can readily decide that in fact it does not regard the item as useful.

115. Mr Sharpe, appearing for the Competition Commission set out very fairly how the Competition Commission wishes to proceed:

> "… we do not want, we do not welcome or invite a ceaseless barrage of new paper at irregular intervals. The Commission is at the stage now when it has begun to

> isolate the issues which it thinks are important and in due course will be contacting the parties for specific targeted pieces of evidence in relation to the issues which arise, and that is how we wish to proceed. That does not mean to say, and let me emphasise this, if something of importance or relevance does emerge, and the parties are terribly keen to let us know about it, we are not going to say: "Inadmissible, we do not want to know". What we would like to do is for them to make us aware of that evidence and we will consider whether we wish to seek it, and to use it. We think that is the appropriate way forward and respectfully we would wish you to endorse that."

116. The Tribunal does certainly endorse that as a sensible way forward. Therefore we do not grant permission to H3G to adduce the WIK Report or the other documents sought to be added after 7 March. The Competition Commission is now aware of the existence of those documents and, if it wants to, it can ask the parties for submissions on all or any of the matters discussed. From now on, if H3G or any other party comes across any further document it considers relevant to its case, it should draw the document to the Competition Commission's attention. The other parties should not respond or comment on the new document unless or until the Competition Commission asks them to do so. There is no need, therefore for further applications to adduce evidence in order to alert the Competition Commission to such publicly available material. The Competition Commission will identify what if any gaps there are in the material it needs to make its determination and will seek that from the parties.

VIII. NEXT STEPS IN THE H3G APPEAL

117. In its letter of 31 March 2008, when the Tribunal set the date for the CMC which took place on 21 April, the Tribunal also suspended the timetable that had been set for the exchange of further pleadings in the H3G appeal. That timetable had ordered Ofcom to serve its confidential response to the H3G Supplementary Material by 4 April and the non confidential version of that response by 14 April. The interveners were then to serve their Statements of Intervention by 21 April with replies served on 6 May. That letter indicated that despite the temporary suspension of the timetable, the parties should continue to prepare their submissions on those parts of the Supplementary Material which were not challenged as inadmissible in the expectation that once the timetable is restarted they may be required to submit their pleadings promptly.

118. Mr Sharpe, for the Competition Commission, urged the Tribunal to provide both clarity and finality as to what was included and what was excluded from the Supplementary Material. In the following paragraphs we therefore apply the Tribunal's rulings above to the Supplementary Material so far as possible. As regards the material which the Tribunal has *not* excluded, it is open to the Competition Commission to form its own views as to the relevance of the arguments and material raised and as to the weight to be attached to them. The fact that the Tribunal has not ruled that a point is inadmissible does not impede in any way the Competition Commission's discretion to determine which of these points it needs to address in order to arrive at the answers to the questions that the Tribunal has referred to it.

The Supplemental Submission

119. **Section 1 headed "Introduction":** This remains except for the following passages which are ruled inadmissible:

(a) the words in parenthesis at the end of paragraph 1.2(c)(i)(A) referring to Mr Russell's statement and the less than 0.4 ppm rate;

(b) paragraph 1.2(c)(iii) which refers to the LRIC cost estimates which relate to the marginal cost argument;

(c) paragraph 1.2.(c)(iv) (which refers to the welfare model) in so far as the calculations deal with any matters ruled as inadmissible in this ruling.

120. **Section 2 headed "NPZ – Overview":** Parts of this section are inadmissible. The paragraphs which remain are to be read as applying only to the zero rate NPZ argument as set out in the Price Control Appendix. The Tribunal rules that the following paragraphs only are admissible:

(a) the whole of paragraphs 2.1, 2.2, 2.3, 2.4, 2.5, 2.6, 2.9, 2.10, 2.12, 2.13, 2.15 and 2.19;

(b) paragraph 2.7 except for the reference in the penultimate line to F2M rates;

(c) the first two sentences of paragraph 2.8;

(d) paragraph 2.16 is admissible to the limited set out in paragraphs [91]-[93] above;

(e) paragraph 2.20 is allowed on the basis described above (paragraphs [106]-[107] above).

121. **Section 3 headed "Precise Form of the Remedy".** This section is predicated on the basis that M2M and F2M MCT rates should be brought into line with M2F rates. This section is therefore inadmissible and falls in its entirety.

122. **Section 4 headed "Conclusion".** The Tribunal has serious concerns about allowing this section to remain. It contains many generally worded allegations to the effect that OFCOM should have carried a fundamental review that adequately assessed the impact of MCT regulation on a late entrant and that the NPZ remedy would "promote competition more generally in the mobile sector". In so far as these simply summarise points that the Tribunal has ruled are legitimately raised, the paragraphs are unobjectionable but do not supplement anything that appears in the Price Control Appendix. However, it is precisely these kind of general statements that H3G has relied on to introduce issues which fall for example under the general heading of "promoting competition generally". In order to forestall further disputes between the parties, the Tribunal rules that Section 4 should be excluded.

Other materials

123. **Appendix 1 – "Legal Basis for NPZ".** Subject to the rest of this paragraph, this is admissible provided it is read as applying only to NPZ properly so called that is, the proposal that the rates among the MNOs be set to zero. Paragraph 6 which clearly refers to the non-zero ppm alternative and to additional inadmissible arguments for NPZ is excluded. Footnotes 20 and 21 are inadmissible since they

raise the issue of capacity based charges which do not form part of the appeal. Paragraph 7.4 is admissible up to "consumer benefits" in the third line. The rest of paragraph 7.4 is inadmissible.

124. **Schedule of Evidence.** This is admissible except for:

(a) the papers and other materials referred to in any of the paragraphs or footnotes are to be relied on only to the extent indicated by the Tribunal in paragraphs [106]-[107] above;

(b) paragraphs 3.4 and 3.5 which relate to the intrusive and burdensome regulation argument are excluded;

(c) paragraphs 3.12 – 3.15 which relate to other impermissible arguments in favour of NPZ are excluded;

125. **Third witness statement of Kevin Russell.** This statement largely comprises submission rather than evidence properly so called and much of that submission is directed at arguments that the Tribunal has ruled are inadmissible. The only passages in this Statement which, in the Tribunal's judgment, properly introduce evidence to supplement the arguments raised in the Price Control Appendix are paragraphs 43 to 48 relating to the experience in Hong Kong of an NPZ regime. The rest of this statement, other than the introductory paragraphs, is excluded.

126. **Second witness statement of David Dyson.** This statement was not contested by the other parties and is admissible in its entirety.

127. **Witness statement of James Westby.** This statement is largely directed at explaining the difficulties which arise in implementing the zero-rate NPZ regime. As such it is admissible. It is not admissible in so far as it argues for the less than 0.4 ppm rate for MNOs or for a substantial reduction in the F2M rates.

128. **The Oxera Report** This is admissible.

129. **Document headed "Estimates of origination and termination LRAICs".** This relates to the marginal costs arguments and hence is inadmissible.

130. **Summary of welfare analysis**: see Tribunal's ruling in paragraphs [91] and [92] above.

131. **Additional materials in Annexes 8 to 13:** these materials are admissible only in so far as the relate to the issues that are properly raised in the appeal in accordance with the Tribunal's ruling.

132. Once this ruling has been handed down the Tribunal will set a revised timetable for pleadings in the H3G appeal.

IX H3G'S STATEMENT OF INTERVENTION IN THE BT APPEAL

133. H3G was granted permission to intervene in BT's appeal on 10 July 2007 and served its outline Statement of Intervention on 30 November 2007 ("the Outline SOI"). OFCOM and the 2G/3G MNOs (who are also interveners in the BT appeal) object to much of what is pleaded in that Outline SOI on the grounds that it goes beyond responding to the points that BT has made in its appeal and attempts to introduce into the BT appeal the same issues as H3G raises – or has attempted in the Supplementary Material to raise – in its own appeal.

134. Miss Lee who appeared on behalf of BT confirmed what is plain from BT's Notice of Appeal: that BT's appeal is limited to challenging three aspects of OFCOM's treatment of the MNOs' costs namely the treatment of spectrum costs, the treatment of the MNOs' administration costs and the inclusion of a network externality surcharge. The remedy BT seeks is that MCT rates should be set at 3.73 ppm.

135. H3G's arguments in favour of NPZ (whether in its zero rate or its "less than 0.4 ppm" rate form) have nothing to do with any of those three grounds. Indeed, this is acknowledged in paragraph 1.4 of the Outline SOI where H3G says:

> "… BT's MCT Appeal is misconceived to the extent that it criticises elements of the regulatory model chosen by OFCOM rather than recognise that it is the choice of that model in the first place that is flawed."

136. It became clear at the hearing that H3G's submission that its challenge to the choice of model was within the scope of BT's appeal was based not on anything in the BT Notice of Appeal itself but on passages in the witness statements served by BT from their expert economist, Professor Yarrow and their Director of Strategy in BT Retail, Mr Richardson. Mr Kennelly explained that the notice of appeal lodged with the Tribunal comprises both the notice of appeal and the supporting evidence – and the supporting evidence has to be produced at the very beginning of the process. The case, he says "has to be seen as a whole". To the extent that those statements are "live" before the Tribunal because they have not been challenged as inadmissible, H3G is able to address them in its Statement of Intervention. H3G pointed us to passages in Professor Yarrow's statement where he, H3G says, makes a general challenge to OFCOM's approach and where in particular Professor Yarrow mentions the possibility of setting MCT rates at zero. He also refers to passages in Mr Richardson's statement referring to on-net/off-net pricing.

137. The Tribunal rejects the suggestion that an intervener is entitled to treat evidence served by an appellant as in effect extending the scope of the appeal in a way which then also entitles the intervener to raise those issues even if they are not included in the Notice of Appeal itself. The fact that the Tribunal's Rules provides that the notice of appeal must as far as practicable have annexed to it a copy of every document on which the appellant relies including the written statements of all witnesses of fact, or expert witnesses, certainly does not mean that every point made by a witness is to be treated as part of the grounds of appeal in the manner described by H3G.

138. The Tribunal therefore upholds the objections made by OFCOM and the 2G/3G MNOs to the content of the Outline SOI in so far as that pleading:

    (a) duplicates issues which are properly included in H3G's own appeal but which are not raised by BT's appeal;

(b) raises issues which were included in the Supplementary Material but which the Tribunal has ruled should be excluded; and

(c) raises issues which rely on passages in BT's evidence if that evidence is not properly in support of issues raised by BT's Notice of Appeal.

139. Applying those findings to the content of the Outline SOI, the Tribunal rules as follows.

140. **Section 1 headed "Introduction".** The Tribunal rules that this section is admissible except that paragraph 1.4 other than the first two sentences is inadmissible.

141. **Section 2 headed "The Context in which to assess the imposition of the price control remedies".** This broadly sets out a description of the market as H3G sees it summarising those parts of H3G's own Notice of Appeal which set out why H3G argues that it should not be subject to a price control at all. These passages are inadmissible because they do not relate to BT's appeal. Further in paragraph 2.1(d)(i) H3G refers to on-net/off-net pricing strategies adopted by the 2G/3G MNOs as having an adverse effect on H3G. This is precisely the point that the Tribunal ruled H3G was not permitted to raise in its own appeal. BT's appeal does not depend in any way on the existence or effect of such an alleged differential. On-net/off-net pricing or the causes of traffic imbalance as between H3G and the other 2G/3G MNOs is not put in issue by BT's appeal and is not admissible in the Outline SOI. The Tribunal rules that the whole of section 2 should be excluded.

142. **Section 3 headed "Summary grounds of intervention".** Paragraph 3.1(a) raises the same arguments as H3G has raised or attempted to raise in its own appeal namely NPZ, asymmetrical price regulation and F2M rates "set at substantially reduced levels". None of this arises from BT's limited appeal and this paragraph is inadmissible. The remainder of this section is admissible.

143. **Section 4 headed "Relief sought".** This sets out the relief that H3G seeks in its own appeal. H3G does not appear to be seeking any different relief in the BT appeal.

(a) Paragraph 4.1(a) must be excluded because this relates to the NPZ remedy which is only properly part of H3G's appeal.

(b) Paragraph 4.1(b) remains but the reference to the rates and an appropriate glide path taking "account of actual market circumstances" must be read as referring only to those aspects of the market which are referred to in those parts of section 6 of the Outline SOI which are ruled admissible below.

(c) Paragraph 4.1(c) is excluded other than the first sentence.

144. **Section 5 headed "BT's MCT appeal incorrectly assumes that OFCOM's overall approach in setting the price control was correct"**. The first four paragraphs of this section repeat the assertion that regulation of MCT rates should recognise that the marginal costs of most voice traffic is close to zero. The Tribunal has ruled in relation to H3G's own appeal that this is a new ground and the Tribunal has refused H3G permission to amend to include it. There is nothing in BT's Notice of Appeal which puts the whole of OFCOM's cost analysis in issue and in so far as such arguments are referred to in BT's witness statements, the Tribunal has explained that H3G's reliance on those statements is misconceived. Paragraphs 5.5 to 5.8 raise the question of on-net/off-net price differentials which is impermissible. Paragraphs 5.9 – 5.11 raise the NPZ argument raised in the H3G appeal. It is not appropriate for these issues to be duplicated here because they do not arise from the BT Notice of Appeal. Paragraphs 5.12 to 5.15 raise the same issues as regards asymmetrical price regulation that are raised in H3G's own appeal with the addition of the on-net/off-net pricing issue. In the Tribunal's judgment, the whole of section 5 should be excluded.

145. **Section 6 headed "BT's Grounds of Appeal".** In this section H3G sets out the points it wishes to make as regards the issues in fact raised in BT's appeal. Most of this is accepted as admissible by the other parties.

146. However, the 2G/3G MNOs challenge the references in paragraphs 6.25 and 6.29 – 6.34 to on-net/off-net differential tariffs. H3G argues that the inclusion of an externality surcharge aggravates the incentives that the 2G/3G MNOs already have to engage in on-net/off-net price discrimination. BT has adopted an ambivalent stance to this. The section of their Notice of Appeal challenging the inclusion of the 0.3 ppm externality surcharge in OFCOM's calculation alleges that externality allowances are unusual and constitute interferences with normal competition between FNOs and MNOs. BT indicated in their letter to the Competition Commission on 15 April 2008 that they accept that BT has put the impact of the network externality on patterns of competition in issue in its Notice of Appeal and thus it seems a legitimate point for H3G to make to say that it also has the potential to distort competition as between MNOs.

147. It appears that the point that H3G is making here is (i) that one effect of including an externality charge is to provide an incentive for larger networks to charge more for off-net calls than for on-net calls and (ii) that if the 2G/3G MNOs did so, this would have an adverse impact on smaller networks such as H3G. The Tribunal has concluded that both those points can properly be made without the need to explore whether the MNOs are *currently* differentiating between on-net and off-net calls and whether this is *currently* having an adverse effect on H3G. If the point is limited to a theoretical potential disbenefit arising from the inclusion of the externality surcharge then it can be seen to arise properly from the arguments raised by BT in paragraphs 167 to 171 of its Notice of Appeal and will not cause the difficulties that the Tribunal foresaw when refusing permission to H3G to introduce the point in its own appeal. The Tribunal considers that this is best achieved by not excluding paragraphs 6.25 and 6.30 of the Outline SOI but directing that the Competition Commission should consider the points made in them only to the extent as they are raised as a potential disbenefit without requiring any analysis of whether on-net/off-net pricing currently exists or whether it is the cause of H3G's traffic imbalance with the other MNOs.

148. Paragraphs 6.29 and 6.31 – 6.34 are objectionable for reasons other than their references to on-net/off-net pricing. Paragraph 6.29 reverts to the marginal costs arguments which the Tribunal has ruled inadmissible. Paragraph 6.31 raises the question of call externalities (that is the benefit that subscribers enjoy from receiving calls) apparently as an argument for setting MCT charges below even marginal cost. Paragraphs 6.32 – 6.33 contain material which is either relevant only to H3G's appeal or inadmissible and so should be excluded. The Tribunal rules that paragraphs 6.29 and 6.31 to 6.34 are excluded.

149. On 21 April 2008 H3G served its full Statement of Intervention ("the Full SOI"). This was stated, at paragraph 1.2, as "intended to supplement, not supersede, H3G's Outline SoI". The Tribunal has not received submissions or heard argument as to the inadmissibility of any part of the Full SOI.

150. Pursuant to the Tribunal's order of 25 February 2008, BT and OFCOM were to file any reply to the full statements of intervention of H3G and the other interveners by 6 May 2008. Given the uncertainty as to the admissibility of certain sections of H3G's intervention, the Tribunal instructed the Tribunal Registry to write to BT and OFCOM informing them that the Tribunal would consider BT and OFCOM to have complied with the Tribunal's order provided their Replies address the uncontested sections and paragraphs of H3G's Outline SOI and sections 5, 6 and 7 of H3G's Full SOI. BT and OFCOM filed their Replies on 6 May 2008.

151. Having regard to the various points made in this ruling in relation to the Supplementary Materials filed by H3G in its own appeal and in relation to H3G's Outline SOI in the BT appeal, the Tribunal remains of the view that it is not necessary for BT or OFCOM to respond to sections 1 to 4 or 8 to 9 of H3G's Full SOI.

    (a) Sections 1 and 2 provide an introduction and a summary of BT's appeal. These sections are unobjectionable. In Section 2 H3G quotes a lengthy passage from section 63 of BT' Notice of Appeal, emphasising various phrases and sentences which, we understand, they rely on as providing the basis for the broad scope of their Intervention. In this regard we refer to

the passage from the Tribunal's earlier ruling cited at paragraph [84] above. Paragraph 63 appears in the section of BT's Notice of Appeal headed "Summary of BT's Grounds of Appeal" not in the later section headed "Grounds of Appeal". BT made clear in its own application for permission to amend that it did not contend that anything outside the latter section constituted grounds of appeal. H3G cannot therefore rely on these summary paragraphs as going wider than the actual pleaded grounds. It is not, in the Tribunal's judgment, necessary for BT or OFCOM to respond to anything contained in these sections;

(b) Sections 3 and 4 are addressed in the following paragraph;

(c) Section 8 contains a single paragraph relating to a ground of appeal on which BT no longer seeks to rely. Evidently, there is no need for BT or OFCOM to respond to this point; and

(d) Section 9 sets out the relief sought by H3G. Sub-paragraph (a) asks for lower MCT rates based on marginal costs and so should be excluded. Sub-paragraph (b) appears to seek relief consequent on the properly pleaded parts of H3G's SOI and sub-paragraph (c) asks for the remainder of BT's appeal to be dismissed. The Tribunal rules that sub-paragraph (a) is excluded since relief is not properly part of the BT appeal. The other two sub-paragraphs remain.

152. In the Tribunal's judgment, sections 3 and 4 of the Full SOI suffer from the same flaws as sections 2, 3 and 5 of the Outline SOI in that they seek to import into the BT appeal (i) H3G's grounds of appeal in its own appeal and/or (ii) arguments in respect of which H3G has previously been refused permission to introduce in its own appeal and/or (iii) arguments in respect of which H3G has been refused permission pursuant to this ruling. In so far as H3G attempts to import these points into BT's appeal on the basis of comments in the evidence of Professor Yarrow and Mr Richardson, the Tribunal has explained earlier why that reliance is illegitimate. Consequently, the Tribunal rules that sections 3 and 4 of H3G's Full SOI are inadmissible.

153. Three documents were annexed to H3G's Full SOI:

(a) **Annex 1:** A Morgan Stanley Report on the Vodafone Group, referred to at paragraph 3.9 of H3G's Full SOI;

(b) **Annex 2:** a table of on-net/off-net price discrimination references, relied on in support of the arguments contained in section 4 of the Full SOI; and

(c) **Annex 3:** an expert report of Professor Martin Browning of Oxford University, which analyses the econometric work undertaken for BT by Dr Maldoom, and to which reference is made in section 5 of the Full SOI.

154. The Tribunal's decision to rule sections 3 and 4 of H3G's Full SOI inadmissible clearly applies also to the annexes referred to therein (and not incorporated elsewhere in the Full SOI), namely Annexes 1 and 2. However, in respect of the Morgan Stanley report contained at Annex 1, this is the same report which H3G sought to adduce as evidence in its own appeal and which is considered at paragraphs [113]-[116] above. The Tribunal has indicated at paragraph [116] how such documents should be dealt with. Conversely, the expert report of Professor Browning contained at Annex 3 is relevant to section 5 of the Full SOI, which is admissible and is one of the sections of the Full SOI to which BT and OFCOM were instructed to respond by 6 May 2008.

X. CONCLUSION

155. The hearing which took place to argue the matters considered in this ruling was attended by ten counsel with their teams and lasted until past 6 pm. As is clear from this inevitably lengthy and complex ruling, the Tribunal has found that most of the complaints raised by OFCOM and the 2G/3G MNOs were well founded. All the decisions set out in this ruling have been arrived at unanimously by the Tribunal. H3G has disregarded the clear guidance that the Tribunal gave at the case management conference on 25 February 2008.

156. The Tribunal notes that the pleadings in H3G's appeal are not yet closed. The Tribunal expects all the parties to take account of this ruling in considering what

matters to raise in their pleadings. These proceedings have now been underway for a year and the Tribunal will deal very firmly with any attempt to raise matters which expand the ambit of the appeal beyond the issues which now properly form part of it.

Vivien Rose Andrew Bain Adam Scott

Charles Dhanowa
Registrar

Date: 20 May 2008