IN THE COMPETITION APPEAL TRIBUNAL

Case No. 1146/3/3/09

Victoria House,
Bloomsbury Place,
London WC1A 2EB

28th October 2010

Before:

MARCUS SMITH QC
(Chairman)

PROFESSOR PETER GRINYER
RICHARD PROSSER OBE

Sitting as a Tribunal in England and Wales

BETWEEN:

BRITISH TELECOMMUNICATIONS plc Appellant

– and –

OFFICE OF COMMUNICATION Respondent

– and –

(1) CABLE AND WIRELESS UK
(2) VIRGIN MEDIA LIMITED
(3) GLOBAL CROSSING (UK) TELECOMMUNICATIONS LIMITED
(4) VERIZON UK LIMITED
(5) COLT TECHNOLOGY SERVICES Interveners

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HEARING
(Partial Private Circuits)
DAY SIX

APPEARANCES

Mr. Graham Read QC, Mr. John O'Flaherty and Mr. Ben Lynch (instructed by BT Legal) appeared for the Appellant.

Mr. Pushpinder Saini QC, Mr. James Segan and Mr. Hanif Mussa (instructed by the Office of Communications) appeared for the Respondent.

Miss Dinah Rose QC and Mr. Tristan Jones (instructed by Olswang) appeared for the Interveners, Cable & Wireless UK, Virgin Media Limited, Global Crossing (UK) Telecommunications Ltd, Verizon UK Limited and COLT Technology Services (the "Altnets").

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THE CHAIRMAN: Mr. Saini?

MR. SAINI: Good morning, sir. I hope on your desk in front of you have a copy of our closing submission and a little selection of authorities ----

THE CHAIRMAN: I have indeed.

MR. SAINI: -- to which I shall make reference in due course. I should also explain that we are very grateful for the questions that the Tribunal would like us to answer, and we have dealt with those at the end of our closing submissions at paras. 20 and 29. We have set out the questions and then our answers in summary form to those specific questions.

THE CHAIRMAN: Splendid, that is very helpful.

MR. SAINI: I will develop those answers during the course of my submissions. As you will see from my closing submissions at para. 2, there are essentially seven parts to our submissions. I am reluctant to repeat things I have said in opening because in this case we probably both opened the case in a rather longer fashion than one would normally expect, but I am going to have to emphasise certain points I made again.

The first issue I can deal with quite shortly, which is the question of the decision to accept the disputes which we deal with between paras. 3 and 6.

This particular point has not been developed by Mr. Read and, as I understand it, he still does pursue this point, he has confirmed that to me this morning. He is still pursuing this point. There is an issue of law underlying it, but I want to deal with it very shortly by just referring the Tribunal to what we say in para.4, which is as the Tribunal observed in the *Orange v Ofcom* case if someone wants to complain about the initial decision to accept a dispute, but that particular question is not resolved, or decided upon until the end of the dispute it is difficult to see what useful remedy the Tribunal could be asked to order. It becomes a point which has effectively lost its purpose, and that does apply with substantial force in this case, because the Tribunal has heard the whole dispute. I am not going to say anything further about that, I just want to put down one marker, which is that in our submission the decision of the Tribunal in *Orange v Ofcom* may well be wrong. We do not accept necessarily as a matter of law that it was a correct decision, but this Tribunal has enough on its plate to deal with, and this is a minor point so I am not going to make any submissions on that other than to rely on what is said in *Orange v Ofcom* which if we go to para. 4, which is: what is the point of such a challenge if you have actually heard the substantive appeal.

I am not going to say anything further about that issue, I am going to turn straight to our second matter, which is the relevant SMP conditions, and in this regard I also want to

address, while I am dealing with this, the first point raised by the Tribunal which is: what is the correct approach when construing an SMP condition and, in particular, Condition H3. Can I ask the Tribunal first of all to take out the relevant condition which is in ADB2, which is the LLMR statement, the Tribunal may have marked it, but the relevant conditions that we are concerned with begin at p.476, Conditions concerning trunk. The Tribunal already has the submission I made last week which is that as appears from the very first paragraph on p.476, these conditions expressly apply to wholesale trunk segments. The Tribunal will also recall that I took the Tribunal through the further directions which referred expressly to trunk. There is a particular part of these conditions that I want to refer the Tribunal to in relation to the question of construction. Would you look, please, at p.477, you will see it is sub-para.(4), a provision there saying:

> "The Interpretation Act 1978 shall apply as if each the conditions were an Act of Parliament."

If the Tribunal will just go ahead to p.613, you will recall that I referred the Tribunal last week to a specific direction under Condition H3, you will see the same wording about the Interpretation Act appearing in the third paragraph from the bottom of 613:

> "The Interpretation Act 1978 shall apply as if this Direction was an Act of Parliament."

The Tribunal has our submission that these conditions clearly apply to trunk segments, but I should also say a few words about the juristic nature of these conditions. We submit that these are public law instruments. These are conditions made pursuant to a statutory scheme. The relevant principles of interpretation that would apply in the construction of these public law instruments, these directions, are those that apply to statutes and not those that apply to contracts.

There is a recent useful case, which is in the tab of authorities which I hope you have, a case from earlier this year, a decision of Mr. Justice Cranston. This is one of the many, and I am sure not the last, cases in which Miss Rose roundly defeated me. It is the case of *Data Broadcasting International Limited v. The Office of Communications*, a decision of 28th May 2010. Just to give you some background, and I am going to then quickly refer you to some paragraphs, this was a case that concerned the construction of a licence granted in respect of certain broadcasting services, a licence granted under the Broadcasting Act. An issue arose about the implication of certain terms and construction of this licence, and having heard the arguments Mr. Justice Cranston concluded, and these are the points of

general principle, paras.68 and 69, that there were certain principles that applied to these particular statutory licences. If I may read para.68:

> "At the outset it is necessary to identify the appropriate principles for the interpretation of these statutory licenses. For reasons given later in the judgment statutory licences of this character do not constitute contracts between the regulator and the licensees. That being the case, the principles of statutory interpretation are more appropriate to interpreting them that those applicable to contractual interpretation, in the event that there is a difference. The case for using the principles of statutory interpretation for these licences is perfected because, in crucial aspects, the licence conditions track the statutory provisions.
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> There is no need to dwell on the applicable principles of interpretation. In broad terms one must give meaning to the words in the light of their context. Among the contextual features here are the statutory background and the commercial nature of additional services licences. In my view it is unhelpful to draw a dichotomy between the literal and purposive approaches so that the interpretative exercise demands a choice of one over the other. One must begin with the words but give them meaning with the relevant background features in mind. That encompasses both literal and interpretative elements."

If I can just draw the Tribunal's attention to one further passage a few pages ahead at para.88:

> "In my view these licences are not contracts. A contractual analysis distorts their juridical character. The licences are public law instruments. They constitute statutory authorisation permitting the licensees to undertake activities which would otherwise be unlawful and, in this case, place them under particular obligations, breach of which exposes them to the risk of the imposition of statutory financial penalties or ultimately to revocation of the licences. In granting [the licence], the authority acts pursuant to its statutory duties and functions, and there is no intention to enter into any private law legal relations with the licensees. There is no express agreement between the parties in the contract sense. In the main the conditions of the licences are derived directly from the statutory provisions."

Now the context in that case is different. Indeed, that is the case of a licence granted and there the judge is quite firmly of the view that that licence is not a contract it is a public law instrument.

The position as regards the particular conditions in this case is therefore *a fortiori*, these are not even licence conditions we are concerned with, these are directly imposed statutory obligations, therefore they are even more removed from the contractual analysis. That having been said and dealing with these conditions effectively like a statute, there is helpful observation made by Lord Hoffmann in the *Belize* case which I am going to take the Tribunal to, where it is clear that the factual matrix test does not disappear when one is looking at statutes. There is still factual matrix which is relevant and this is a case *Attorney General of Belize and others v Belize Telecom Ltd and another*. Again, some brief background. This is an appeal to the Privy Council where the issue is not the construction of a contract, nor the construction of a statute, but the contract of the Articles of Association of a company, but the observations made by Lord Hoffmann at para.16 are of general application. If I could ask the Tribunal please to go to that at p.1132?

The particular issue in this case was the implication of some terms into the Articles, but if I may read it because one gets a sense of what Lord Hoffmann was saying more broadly. At 16:

> "Before discussing in greater detail the reasoning of the Court of Appeal, the Board will make some general observations about the process of implication. The court has no power to improve upon the instrument which it called upon to construe, whether it be a contract, a statute or articles of association. It cannot introduce terms to make it fairer or more reasonable. It is concerned only to discover what the instrument means. However, that meaning is not necessarily or always what the authors or parties to the document would have intended. It is the meaning which the instrument would convey to a reasonable person having all the background knowledge which would reasonably be available to the audience to whom the instrument is addressed."

Then after the citing the *Investors' Compensation Scheme*, he continues:

> "It is this objective meaning which is conventionally called the intention of the parties, or the intention of Parliament, or the intention of whatever person or body was or is deemed to be the author of the instrument."

So the question for the Tribunal is what would this instrument, and here these SMP conditions mean to a reasonable person having all the background knowledge which would reasonably be available to the audience. Now, the audience here, which is quite important, is the general public, it is nobody else. So if one had to go through the materials that form the relevant part of the factual matrix we can identify two particular matters. First, a

relevant document in construing the conditions must be the LLMR statement. It is not just the LLMR statement as it regards the trunk statements, but also what is said in the LLMR statement about terminating segments, and the conditions imposed in relation to terminating segments. A second piece of material that the Tribunal can look at, and this may be obvious is the primary legislation, the Directives. In this case we say that is where the Tribunal stops. So when construing Condition H3 you can look at the LLMR statement, which gave birth to Condition H3 and/or parts of the LLMR statement and then the primary legislation, the Directives, which specify the circumstances in which SMP obligations can be imposed; that is where it stops.

Crucially, sir, we do not agree that in construing Condition H3, which was finalised in the form we see in the LLMR statement on 24th June 2004, it is relevant to look at any document later than that and, in particular, if one is being a purist about this one cannot look at 30th September 2004 PPC charge control statement, which follows a few months later, to construe what Ofcom intended in the terms of Condition H3. Sir, I hope that that answers the first question that the Tribunal posed in relation to the appropriate approach to construction.

THE CHAIRMAN: What about documents in the distant past like the guidelines?

MR. SAINI: Sir, in our submission those are not matters that would assist in the construction of H3, we do not accept that, but they are indicators of the approach that Ofcom will take to enforcing condition H3.

Sir, I am not going to say anything more about the case of BT in relation to what Condition H3 covers, because as we have said at para.8 it is still not quite clear to us whether or not Mr. Read accepts that Condition H3 applies to trunk segments. Certainly his witnesses, and certainly the most senior of his witnesses, Mr. Pigott, who is the head of portfolio analysis, and we put the citation of his evidence at the top of p.4, he accepted it applied to trunk segments.

Can I emphasise the points, sir, at para. 12 before leaving this issue of the condition? You have seen this many times in the particular wording of H3, if I may quote it provides for "an appropriate mark-up for the recovery of common costs including an appropriate return on capital employed." We submit that the mark-up and the return must be the mark-up and the return attributable to trunk segments, not something else, particularly not terminating segments, which are covered by a distinct condition.

Sir, I am not going to say anything further about burden of proof, but it is relevant later on when one comes to look at what BT's positive case is as to how they complied with the

obligations in this case, or thought they were complying with them. Equally, para. 15, the Tribunal will be very familiar with these points about the distinct regimes of regulation applied to terminating and trunk segments, and we have set that out at some length because we do consider that Ofcom's analysis in the LLMR statement is a relevant aid to the construction of those conditions.

If I may turn then, just while we are dealing with the Conditions, para. 18 et seq. We say that the evidence overwhelmingly establishes, particularly the LLMR statement, that at the time of the LLMR statement there was a serious concern on the part of Ofcom that BT's prices for trunk were not cost oriented. First, one sees the point at para. 18(i) at the bottom of p.6, which is compared to the BT Financial Statements, which were set out at that paragraph, B108 of the LLMR statement, there was an observation by Ofcom that the trunk segments are currently priced significantly above cost, and further observations to the same effect were made again.

What is important, sir, is that although this was Ofcom's view expressed to the world, there could have been no misunderstanding on the part of BT because you will recall the internal document which I would ask you now to turn up. If one puts the LLMR statement away and if one would please turn to bundle BT2, and if one goes to JM6. This is a confidential document, I am not going to read the text of it, but I am going to make certain submissions on it. The Tribunal will be very familiar with this.

The two clear points, sir, before we look at the text – you will remember there are two versions of this, JM6 and JM7 – there are two things that come clearly out of both of these versions. First, the point at para.21(i) that BT was very well aware that Ofcom was treating trunk charges separately from terminating charges in respect of cost orientation; and secondly, that BT considered itself at regulatory risk of a challenge on excessive trunk prices.

In tab JM6, without reading the text in the square box in the middle of the page and comparing that to the text in the square box in the middle of the page at JM7. We say that Mr. Morden was quite wrong, with respect to him, to suggest that the two different versions of this text suggested that BT had not been told by Ofcom that it was not complying with its cost orientation obligations. We find it very difficult to see how the message is not the same in those two particular parts of text. We recite at the bottom of p.7 that the text that we are willing to rely upon, which is the text in version 2, and again I will not read that, it could not have been clearer. One does wonder, with respect to Mr. Morden, and I am not for one moment suggesting that he was not doing his best to assist the Tribunal, why BT

was so sensitive about this document. We submit it is clear why it is sensitive, because this is the greatest possible warning to them that Ofcom considers (a) trunk should be dealt with separately; and (b) that there is a problem with the pricing of trunk.

Just concluding in relation to this issue of the condition and the materials available at the time, we say that it is absolutely clear, first, that condition H3 applies to trunk, and absolutely clear, secondly, that by the end of the LLMR process it was clear beyond any doubt to BT that there was a problem with its trunk charges.

May I then turn to the next main issue at the top of p.8, which is "Aggregation/disaggregation", and the points we make in para.24 I made in opening, so I am not going to repeat those points again, but what is important is the point at 24(i), and, having had a brief look at Miss Rose's written submission this morning, this is a point she focuses on in more detail in some ways. We say that, as a matter of law, before one goes to the further practice, this Tribunal is required to hold that condition H3 applies to trunk on a disaggregated basis. One does not really enter into the further factors about why that is, because condition H3 on its face applies just to trunk. Even, if one puts that to one side, we submit the factors at 24(ii) to (v) are compelling.

What has clearly come out of the evidence, sir, and we have tried to illustrate this at para.25 by reference to Mr. Myers' evidence, and I do not actually believe there is ultimately a dispute between the experts at least on this and Mr. Myers, which is that if one allows an aggregation between trunk and terminating that will have the effect or could have the effect of undermining the strict price control on terminating segments. The price for terminating segments has been decided on the merits. It was determined by Ofcom that that was the appropriate price without any appeal. One cannot allow for a claimed lack of recovery in relation to terminating to be made up by way of trunk segments, because that will undermine the price control as regards the terminating aspect.

It is also clear, sir, if I can draw your attention to para.27, that within BT's own materials, despite saying that they regard the product as being PPCs as a whole, their own materials at various points and their own financial statements describe wholesale trunk segments as a separate service on a separate bandwidth by bandwidth basis.

Can I just show you one of those because we have not looked at these before, if one can put away BT2 and open DF3. Can we, first of all, go to tab 8 within that, this is a copy from BT's Wholesale Catalogue immediately following the LLMR review. I do not believe the Tribunal has been shown this before, but I apologise if you have. There the catalogue described the service as Wholesale Trunk Services. It does, to be fair, say under "Service

Offering" that PPC services are not sold separately. There is no doubt that there is a service.

It is also clear, sir, on the evidence as it finally emerged that BT's own witnesses accepted that the separate price of trunk segments was an economically meaningful factor for decision making. You will recall the cross-examination of Mr. Morden. I believe again – and I am grateful to Miss Rose, there are more detailed references in her closing to this – he accepted that when it came to a pricing decision, and when it came to deciding to purchase a PPC circuit a communications provider would look at the separate prices when making his decision.

Sir, that is what I want to say about aggregation and disaggregation, but I do want to deal with now with legitimate expectations, and I say it with this caution, which is that it is not at all clear to us that legitimate expectation was ever pleaded by BT. No doubt when Mr. Read makes his submissions, either later today or tomorrow, he will identify in his notice of appeal where he pleaded it. There is no doubt that it appears footnoted in his skeleton, and we are grateful for the Tribunal yesterday identifying where those points appear. We are not absolutely clear what the legitimate expectation is, or how it is meant to arise, but we have done our best to try and work out what it is. Can I begin at para.28. As we understand it, the target of this argument is the meaning of condition H3. As we understand the position, it is said by BT that certain things said and done by Ofcom affect the interpretation of condition H3.

The starting point for this argument is that condition H3 is what Ofcom says it means, which is that it concerns trunk, but BT would like to argue that the conduct of Ofcom has led BT, to its detriment, to believe that it would be enforced or applied in a different way. There is a threshold issue there, sir, which we are grateful to the Tribunal for identifying in its questions yesterday, which is that can conduct on the part of a public authority as to how it is going to interpret a particular provision actually change the meaning of that provision. I am going to come back to that point.

What I am going to say now is that, without prejudice to our submission, conduct cannot affect the interpretation. Let us take BT's case on the merits. As we understand it, and this is para.29 of our submission, it is said that there two things that Ofcom have done to engender some legitimate expectation as to the interpretation of condition H3. The first is the rebalancing proposal in 2004 and the second is the closure of the own initiative investigation. The facts in relation to those we have dealt with at para.31, but perhaps the Tribunal should first see a case, which is now well established, setting out the test in

relation to legitimate expectation. That is the decision in a Westlaw print-out. It is *Regina v Inland Revenue Commissioners*. Just to give you some background context, this is a case in which various claimants were arguing that the Inland Revenue had given assurances to them as to the tax treatment that would be applied to certain bonds. They said that because the Inland Revenue departed from its assurances as to that tax treatment, they had defeated the legitimate expectation of the claimants. The actual disposition of the case does not matter, but I can perhaps pick it up in the holding at the bottom of the first page, about five lines down, and if I can ask the Tribunal to note that the ruling is meant to be the conduct of the Inland Revenue, which was relied upon to give a basis for its legitimate expectation argument. There it is said in the holding that such a ruling should be clear, unambiguous and devoid of relevant qualifications, and just to pick up in the body of the report if one goes, please, to p.23 of 28 and if I may read from the judgement of Lord Justice Bingham. I do not believe there is any dispute about relevant legitimate expectation, I will just read it out:

> "In so stating these requirements I do not, I hope, diminish or emasculate the valuable, developing doctrine of legitimate expectation. If a public authority so conducts itself as to create a legitimate expectation that a certain course will be followed it would often be unfair if the authority were permitted to follow a different course to the detriment of one who entertained the expectation, particularly if he acted on it. If in private law a body would be in breach of contract in so acting or estopped from so acting a public authority should generally be in no better position. The doctrine of legitimate expectation is rooted in fairness. But fairness is not a one-way street. It imports a notion of equitableness, of fair and open dealing, to which the authority is as much entitled as the citizen. The revenue's discretion, while it exists, is limited. Fairness requires that its exercise should be on the basis of full disclosure. Mr. Sumption accepted that it would not be reasonable for a representee to rely on an unclear or equivocal representation. Nor, I think, on facts such as the present, would it be fair to hold the revenue bound by anything less than a clear, unambiguous and unqualified representation."

They have been taken then subsequently in public law as being a relevant test. Has there been a clear, unambiguous and unqualified representation? If one tests, going back to 31 of our skeleton argument, the two matters relied upon by BT against this articulation of the principle, we say that rather than supporting BT's case, that Ofcom were representing they

would take an aggregated approach, the two particular matters relied upon, first the rebalancing proposal in September 2004, and the closure of the own initiative investigation showed the opposite because dealing with 31(i) the reason that the rebalancing proposal in part was rejected was because BT had not provided data that would allow Ofcom to analyse on a disaggregated basis the relevant charges.

Secondly, on the own initiative investigation the reason that was closed in part was because BT had not provided disaggregated data, it was sent away to provide disaggregated information. Had Ofcom believed that an aggregated basis was appropriate, and this is the point we make at the top of p.11, it would make no sense to send BT away to collect disaggregated information, so we are very, very far away from any clear unambiguous and unqualified representation by Ofcom.

We also make the point, which perhaps has not been noticeable before, at para. 33 that in fact if one goes back to the guidelines, they require disaggregated cost information, which is a point I do not think anyone had spotted before. You will also see the concessions made in evidence by Mr. Morden at para. 35. Mr. Morden is the man on the ground dealing with trunk segments. He accepted in an unqualified manner when I put to him that BT was well aware that Ofcom required trunk prices, not the terminating trunk to be combined, and the trunk prices were to be cost oriented.

So the case fails on the facts but there is the point that we make at para. 37 following up on the Tribunal's question from yesterday. Let us assume against ourselves that Ofcom had made a clear and unqualified representation as to how it was going to interpret Condition H3. We say as a matter of law this court could give no effect to such a legitimate expectation and I can deal with this very shortly by taking you to a passage from **De Smith's Judicial Review** ,and at p.493 at 9-021 there is a general statement of the principles concerning legitimate expectation – we put that there for completeness, but the particular part I would ask the Tribunal to focus on is at p.494, para. 9-023 and again I do not believe there is any dispute about this, but we will hear what Mr. Read says.

"A public authority cannot effectively disable itself by contractual or other undertakings from making or enforcing a bylaw, refusing or revoking a grant of planning permission, or exercising any other statutory power of primary importance, such as a power of compulsory purchase, nor can it effectively bind itself to exercise such a power in any particular way. Similarly, it cannot be estopped by its inertia or acquiescence from fulfilling a duty to exercise a power when the occasion arises for it to be exercised. These principles apply *a fortiori* to fettering the effective discharge of public duties.

These are general principles, but how do they apply here? If in fact Condition H3 on its proper construction applies only to trunk segments, the general public and, in particular the communications providers are entitled, as a matter of law, to the enforcement and interpretation of those conditions in accordance with their true meaning. Bilateral conduct as between Ofcom and BT, and we do not accept there is any such conduct I emphasise, cannot change the meaning of those provisions.

Those conditions were imposed in the public interest, in order to regulate an entity with significant market power. While I am on this issue, sir, I can perhaps also just draw your attention right at the end of our submissions at p.28, at the bottom of the page, I am not going to take you to this case, it is in the extracts on your desk. At the bottom of p.28 you will see a reference to the *Rowland v Environment Agency* case, that is just a recent example of that principle, that there is a rule under English that a legitimate expectation can only arise on the basis of a lawful promise or practice. It would not be lawful for Ofcom to say although we have published and imposed this Condition H3, meaning that it will apply to trunk segments. We have agreed with BT that it will not really apply to trunk segments. That is the crucial distinction, sir, between estoppel as we know it in private law, and legitimate expectation in public law, and you raise the issue, sir, as your second question one sees at p.28, but there is law on this issue – again, I suspect that Mr. Read mentioned estoppel but did not really develop it because he is aware that in a public law context the private law context of estoppel does not really work, and perhaps I can just show you, sir, what Lord Hoffmann said about using estoppel in public law cases, in the *Reprotech* case which we cite at p.28. In fact, one does not even need to go to the body of the report because the principle is set out in the headnote – this is *R v East Sussex County Council (ex parte Reprotech).* If I may just read the first page: "It is unhelpful to introduce private law concepts of estoppel into planning law." Can I just stop there for the moment, just to make it clear that what is said here is in the context of planning law, but I do not believe there is any dispute that what is said here applies generally to public law as well.

"Estoppels bind individuals on the ground that it will be unconscionable for them to deny what they have represented or agreed, but those concepts of private law should not be extended into the public law of planning control, which binds everyone. In that area, public law has already absorbed whatever is useful from the moral values which underlie the private law concept of estoppel, and the time has come for it to stand upon its own two feet. Although there is an analogy between a private law estoppel and the public law concept of a legitimate expectation created by a public authority, it is no more than an analogy because

remedies against public authorities also have to take into account the interests of the general public that the authority exists to promote. Public law can also take into account the hierarchy of individual rights which exist under the Human Rights Act."

I will not read any more than there, but just for your note in the body of Lord Hoffmann's speech, these paragraphs, which are summarised in the headnote appear between 33 and 35. I have not taken you to those because I consider that to be a fair summary.

I should make it clear however, going back to our written submission at paras. 28 and 29, that a legitimate expectation cannot change the meaning of a legal instrument, or cannot bind Ofcom to apply that legal instrument contrary to its terms. However, we do accept, following up on one of the questions that the Tribunal raised, that when one comes to consider issues of repayment in principle if we have led a regulated company to believe that the particular enforcement attitude towards an instrument is going to be one thing, and it turns out later on – following a hearing – that we made an error, we accept that principles of fairness would come into play when one decides whether or not to order repayment. In fact, that has happened in a case where last year – to give you an example – where BT was found to have been overpaid by various entities including the Carphone Warehouse. It was decided that there was a breach of cost orientation, but in that case the matter of fairness to BT was decided that because of certain conduct of Ofcom it would not be fair to require them to disgorge the sums. So considerations of fairness, for which legitimate expectation is just one aspect, do come into play when one comes to questions of discretion on repayment, but they do not come into play in interpretation and enforcement of cost orientation conditions.

I do emphasise, however, that in this case we were not in that territory because we had done nothing to indicate to BT that we would not apply Condition H3 according to its terms. We will return to s.190(2)(d) in due course towards the end of my submissions because there was a question the Tribunal raised about factors that can be considered when exercising that discretion.

If I may then turn, sir, to para. 39, and the issue of DSAC as a first order test, there are essentially three criticisms that we believe at the end of the evidence that are still being maintained. First of all, that there is a failure of legal certainty, secondly, that DSAC cannot be used just as a screening test because it is just an arbitrary pass/fail test; and thirdly, that it provides no reliable guidance because it is volatile and calculated retrospectively. If I can take each of those in turn, on legal certainty we have identified in para.43 the very clear documents, BT's own documents, primary accounting documents and current cost financial

statements in which BT itself accepts and reports upon DSAC as a test of cost orientation. There is, however, one document, sir, which I did not show you, which is important, and it is referred to at the top of p.14 of our submissions, and if I can ask the Tribunal to take up bundle DF2, tab 11. You will recall, sir, the context is, the background is that in appendix 2 to the notice of appeal, which is a document that BT's witnesses say that they helped prepare, that explains the background to DSAC and how they claim in that document that they did not really know that DSAC was going to be applied. They refer to certain things that Ofcom said, but they did not refer, sir, to this document, which is at tab 11, that will stay in the background.

During 2006 Ofcom decided to undertake a consultation exercise on regulatory financial reporting obligations, and just for your note, we may want to flip back, one sees that consultation exercise just in a previous tab, the consultation paper. One sees at various points in that descriptions of DSAC and first order tests, etc, very similar to those we have seen before, and if I could just ask the Tribunal to note the pages – p.37, para.5.22, and p.38, para. 5.27. Without taking time on those, what I want to identify for you, sir, is what BT was saying in 2006, so this is soon after the LLMR obligations were imposed, and if I can identify what BT was saying, first going to p.3. The context is that, Ofcom had asked, under questions 13-30, "What do you, including BT, think should be reported?" And first of all there is a note concerning cost orientation, and if I may read that it says:

> "Note that the terms 'cost oriented' and 'cost orientation' which are used both in Ofcom's consultation document and in this response are effectively shorthand for the phraseology used in the formal Conditions imposed upon BT by Ofcom in relation to SMP markets. For example, SMP Condition 13 [that is effectively the same as condition H3]. It is this that the term 'cost orientation' is used to indicate.

If one goes over the page please, sir, to the very bottom paragraph on p.4:

> "In relation to SMP markets, the main objective is to provide sufficient assurance that the firm with SMP has complied with key regulatory accounting and reporting obligations. These may include providing first order evidence of non discrimination, cost orientation of prices for key products and compliance with ex-ante price controls".

But then dealing specifically with particular measures of cost, if one goes over, please, to p.6, to the second bullet point. "Cost orientation of prices for products in SMP markets":

> "For products subject to periodic price controls this test is, in broad terms, satisfied by the fact that prices are being controlled ex ante by the regulator. Comparison of

average charges with costs is a good first-order test of cost-orientation. Although the accounts cannot show anything more than a first order test, this approach has been in place for ten years and is widely accepted as an appropriate measure".

And we say this is BT being well aware of the test which it is already applying, those of DSAC and DLRIC, referring to them being in place for ten years, which is a reference back to 1997, and in its own words BT is saying that these are widely accepted as an appropriate measure. And if I could ask you please and, sir, to go to p.12 of this document, to the answer to question 25:

"Do you consider the publication of LRIC floor and ceilings" —

and here, sir I am reading from the question, here LRIC floors are the floors, the ceilings are effectively DSAC ceilings. And then if I can read BT's answer:

"LRIC can be a valid approach for the assessment of the cost floors for cost-oriented interconnection tariffs, providing Communications Providers with first level assurance of BT's charges are properly cost oriented".

Then they go on to say that they do not:

"… believe it is necessary to [provide] comprehensive detail of floors and ceilings".

Next, there is a point about next generation networks which is next generation networks was going to be the roll out of a particular, the way in which BT's network was going to be rolled out in the future, but if I can pick it up, perhaps I should read it from the beginning:

"The impact of BT's [next generation networks] on product costing will be wide-reaching. Many services will be provided over a common IP-based platform and as a consequence the common costs associated with any individual service are likely to dominate the cost stack, making LRIC and other traditional costing approaches far less meaningful concepts. Some of these problems are already evident in BT's existing network configuration, and the adoption of DLRIC and DSAC reflect the fact that LRIC and SAC are less meaningful when fixed and common costs dominate the cost stacks for many core network components".

And you see the definitions of DLRIC and DSAC. Now, what is being said here, sir, is that true LRIC and true SAC are not meaningful, and that is essentially why we have adopted DLRIC and DSAC.

Now sir, in the context of BT's primary accounting documents, in the context of its current costs financial statements, in the context of this document, the suggestion that BT did not know that DSAC was going to be the test is simply unsustainable. But one does not stop there, because one sees, going back to our original document at p.14, that by the end of the

evidence all three of the witnesses that I cross-examined, Mr. Budd, Mr. Morden and Mr. Pigott accepted that DSAC was the first order test for compliance with cost orientation conditions. The most that they could say — and this point has been echoed in the cross-examination by Mr. Read at para.46 — is that okay, even if we did know that, you should have looked at our regulatory financial statements and seen that we were either below DLRIC or terminating, and had exceeded DSAC for trunk. But, sir, one has to see the relevance of that point. It could well have been that, despite being outside these floors and ceilings, BT's charges were cost oriented, because these are first order tests only. BT are bearing the burden, one would expect, had evidence that despite being outside these floors and ceilings, they could satisfy Ofcom in due course that they had met condition H3. It cannot be right, however, to say that, just because Ofcom was silent, Ofcom did not really believe DSAC and DLRIC were relevant parameters. In fact, you will recall on the one occasion prior to the present dispute where DSAC and DLRIC were focused upon, in particular DSAC, you will recall the LLMR statement when a complaint was made by Ofcom that BT appeared to be over-charging on trunk prices in the LLMR statement, it was by reference to BT's DSAC figures, and you will recall (and I will just give you the references in the LLMR statement which is in ADB2 and it is p.340, para.B108) and there is a table there and, looking at that table which sets out a DSAC ceiling, relying upon that DSAC ceiling, Ofcom had concluded that BT was pricing above the appropriate level.

Sir, I am going to deal with the second sub-issue within DSAC which is its legitimacy. And there were some very useful evidence given to you, sir, by Mr. Bolt in this regard, we set it out at para.48. And he came up with the wording that it created a rebuttable presumption. Now, Mr. Myers, probably because he is an economist rather than a lawyer, was not happy when Mr. Read was putting to him points about presumption; but in effect we say that Mr. Bolt had got it completely right. When you have a first order test, if the first order test is failed, then it must have some significance. The significance is that there is a case to answer a rebuttable presumption. What we do not understand, sir, is what is meant by a screening test, then, because when we asked Professor Yarrow what — if you fail screening test what happens, what does it mean, he would not commit himself. I think he ended up saying "Well, it's effectively like a guide for a junior person, that they need to do some relevant investigation". But, with respect to Professor Yarrow, it is much more than that, because it is the first order rather than anything else. And you will recall his evidence that he thought "first order" in this context meant just "first in time", and we have given the

reference to that transcript at the bottom of p.16. With respect to Professor Yarrow, clearly that is not what was intended in the guidelines.

What is important as well, sir, is that the guidelines themselves say what it is a first order test of, and we have set out (para.49) an extract from the guidelines which says:

> "Whilst Oftel will consider evidence that any charge has an anti-competitive effect, it generally starts with the presumption that charges will not be anti-competitive or excessive if they fall between the floor and the ceiling".

So, it is a first order test of excessive pricing or anti-competitive pricing. And it is also clear, sir — and again there is common ground on this from the witnesses, if one looks at para.50 — that if one looks at DSAC on a disaggregated trunk-only basis, it is an extremely generous test, allowing a 54 per cent return on average. Four times larger than BT's weighted average cost of capital. Again, none of that is disputed. Now, ultimately, what is said about DSAC as a legitimate test we do not really know, but what this Tribunal can do is to stand back from the evidence and say that three professional economists, that is Mr. Myers, Mr. Bolt (this is para.51) and Mr. Ridyard consider DSAC to be a legitimate first order test.

BT itself, in the document I have just shown you from DF2, to quote, said: "It is widely accepted as an appropriate measure".

Now, everyone agrees that you need to have some test; everyone agrees that the starting point in cost allocation is going to be arbitrary in a certain sense, but you have three professional economists attesting to the legitimacy of DSAC. But, in addition to that, sir, you have the Competition Commission very recently, a matter of months ago (and this is para.52) also accepting that DLRIC floors and DSAC ceilings are an appropriate test of cost orientation. And we have set out at para.52 those paragraphs.

I know Miss Rose, in her submissions, is going to show you more of the Competition Commission decision, but just restricting oneself to this part, they clearly did consider that DSAC and the boundaries set by DLRIC and DSAC were appropriate tests of cost orientation. This is classically one of those cases, sir, where one could have another approach to cost allocation. We wait to hear what Mr. Read says about the approach that BT say would be appropriate, but this is — no-one is suggesting and I do not believe even Mr. Read suggests this — that DSAC is irrational or something that no reasonable Regulator could adopt. But this is one of those cases which falls squarely within what the Tribunal said in the *Vodafone* case (which we set out at para.53) that there may be a number

of different approaches to certain regulatory issues and the Tribunal should be reluctant to interfere when there is more than one reasonable approach.

Miss Rose is going to show you the *TRD* case, a very similar statement was made in the *TRD* case. Now, that is not to say that this is not a merits Tribunal, it is nothing to do with that point. But the point simply is that, if there is more than one reasonable approach, unless it can be said that Ofcom's approach is irrational, the Tribunal should not interfere. Because what is going to otherwise happen, sir, is this Tribunal ends up being the Regulator, and you are not the Regulator, with respect, sir.

It is also worth bearing in mind some important evidence, sir, that Mr. Ridyard gave, which is that it was put to him that this is arbitrary, and he made a very good point in response to that. He says that any cost measure is arbitrary, but it is not arbitrary in the sense that it is capricious, in the sense that nobody knows that this is the measure. So, in so far as arbitrariness implies uncertainty, it is clear that there was no uncertainty that this was going to be the appropriate test.

Now, it is clear, sir, contrary to what has been said by Mr. Read repeatedly in his submissions and also in his cross-examination of Mr. Myers, that we did not apply DSAC in a mechanistic way. We set out (at the bottom of p.17 going over to p.18) other material that was considered. What I would like to emphasise, sir, is that a very important factor, a striking factor in terms of further material, were the rates of return. I am going to come on, to look at some of the evidence in due course, in relation to second order tests at para.61, but it is absolutely clear that the rates of return on trunk segments were very substantial. You will bear in mind, and I think Professor Grinyer may have a better recollection than others, because he was on the Tribunal in the *Napp* case, that in deciding that there was overcharging, and that was a classic *ex post* case, one of the factors which the Tribunal gave very substantial weight to in concluding that there had been excessive pricing was the rate of return. That was a very important factor. It is an important factor in an *ex post* case. Equally we say it is a very important factor in an *ex ante* case, the rate of return.

Before going back to those second order tests, can I finally address the utility of DSAC. It was suggested in the evidence of BT that DSAC was not an appropriate measure because there was no predictability of DSAC. Mr. Myers gave a very convincing answer to that, which we have set out in full at para.58. First of all, he made the point that:

> "… DSAC as a proportion of fully allocated costs is a relatively consistent ratio …"

when one looks at BT's figures, and one would expect BT to have an understanding of its own costs. Moreover, this was not a case of a marginal failure of the DSAC test, that year after year and by very, very substantial proportions, DSAC was exceeded.

What appears to have happened, sir, is that those people on the ground, such as Mr. Morden, who are fixing the prices, and those people who prepare the Regulatory Accounts do not appear to speak, Mr. Morden, who was plainly an honest witness, was a salesman, he wanted to price his product competitively and he wanted to ensure as best as he could that he was behaving in a cost orientated way, or setting prices in a cost orientated way, but he thought, "The way I do that is I just do not raise the price", and we have quoted that at the end of para.59, "I did not raise and therefore everything was fine".

We say, with respect, that is not an appropriate way for BT as a regulated firm to approach cost orientation when it bears the burden. What it should have been doing is, if it was exceeding DSAC, it should have equipped itself with evidence to say, "Okay, we are exceeding DSAC, but we have done combinatorial tests which satisfy us and which in due course will satisfy Ofcom that we are acting in a cost orientated way" or some other tests. They simply have not done anything. They were repeatedly exceeding DSAC.

Can I then deal, sir, with the fifth part of our submissions, which are the second order tests, which is that it was not known what second order tests would be applied. It is, first of all, suggested that it was something that BT could call upon Ofcom to provide, but that again, sir, ignores the burdens and the terms of the cost orientation condition. It was for BT to demonstrate that it acted in a cost orientated way. Ofcom had indicated a first order test. There was no legal obligation on Ofcom to do anything further. One thing that Ofcom has definitely relied upon, and there was no unpredictability about that, was the rates of return. I do not believe that BT disputes – certainly Mr. Budd did not dispute – that rates of return were a relevant factor.

The two additional points that BT sought to rely upon as second order tests were combinatorial testing and international benchmarking. It is not clear precisely where BT's case now lies on those issues. On combinatorial testing, to us the position, and we have summarised it in para.69, appears to be that the fundamental objections with the combinatorial tests were conceded by BT's witnesses. There was the conceptual problem, sir, which is that a failed combinatorial test will not indicate the service that has failed, that has caused the failure, and then there is the more practical problem which is that if you are going to do combinatorial tests you need to do tests involving the services that share common costs with trunk. We know, and I will not mention the percentage because, as I

recall, it is confidential, that a very substantial percentage of BT's other services share costs with trunk. Those other services, many of which lie outside of the core increment, were not the subject of any combinatorial tests by BT.

Professor Yarrow put it fairly at the end of the day, and he is BT's own witness, when he said, "It is a bit of a waste of time and a distraction". If only we had known that a bit earlier we could have avoided trying to understand the way combinatorial tests work. That is BT's own evidence, that is where it lies at the end of the day. I emphasise the point that it was for BT to come up with the combinatorials not for Ofcom to resolve BT's problems for them.

Equally, on international benchmarking, sir, the position at the end of the evidence appeared to be, particularly from Mr. Budd, that Ofcom took into account the benchmarking evidence, but there were problems with the benchmarking evidence. Therefore, the weight that Ofcom would give to it would necessarily be limited.

Professor Yarrow, para.75, had not really even considered the Deloitte's report, yet felt himself able to criticise Ofcom's approach to that benchmarking evidence, which, with respect to him, is rather surprising.

Where we ended up, sir, before we get to the issue of economic harm, is that we have a failed DSAC test, very substantially failed. We have vast rates of return, and the two pieces of rebutting evidence that BT put forward, namely combinatorial tests and benchmarking, do not satisfy Ofcom that the cost orientation obligation has been satisfied.

Can I turn to the issue of economic harm, which is p.23, under section F. There is a threshold issue between the parties here. As we understand it, and Mr. Read will no doubt make his position clear, it appears to be the case that BT say that a full blown competition law economic harm exercise would have to be conducted. They say that is the position from the guidelines. Our position is, no, you have got to interpret the guidelines in the light of this being an *ex ante* obligation where there has already been an analysis of harm or potential harm that will be caused if cost orientation conditions are not imposed. That is an important part of the context, and Mr. Myers gave a very clear answer to that, which we set out at para.81 and explain at para.82. We say at the end of 82 that a "harm" analysis informed the imposition of a condition itself and that any further analysis had to take that into account.

That having been said, there was a consideration of economic harm, but bear this in mind, sir, this particular point, which is that Ofcom was in a position where the first order test had been failed. What does the first order test show? It creates a rebuttable presumption of

anti-competitive behaviour of excessive pricing which, in itself, was harmful. It was then for BT to come forward and say, "Despite what on the face of it looks like economic harm, there is not actually any economic harm here". We say they simply did not come up to proof on that. They still have not come up to proof on that. In fact, one gets to a position, as we believe now BT accept, particularly Mr. Tickel accepts, that if trunk prices significantly exceeded the appropriate level of allocated costs of providing trunk, that would or could distort competition. That appears to be common ground now.

We identified at para.83, taking it from the determination, the three different types of likely harm. I emphasise the words "likely harm", because Mr. Read constantly refers to the guidelines. The guidelines do not require proof of actual harm. They only require Ofcom to consider likely harm.

There were three particular types of likely harm: first of all, reduction in the overall demand for retailed leased lines through increasing retail prices; secondly, distortion of competition between communications providers at the retail level; and thirdly, distortion of investment decisions. As we understand it, those, as likely sources of harm, are not disputed. What appears to be said, and this appears to be the thrust of BT's evidence, is that, "Okay, that harm may well have been likely, but Ofcom should have gone and considered and quantified the extent of that harm". For various reasons Mr. Tickel says that the extent of the harm may have been diluted if there had been a full examination of the market.

Again, one comes back to the burden of proof. It is for BT to make the running on that point. Having failed the first order test, having been found to be earning a vast sum in excess of an appropriate rate of return, if it was going to argue that there is no harm it had to come forward with evidence to show there was no harm. The inevitable inference was that there would be harm.

What is notable, sir, is not only did they fail to do that when the determination was being drafted and prepared and consulted upon, but they have still failed to do it now. They have not been able to establish to the satisfaction of this Tribunal that these inferences of harm are fanciful or they will not occur.

Sir, can I deal, finally, with the question of repayment. It is important in this regard, sir, to have open s.190(2)(d), and that is in the first authorities bundle at tab 7. There are two lots of the Communications Act in here. It is p.173, if one looks at the numbering at the top of the page. If one has that open, sir, and also has the final determination open at the same time, there is a whole section from p.936 to 950 which concerns the repayment issue. I ask

you to have that section in mind and also the relevant sections of Mr. Myers' statement, which we have given references to in our skeleton, if we can just turn up the page. It is core bundle 2, pp.506 to 559. There was no challenge to any of Mr. Myers' evidence in relation to the repayment issue. In fact, we never even went to those parts of his statement during his cross-examination. So the analysis that Mr. Myers set out, which was essentially repeating what had been set out in section 8 of the determination, was not the subject of any challenge.

The analysis was essentially this: the starting point is that the appropriate charge is DSAC, that being the first order test of cost orientation. What other factors are there that should indicate there should not be repayment applying that as a benchmark? If one looks at s.190(2), if I may read it, this is the power that Ofcom relied upon, 190(2)(d):

> "… for the purpose of giving effect to a determination by OFCOM of the proper amount of a charge in respect of which amounts have been paid by one of the parties of the dispute to the other, to give a direction, enforceable by the party to whom the sums are to be paid, requiring the payment of sums by way of adjustment of an underpayment or overpayment."

Sir, we respectfully agree with what Miss Rose says in her skeleton argument, which is that the starting point is that one focuses upon under-payment or over-payment. One does not look at factors such as doing an analysis of profits and losses of a particular communication provider. If they, for example, pass on this overcharge to a customer or they absorb it themselves, those are not relevant factors here. One is focusing on under-payment or over-payment, and one looks back to the determination to, first of all, identify the proper amount of the charge.

Having identified the proper amount of the charge as being DSAC, which I emphasise again is extremely generous because the amount of common costs allows BT to recover, the quantum of the over-charge was a mathematical exercise. However, sir, in exercising the discretion to decide whether or not there should be any repayment, Ofcom, as a sense check (if I may call it that) did consider what the net financial position would be of BT considering its aggregated rate of return.

Could I ask you, please, to go p.940 of the determination in the section that I asked you to open a moment ago, at para.8.30. This is on whether any repayment should be required. Here we have considered that factor. In theory, sir, if in this Tribunal there had been a detailed and permissible investigation of the rate of return of terminating and that you had concluded that the rate of return on terminating was not appropriate – in other words,

contrary to what Ofcom decided in 2004, contrary to what the Competition Commission decided a few months ago – then you could have taken that factor into account and perhaps reduced the rate of return. But there has not been any such investigation.

Sir, in the absence of knowing precisely what Mr. Read's attack is, other than what he has said in his skeleton argument, which he has not pursued with Mr. Myers, we are in a slight difficulty in knowing how to address the case on repayment. What one can say as a matter of certainty, sir, is that this is a discretion and it is difficult to see on the basis of any questions put to Mr. Myers how that discretion is faulted. I will wait to see what Mr. Read says about that. Obviously, I am not entitled to have a general right to reply, but in so far as there is some new point made ----

THE CHAIRMAN: If there is a new point, Mr. Saini, we would be interested in hearing you.

MR. SAINI: Sir, unless I can assist you any further those are my submissions.

THE CHAIRMAN: Mr. Saini, thank you very much. What we will do is take our mid-morning break now and rise for five minutes.

(Short break)

THE CHAIRMAN: Miss Rose?

MISS ROSE: Sir, I hope the Tribunal has our outline closing submission?

THE CHAIRMAN: We do, but they are buried under some papers, if you give me a moment I will just locate them.

MISS ROSE: There is one further authority which is the case of *Royal Mail v Postcomm*.

THE CHAIRMAN: I have both those things. I just must check whether my colleagues do.

MISS ROSE: I am going to follow this document pretty closely but I will not deal with all the points because a number of them have already been made by Mr. Saini.

The starting point is the question of this Tribunal's task, and of course this is a merits appeal and in our submission that means essentially that an appeal will succeed if there is an identifiable error of fact, error of law, or an error in the exercise of a discretion on the part of Ofcom. Precisely what that means will depend on the issue in the case, and the central issue in this particular appeal is whether Ofcom correctly interpreted and applied the phrase that appears in Condition H3, which is "an appropriate mark-up for... common costs", because the essential battle lines are whether the tests that Ofcom applied to decide that the charge was not cost oriented was or was not an appropriate mark-up for common costs.

When you look at that wording, which is the task that Ofcom was undertaking, you can immediately see that that wording in itself incorporates a significant element of discretion for Ofcom because the wording is an appropriate mark-up for common costs. That takes us

to the point that Mr. Saini has already made by reference to the *Vodafone* case, and we make it by reference to the *T-Mobile* case, that there may, in relation to any particular dispute, be a number of different approaches which Ofcom could reasonably adopt in arriving at its determination. There may well be no single right answer to the dispute. To that extent the Tribunal may, while still conducting a merits review of the decision, be slow to overturn a decision arrived at by an appropriate methodology, even if the dissatisfied party can suggest other ways of approaching the case which would also have been reasonable and which might have resulted in a resolution more favourable to its cause.

So in other words, unless it can be shown that Ofcom erred in concluding that this was an appropriate mark-up for costs the case goes nowhere, and the fact that there may be other appropriate ways of marking up common costs is of no assistance to BT.

We say that the point goes further in this appeal because it is actually striking that far from having been able to show that the approach used by Ofcom was not an appropriate or reasonable one BT has not been able to establish that there is any lawful or coherent alternative methodology which should be substituted for that used by Ofcom in determining the dispute. We make a number of points under para.3. First, that the question was asked by you, sir, during the course of Mr. Read's opening submissions: "What is it that BT says is the methodology that Ofcom should have used in determining cost orientation?" It is a question that you have repeated in the list of questions that was sent out to the parties yesterday. We submit that it is not surprising that that question was asked at the outset, and not surprising that it is still being asked, because BT have never, so far, put forward an answer to that central and crucial question.

Secondly, BT accepted in their evidence that SAC combined with combinatorial testing, that was the principal methodology for which they contended in their notice of appeal, were in fact inappropriate for identifying whether BT was overcharging for a particular individual service because of the difficulty in identifying for which service there was an overcharge. As you have heard again from Mr. Saini, combinatorial testing was described by Professor Yarrow as "a waste of time" and "a distraction".

Thirdly, BT accepted in evidence that the international benchmarking evidence was of limited use or relevance, and that Ofcom had fairly analysed the Deloitte's report. Fourthly, BT did not challenge in any significant way the analysis by Ofcom and the Altnets of the economic harm which was likely to result from overcharging on trunk segments, particularly including distortions to competition between communications providers and distortions to the investment decisions that have to be made by communications providers.

We say that in fact the essence of BT's case appears to be as follows: first, Ofcom was entitled to use DSAC as a first order test but ought to have combined it with other somewhat unspecified tests. Secondly, Ofcom ought to have considered whether BT was in breach of condition H3 by aggregating BT's return from the sale of trunk with its returns from the sale of terminating segments. Thirdly, when they were considered together those returns showed that BT would recover less than its cost of capital from the sale of PPCs as a whole if forced to reduce the price of the trunk segments to DSAC, and that finally Ofcom ought to have analysed and quantified the actual economic harm arising from BT's overcharging before it was permissible to find that BT had overcharged for trunk. We respond to these arguments in summary as follows.

As to the first, we say it is simply factually incorrect for BT to suggest that Ofcom applied DSAC as a determinative pass/fail test. It is abundantly clear from the determination itself and from the evidence which you have heard from the determination itself and from the evidence which you have heard from Mr. Myers that Ofcom took into account a range of different evidence and different factors before reaching its conclusion, and that it made careful judgments about the weight to be given to each type of evidence.

Secondly, and this is on aggregation, we submit that it would have been an error of law for Ofcom to determine this dispute by aggregating BT's returns from the sale of trunk with its returns from the sale of terminating segments. It would actually have been an appealable error of law for Ofcom to have approached the dispute in that way. H3 requires that the cost orientation of each and every charge in the wholesale trunk market should be separately demonstrated by BT. That question cannot be answered by considering BT's returns from trunk and terminating segments combined. That interpretation of Condition H3, we say, accords both with the economic rationale for imposing different forms of price control on different services in different markets.

The third point we make is that it is simply not open to BT to complain in this appeal that it was under recovering its costs on the sale of terminating segments. It made the same argument unsuccessfully to Ofcom in 2004 and it chose not to appeal the charge control imposed on terminating segments at that time. We note that there is no challenge to the level of the charge control for terminating segments in this appeal, and obviously there could not be one because it will be many years out of time. Ofcom did give careful consideration to the likelihood of economic harm in the context of an SMP condition that had been imposed because of a prior unchallenged regulatory decision that cost orientation for the sale of trunk segments was proportionate to promote competition and to protect end

users. Nothing in either the guidelines or the statutory scheme required Ofcom to quantify actual economic harm.

We submit that, given the amount by which and the period over which, the charge exceeded DSAC and the very high rates of return that were achieved by BT on the sale of trunk, in a market in which BT had SMP and in which the Altnets were all to variable extents dependent on BT for the supply of trunk, economic harm could be readily inferred.

The only basis on which BT sought to rebut the inference of economic harm was that BT was not overcharging for 2Mbit/s overall. We say that approaching the question of economic harm by considering the overall level of charging for circuits necessarily ignores the distortions to competition caused by the disproportionate pricing of trunk by comparison with terminating segments.

Finally, we make the point that the examples that have been presented by Mr. Harding in the course of this appeal show that Ofcom's inference of economic harm was, in fact, correct, that there had been clear and concrete distortions to competition and inefficient investment as a result of the excessive cost of trunk segments.

In para. 6 we make the fundamental point that underlying much of BT's case has been its complaint that its charges for terminating segments were set too low in 2004 at a level which did not permit BT to recover an appropriate proportion of its efficiently incurred costs, and so BT says it therefore ought to be permitted to allocate more costs to trunk segments to compensate it for that under recovery and to permit it to make a higher return on its circuits overall.

We say that is really at the heart of what BT's complaint is in this appeal, and it is impermissible as an argument in principle for the reasons that I have already outlined, that it is contrary to the wording of H3 and it is contrary to the unappealed decision made by Ofcom in 2004. We say that in any event any such argument mounted by BT simply cannot survive the decision that was made by the Competition Commission on 30th June of this year, because in that decision, after an extensive investigation, in which BT fully participated, the Competition Commission examined Ofcom's decision in the 2009 Leased Lines Charge Control first to reduce the price of 2Mbit/s trunk to the DSAC ceiling, and secondly, at BT's request to permit BT to increase the price of 2Mbit/s terminating segments. The Competition Commission reached the following conclusions.

It is p.3-22 at paras. 3.123 and 3.124.

> "We note there is no dispute between Ofcom and C&W that the price of 2 Mbit/s trunk was above DSAC … The adjustments to the price of 2 Mbit/s trunk … were

> therefore justified as being necessary in order to meet the objective of cost orientation, i.e. ensuring that those services were not priced at levels which posed a risk of distortion of competition."

The reference to that is ADB3, tab 14. That reasoning, we say, amounts to a clear endorsement by the Competition Commission of the methodology used by Ofcom to determine this dispute.

Secondly, in the same decision the Competition Commission reversed Ofcom's decision to permit BT to increase the price of terminating 2 Mbit/s segments. In doing so, it agreed with Cable & Wireless that it had not been shown that the 2004 charge control had failed to permit BT to recover its efficiently incurred costs and a reasonable rate of return across the terminating services that were subject to a charge control. That is a crucial finding by the Competition Commission because they rejected the very argument that BT is still seeking to mount in this appeal. It has already been rejected by the Competition Commission after a full investigation. They concluded that Ofcom did not have any proper basis for concluding that the increase to the price of 2 Mbit/s terminating segments was necessary to rebalance for the reduction in the price of trunk segments, or otherwise to preserve the dynamic efficiency incentives of the terminating segment basket going forward.

We say that decision in relation to 2 Mbit/s circuits destroys the whole basis of BT's complaint, because when you analyse all of the different arguments that BT has put forward in this Tribunal they all come down to this: Okay, maybe we were overcharging for trunk, but overall when you look at our 2 Mbit/s circuits, we were not overcharging because we were recovering too little for our costs of the terminating segment, so overall the price was fair, and we should not have been done for overcharging. That is the very argument which was examined and rejected by the Competition Commission in that decision.

Can I now then turn to the 2004 LLMR and, in particular, to the statutory function and duties that Ofcom was conducting in undertaking that market review. If we can just take up vol.1 of the authorities bundle at tab 7, we have an extract from the Communications Act. We looked at these in opening and the Tribunal has the picture that what Ofcom had to do was to define the markets, then to identify providers that have SMP, which is equivalent to dominance, in particular defined markets, and then to decide whether it was necessary to impose SMP conditions and then, if so, what SMP conditions it was necessary to impose. It is worth just reminding ourselves of the specific duties on Ofcom when it was considering whether to impose SMP conditions in general and, in particular, price control conditions including conditions in relation to cost orientation.

First of all, s.47, which is at p. 47, behind tab 7: "Test for setting or modifying conditions".

> "(1) OFCOM must not, in exercise or performance of any power or duty under this Chapter –
>
> (a) set a condition under section 45, or
>
> (b) modify such a condition,
>
> unless they are satisfied that the condition … satisfies the test in subsection (2)."

And if you go back to s.45 you can see that the conditions at s.45(2)(b)(iv) include SMP conditions.

So the test at s.47(2) must be satisfied and

> (2) That test is that the condition … is-
>
> (a) objectively justifiable in relation to the networks, services, facilities, apparatus or directories to which it relates;"

That is important when you are considering the scope of Condition H3 because Ofcom must be able to demonstrate that H3 was justifiable in relation to the trunk segment market, and services in the trunk segment market.

Secondly, that it is "not such as to discriminate unduly against particular persons", thirdly, that it is "proportionate to what the condition or modification is intended to achieve;" and finally, that "in relation to what it is intended to achieve [it is] transparent". Of course, a failure by Ofcom to comply with any of those duties would be a ground of appeal.

So that is the general duty at s.47.

Then when we come specifically to SMP conditions going on to s.87 the Tribunal can see that there is a whole range of different SMP conditions that Ofcom can set. For example, if you look at 87(3):

> "This section authorises SMP conditions requiring the dominant provider to give such entitlements as OFCOM may from time to time direct as respects –
>
> (a) the provision of network access …
>
> (b) the use of the relevant network; and
>
> (c) the availability of the relevant facilities."

Then looking at subsection (7):

> "The SMP conditions authorised by this section also include conditions requiring the dominant provider to maintain a separation for accounting purposes between such different matters relating –
>
> (a) to network access to the relevant network, or

(b) to the availability of the relevant facilities."

Then subsection (8), conditions imposing requirements about accounting methods. Then at subsection (9): "The SMP conditions authorised by this section also include (subject to section 88) …" so this is a particular additional requirement, s.88:

"… conditions imposing on the dominant provider – (a) such price controls as OFCOM may direct …" so that is price control, then the second: "such rules as they may make in relation to those matters about the recovery of costs and cost orientation." So what we see at s.87 is a range of different types of SMP condition, the last of which two identified at s.87(9) are conditions relating to the control of price, whether they are an actual price control or cost orientation condition. Those types of SMP condition are subject to further control by s.88.

If we turn the page you see s.88 and it starts with a prohibition.

"(1) OFCOM are not to set an SMP condition falling within section 87(9) except where –

(a) it appears to them from the market analysis carried out for the purpose of setting that condition that there is a relevant risk of adverse effects arising from price distortion."

So that is the first requirement. It cannot set any kind of cost orientation unless you are satisfied that there is a relevant risk of adverse effects. So this is the starting point for saying: "If you are worried about demonstrating a risk of economic harm, Ofcom does not have the power to set a cost orientation condition unless it is satisfied that that requirement is met", and you see a definition of relevant risk of economic harm at s.88(3).

"For the purposes of this section there is a relevant risk of adverse effects arising from price distortion if the dominant provider might –

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

(b) so impose a price squeeze,

as to have adverse consequences for end-users of public electronic communications services."

So Ofcom has already had to have made that finding before it can impose a cost orientation condition. But then, going back to 88(1), that is only the first hurdle that Ofcom has to go through. The second hurdle, again the prohibition, is not to set an SMP condition except where "it also appears to them that the setting of the condition …" so this is looking at the specific terms of the condition,

"… is appropriate for the purposes of -

(i) promoting efficiency;

(ii) promoting sustainable competition; and

(iii) conferring the greatest possible benefits on the end-users of public electronic communications services

We say there are a number of points that can be derived from the structure of the Statute there. The first is that the Statute regards the price control including cost orientation, as the most intrusive form of SMP condition and one can understand why. To seek to control the prices of an independent undertaking or company is obviously extremely intrusive regulation.

The second point is that for that reason the normal obligations that apply to Ofcom of proportionality and transparency and so on are supplemented by stringent additional tests in s.88 which have to be met before cost orientation or charge control can be imposed, and they necessarily include an assessment of the risk of adverse effects to end users. They also include an assessment of the need for the particular form of condition that is being imposed in relation to efficiency and sustainable competition and greatest possible benefit. That applies, of course, not only to condition H3, which is the subject of this appeal, but also to the price control condition that was imposed in relation to the terminating segment. So this Tribunal, we submit, must approach the charge controls that were imposed as a whole, on the basis that they were valid because they were never challenged, and that therefore Ofcom was correctly satisfied that not only the imposition of a price control on terminating segments, but the level at which the price control was imposed on terminating segments was the appropriate level for supporting efficiency and sustainable competition and the maximum benefits to end users.

When you look at that statutory scheme you can understand why the whole argument mounted by BT based on the alleged under-recovery for terminating segments is simply impermissible, it is contrary to the whole statutory scheme and the decision that was taken by Ofcom in 2004.

If we just return to our written text we make these points at paras. 17 et seq, and in particular at para. 17 we make the point that the suggestion that was made by Professor Yarrow in his evidence that the imposition of a cost orientation condition on trunk segments was a sign that the trunk segment market was regarded by Ofcom as prospectively competitive, with respect, showed the basic misunderstanding by Professor Yarrow of the

nature of the statutory scheme. If Ofcom had thought that about the trunk segment market, the imposition of condition H3 would have plainly been *ultra vires*.

Then at para. 21 we address the question that you asked, sir, about the proper approach to interpretation and we agree with the submissions made by Ofcom, particularly in relation to the *DBI* case and the other authorities that were cited by Mr. Saini.

We also agree with his submission that it cannot be the case that any private bilateral understanding or agreement between Ofcom and BT could alter the meaning of H3 or in any way fetter Ofcom's discretion to exercise its powers under H3 and under the Act in the public interest and in pursuit of its statutory duties.

Then turning to the particular grounds of appeal, Ofcom's decision to accept and resolve the dispute - we have nothing to add to what we said in our opening skeleton argument and to the submissions of Mr. Saini.

Then the question as to whether BT knew that DSAC was a first order test, again we respectfully adopt the analysis of Mr. Saini in relation to the law on legitimate expectation. We agree that estoppel has no application in public law, and we agree with the submissions that he has made on the facts, and we have set out our own analysis here, but I do not believe I need to take you to it orally, I invite you to read it in your own time.

The second question is whether Ofcom erred in the weight it placed on DSAC and the reason we put it in that way is because it does not appear to us, having heard the evidence, that BT is contending any more that it was wrong in principle for Ofcom to use DSAC as a first order test, the dispute is simply over how much weight should have been given to DSAC in that role.

Again, much of this is familiar ground, the fact that there is no single perfect test, and the evidence of this of Mr. Ridyard we have set out at para.39, where he gave his view on the meaning of the term 'arbitrary', and again I would invite the Tribunal to read that because we again submit that that is a helpful discussion of the regulatory judgments that have to be made in a situation where there is no single, unique, perfect, right approach, where what you are trying to do is just reach a judgment about what is an appropriate mark up for common costs. There is a range of different methods by which you might do that.

We refer in this regard to a decision, *Royal Mail Group v Postal Services Commission*, which I have handed up. This was a case in which the Postal Services Commission had imposed a significant financial penalty of over £9 million on the Royal Mail for breach of its licence conditions. Essentially what Royal Mail had done was it had failed properly to retain or train postmen and they appeared to be just stuffing the mail under hedges and not

surprisingly Postcomm took a fairly dim view of that conduct. But Postcomm had a problem, because Postcomm had internal guidance which governed the way in which it was to assess penalties. And that guidance said that when considering the level of the penalty, they had to consider whether the Post Office had benefited from the breach, which it clearly had not; or alternatively whether the breach had imposed burdens on end users and consumers.

And the difficulty for Postcomm was it was extremely difficult to tell how much post had gone astray because of Royal Mail's breach of its condition and how much would have gone astray even if Royal Mail had properly fulfilled its regulatory obligations, because there is always going to be a certain amount of post that gets lost, even if the postal operator operates carefully and in accordance with the licence. So, this was the problem that the Postal Services Commission was wrestling with. And eventually — the Postal Services Commission, they looked at all sorts of evidence including international benchmarking and concluded it really was not much help at all — and eventually they concluded that they simply had to take a view. And they said that they would take a view that if the Royal Mail had complied with its condition, 50 per cent of the mail which it had lost, because they could see how much it had actually lost for the period, would not have been lost, and they used that as the starting point for the calculation of the penalty.

Royal Mail said, "That is a breach of your internal guidance which requires you to operate on the basis of soundly-based evidence, and there was no evidence here, all you have done is simply pluck a figure out of the air, it is arbitrary, it assumes what you have to prove, and it is a breach of your statutory duties", and that was the issue before the Court of Appeal in this case.

Now, obviously it is somewhat different because it is about the imposition of a penalty and of course it is a slightly different statutory scheme, but in my submission the comments that are made in this case about the need for regulatory judgment and the entitlement of a Regulator to make reasonable assumptions in the exercise of that judgment are of general application.

So, if we just take the case up and go to para.19, you can see the submission that was being made:

> "On behalf of Royal Mail, Mr. Beloff QC's submission is directed to a single objective which is to demonstrate that Postcomm's entire quantification of the penalty imposed is unsound by reason of the adoption of 50% as the percentage of lost items of mail attributable to the breach of licence proved. Section 31 of the

2000 Act requires Postcomm to adopt a statement of policy in relation to penalties. They have done so and have purported to apply it. Paragraph 8 of the statement requires decisions taken when assessing penalties to be 'soundly based in fact'. The percentage of 50 was not 'soundly based in fact' but was plucked out of the air by Postcomm, it is submitted. Other expressions used by Mr. Beloff in his forceful submissions were that the figure was merely an assumption which lacked any evidential foundation whatsoever, that it was an arbitrary factual assumption, that a starting point for the penalty had not been rationally identified and that the assumption had no logical factual basis.

Then para. 20:

> In the absence of such a basis, the assumption is arbitrary and a decision based on it unreasonable unlawful as outside Postcomm's powers …".

So, that was the submission. They then quoted a passage from the reasoning of the judge at first instance, which Royal Mail were contending was wrong. The second passage here:

> "As I have already stated [Postcomm] could not justify by reference to facts 50 per cent rather than 40 per cent or 60 per cent, but clearly the Commission, if it was to impose any penalty, as it plainly was right to do, had to arrive at a figure somehow. It seems to me that the method which it adopted to arrive at the ultimate penalty imposed was a reasonable one. That it included matters of judgment is plain: it had to. The burden is on Royal Mail to show that the figure at which it arrived was not reasonable. In my judgment, it has failed to do so".

So that was the decision that was being appealed. They then consider the various evidence, and the conclusions start at para.31. And at para.31 they address the expression "soundly based in fact" that was from the statement of policy, and they say that that must be seen in the overall context of the statutory scheme. Similarly, we submit that the guidelines, the 1997 and 2001 guidelines on which BT relies in this appeal must be read in the context of a statutory scheme, and that includes the stringent statutory obligations that I have just shown to the Tribunal that had to be satisfied before the SMP condition was imposed.

Then, at para.32:

> "It would be wholly unrealistic to infer that the serious and persistent breaches of licence found to be proved had not imposed a burden on others as a result of the contravention of the licence condition. In making any decision on financial penalties, Postcomm must 'endeavour to ensure' that the decision is 'soundly based in fact'. Best endeavours have undoubtedly been used but these have not made

possible, nor could they have made possible on the evidence, a precise calculation of how many of the 15 million lost items were lost because of the breaches of condition as distinct from other causes. What Postcomm has done, as an expert tribunal familiar with postal services and their problems, is to consider the nature, seriousness and length of the breaches of condition and to assess their likely consequences in a situation in which the possibility of losses from other causes, some the fault of Royal Mail and others beyond their control, must be kept in mind".

Now, we say that is a paragraph that has relevance to two aspects of this appeal: first, to the selection by Ofcom of DSAC as a first order test, that we submit that they are entitled as a matter of regulatory judgment to decide that that is the appropriate basis for calculating a reasonable mark up for common costs; and secondly, in relation to economic harm, that a very similar concept was being addressed here by the Court of Appeal — the question of whether the breach of licence had imposed a burden on end users.

And the point that the Court of Appeal made was, yes, it is true that the guidance required them to be soundly based in fact and they were not able to prove that there was any precisely calculatable burden on any individual consumers, they were not able to calculate how many millions of pounds had been lost by individual consumers over the United Kingdom over the period. "But", they say, "that doesn't matter". First of all it is reasonable to infer, given the seriousness of the breach and the length of time over which it persisted, that there must have been a burden; secondly, that they are an expert body and they are in a position to assess the likely consequences in a situation where they know the industry. We submit that precisely the same points can be made in this case about the assessment of economic harm. As Mr. Saini said, this was not a situation of a marginal exceeding of DSAC for a short period of time — these were massive prices, massively in excess of the DSAC ceiling for a period of years, where returns were being earned, returns on capital for trunk were being earned, many times above the cost of capital. And we say that the obvious inference from that is that it would cause economic harm, including the types of harm that Ofcom as the expert Regulator in the field has identified, distortion to competition, inefficient investment, effects on retail pricing. And indeed the evidence before this Tribunal has shown that Ofcom's assessment of those likely forms of economic harm were completely correct. So we submit that this judgment has two particular aspects in which it is relevant to this appeal.

And then, at 36, the Tribunal can see that they say that:

"The statutory purpose would be defeated if Postcomm could impose no penalty at all unless it proved a precise percentage of loss resulting from breach of licence, in

> circumstances in which it is the licence holder, as operator of the postal services, which either has the relevant information or, if not, at least the best opportunity to obtain it".

And the appeal was dismissed. We then deal, coming back to our written argument, at para.42, we deal with the various alternative second order tests that were put forward by BT, and these points have been made already by Mr. Saini in relation to combinatorial tests, international benchmarking, rate of return and the circuit analysis.

Then, at p.14, we come to the question of aggregation. And we make the first point that BT's suggestion that Ofcom were obliged, when considering the question of overcharging, to aggregate returns on trunk and terminating segments would actually have been impermissible, would have been an error of law as being contrary to the plain meaning of condition H3. Now, you have heard many submissions on the meaning of H3 which I do not intend to go over again; but there is one point that I want to make, which is that H3 must be read in the context not only of the statement itself, but of the other SMP conditions imposed on other markets. They include Condition G that was being imposed on the low bandwidth terminating segments. If we take up bundle ADB2, tab.3, p.439, this is relating to terminating segments, including the 2 Mbit bandwidth. Condition G3.1, p.439, is a cost orientation condition in exactly the same terms as Condition H3. As you can see, like Condition H3, it applies to each and every charge offered, payable or proposed for network access covered by Condition G1. So there is a cost orientation condition in relation to each and every charge in the TISBO market.

And then, at G3.2:

> "For the avoidance of any doubt, where the charge offered, payable or proposed for Network Access covered by Condition G1 is for a service which is subject to a charge control under Condition G4, the Dominant Provider shall secure, and shall be able to demonstrate to the satisfaction of Ofcom, that such a charge satisfies the requirement of Condition G3.1".

Now, that is significant because what that shows is that the charge control is not an alternative to cost orientation. There are two obligations on BT in relation to the terminating segment market: first, that the basket of charges in each of the baskets of charges overall must be in line with the charge control cap; but secondly, that each and every individual charge inside the basket must be cost oriented.

We submit that when you look at that provision, together with H3, it is simply impossible to see how the purposes of these conditions could be met by an aggregation. You are not even

allowed to aggregate the terminating charges within one charge control basket to see if they are cost oriented, and yet on BT's case not only are you permitted, but they would say Ofcom is obliged to aggregate charges from a completely different market, the trunk market, together with these price controlled and separately cost oriented charges in the termination market, and we submit that is simply an impossible construction.

We then deal with the economic reality and the economic significance of trunk segments, that is at para.57, again, these points have been made by Mr. Saini, and we have supplied a number of references to the evidence where various witnesses accepted the economic significance of pricing for trunk.

We then point out the consequences of BT's approach and its obvious difficulties for the regulation of trunk prices, and in particular Mr. Ridyard's point (para.60) that:

> "BT's approach would undermine the regulation of terminating segment prices because aggregating trunk and terminating segments may lead to de facto price cap evasion".

Now, in that context the evidence of Professor Yarrow is of some interest, because if we look at his second report core bundle 2, tab.26, we can see what he said about Mr. Ridyard's evidence. So, at para.72 Professor Yarrow recorded Mr. Ridyard's point. He said:

> "Secondly, the RBB report argues that there are problems associated with the aggregation of products inside and outside of a price cap when making assessments of over-charging. While we agree with this as a general proposition" —

So that is the starting point, that Yarrow and Decker agreed with the general proposition made by Mr. Ridyard. But then they said:

> "– we note that much will depend on the nature of the specific price cap arrangements and critically on the level of the price cap that is set in the first instance, specifically where the level of the price cap is set at too low a level which does not allow a firm to get even close to recovering its efficiently incurred costs from the products within the price cap, then the argument no longer holds".

The only reason why Professor Yarrow was suggesting that it might be permissible to aggregate the charges from the trunk segment market with the terminating segment was that he was saying, "This might be permissible if recovery on the terminating segment charges is much too low to allow for efficiently incurred costs". That was the only basis he put forward for disagreeing with Mr. Ridyard.

We see that his argument proceeds, over the page at para.76, by relying on the decision made by Ofcom in the 2009 Leased Lines Charge Control and the one-off rebalancing of

the level of prices for terminating services to reflect the fact that the charges were materially out of line with the underlying costs of provision.

So that was the basis of Professor Yarrow's disagreement with Mr. Ridyard on the question of why it was permissible to aggregate. Unless that was the position he agreed with Mr. Ridyard that it was not permissible to aggregate. He made that point with even greater emphasis in his oral evidence, and we have set it out at para.64. You can see where I have put it in bold and italics. He says:

> "***This is where I keep coming back, and I refer again the Tribunal, to the 2009 charge control, paragraph 4.183 – 183 of Chapter 4.***"

So he actually had the very paragraph number at his fingertips, it was so important to him.

> "***Ofcom says that unless it allows BT to put up its prices of terminating it won't be able to get a normal rate of return on terminating and trunk combined. This is the new price control. That is treated as a serious problem, because Ofcom allows BT to put the prices up immediately. The reason it says we've got to allow the immediate price increase is because if we don't do this BT will not be able to earn a normal rate of return, won't cover its costs of capital on trunk and terminating combined. That's Ofcom. That's my position as well.***"

So he committed himself very clearly to that position. Without wishing to labour the point, as the Tribunal knows, the problem for Professor Yarrow was that he was unaware that that very finding, that very paragraph, which he was so keen to draw to the Tribunal's attention, had been reversed by the Competition Commission. The Tribunal should now have the Competition Commission's decision at tab 14 of ADB3.

We have set out here the various references that we rely on in the Competition Commission decision. I do not intend to turn them up now, but the essential point is that the Competition Commission did not accept that BT had established that, from the 2004 price control, its rates of return for 2 Mbit/s terminating segments were too low to permit an efficient rate of return. That argument was rejected in relation to 2 Mbit/s circuits, and of course it is 2 Mbit/s circuits which are the subject of this appeal. Nobody ever has a PPC segment circuit which has a 2 Mbit/s terminating end and a 64 kbit middle part. It is an impossibility.

We submit that that fundamentally, with respect to Professor Yarrow, undermined any suggestion that aggregation was permissible.

The second point that was made by Professor Yarrow – this is at para.67 – was that it could be inferred from the relative lack of market entry into the trunk market by communications

providers that trunk was not overpriced. His argument was that he said there was no evidence that there were genuine barriers to entry in the trunk market on a scale such as might justify the abandonment of trunk charge liberalisation. That was his first report at paras135 to 138. You can see I have given the reference there.

He accepted in that paragraph that if there were such barriers to entry it would have established that the economic context is one in which excessive pricing is feasible and economically rational. The problem again, with respect to Professor Yarrow, is that his argument was based on an incorrect factual premise. It was not the case that this was a market in which there was no evidence of significant barriers to entry. On the contrary, this was a market in which in 2004 Ofcom had specifically found that there were high structural barriers to entry. You have seen the material on that. That was the basis on which the cost orientation provision, the most draconian level of SMP condition was imposed in the first place.

Then in 2008/09 Ofcom reaffirmed the conclusion with even greater force and concluded that actual price control was necessary on trunk because principally of the high structural barriers to entry. That second decision by Ofcom was taken before Ofcom resolved this dispute. So that was a decision in which all of these parties had participated by consultation. Everybody was aware that Ofcom had already made that finding. Yet Professor Yarrow's suggestion was that in some way all of that evidence should be disregarded because it was not set out again in detail in this particular dispute resolution. With great respect to Professor Yarrow we submit that his evidence carries no weight whatsoever.

Before I leave this point can we just go back to para.60. We made the general point that Mr. Ridyard made about the risks of aggregating, terminating and trunk segments. The only challenge made in cross-examination to that evidence was the suggestion from Mr. Read that BT made efficiency gains by driving down costs that were common to both trunk and terminating segments. As Mr. Ridyard pointed out, there was no evidence that the efficiency savings made by BT were in relation to the common costs. It certainly was not suggested by Mr. Read that all costs were shared between trunk and termination.

The final point that we make on this particular point is that, as a matter of principle, any challenge to the 2004 charge control would be impermissible. We have set out some *dicta* – this is paras.71 and 72 – on the presumption of regularity and the fact that a public law act is presumed to be valid unless and until it is challenged within the appropriate time limit. In the absence of any challenge, it simply is not open, with respect, to this Tribunal to

conclude that the 2004 charge control on terminating segments was set at a level below the level that was required of Ofcom under ss.47, 87 and 88 of the 2003 Act.

Finally, at para.76, we make the point that there is actually no evidence on which this Tribunal would be in a position to conclude that BT was under-recovering for its terminating segments. In the absence of any ground of appeal in relation to this issue, Ofcom and the Altnets have not put forward evidence to show that the level of the charge control was proportionate and enabled the recovery of efficiently incurred costs. We identify some headline points of the evidence that would have been necessary: first of all, the level of BT's efficiency as a provider of the charge controlled services for each year of the charge control, the rate of BT's return for each service in the charge control basket. I would just make the point there that BT may say that it is not recovering in relation to its weighted average costs of capital in relation to one particular type of terminating segment, but there are a number of services in the basket, and it might have been slightly over-recovering for others. One simply does not know.

Then the actual accuracy of BT's asserted figures in relation to DLRIC and the rates of return, the one thing we do know is that regrettably in the past BT's internally generated figures have not proved to be accurate or reliable.

That now brings me to economic harm. The Tribunal already has the submission about the need to consider the statutory context and the relevance of the *Royal Mail* case in that context.

We draw attention also to a point in the 1997 Guidelines. Can we just take up BT3 and go to tab 12.1. Mr. Read relied very heavily on para.3.5 of these Guidelines, and in particular the second half where it says:

> "In the event of a complaint under Condition 13.3 that a charge is not reasonable, or under Condition 13.4 to the effect that a charge is not reasonably derived from the forward looking incremental costs of the service, a first order test will be whether the charge in question falls between its incremental cost floor and stand-alone cost ceiling. The primary focus of investigation of a complaint under Condition 13.3 or 13.4 will however be the effect or likely effect of the charge on competition and on consumers."

Then this:

> "The methodology for deriving floors and ceilings …"

so that is the first order test –

> "… is described in detail at Annex C to these Guidelines. Oftel's approach to complaints is explained in Section 4."

So when you look at the question, "How do you investigate economic harm", you are referred to section 4 of the same guidance.

If you go on in this document to section 4, you will see at para.4.22 under the heading "Complaints to Oftel" – I am afraid I do not have any page numbering in this document:

> "Complaints should usually be presented with an explanation of the potential effects on competition in the relevant market of the behaviour (or omission) complained of or of its unreasonableness with regard to terms and conditions for interconnection. Where an effect on competition is difficult to demonstrate (or cannot be demonstrated), the complainant may nevertheless have good arguments that the act or omission is unreasonable (under Condition 13)."

We submit that when you read that together with para.3.5 it is very clear that Oftel is not saying that in order to establish a breach of condition 13.3 or 13.4 it is necessary not only to show that the condition is unreasonable or not reasonably related to costs, but also to show actual observable quantifiable economic harm. On the contrary, Oftel is saying the absolute opposite of that. It recognises that there may be cases where economic harm is difficult or impossible to demonstrate but where a charge may nevertheless be unreasonable. We say that that is further material for showing that, in fact, Mr. Read has taken 3.5 out of its context and given it undue prominence.

Turning to the harm in this case, para.84 of my text, we have identified the three main sources of economic harm that Ofcom referred to in the determination, and we have noted in the following paragraphs that each of these is substantiated on the evidence before the Tribunal. Indeed, there is no serious dispute about it. We have set out the details here on retail prices, distortion of competition between CPs and distortion of investment decisions.

In relation to the second, the distortion of competition, can I just emphasise the point at para.89. BT has no real answer to this, since it is very clear from the evidence that different CPs have different needs for trunk, that smaller networks buy more circuits with trunk and more circuits with longer length trunk, as you would expect, and therefore they are disproportionately adversely affected by an inflated price for trunk. Of course, that is another reason why you cannot aggregate trunk and terminating, because even if you hypothetically have a situation where overall the price for the circuit was cost orientated, if the price for terminating was too low and the price for trunk was too high that would still distort competition between the CPs since it would benefit CPs who only need to buy

terminating segments and relatively few trunk segments, and disproportionately disadvantage those who need more trunk segments. So that is another good reason why you cannot aggregate terminating and trunk. And what BT says, at para.89 is:

> "… that the distortion in competition between CPs should not be regarded as a form of economic harm, because it also affects BT's own downstream operations (principally BT Global Services), which purchase PPCs, including trunk segments, from BT Wholesale".

The first point we make is that this simply misses the point, as it may well be that BT Global Services is also suffering from a distortion in competition and economic harm as a result of the over-inflated price of trunk, but that in no way alters the fact that it is a distortion of competition and an inflated price of trunk just because it also affects BT Global Services. Of course, the reality is that BT must have some economic incentive for maintaining the price of trunk at such a high level, even though its own downstream operation is being affected, and we say, well, it's not rocket science. It's fairly obvious what the benefit is because BT overall is one entity, and what you are talking about is an internal shift of profit between the wholesale and the downstream arm. But BT as a whole is benefiting from the influx of excess revenue from the CPs who have no alternative but to purchase their trunk from BT. And the CPs of course have no such compensating advantage, because they have very little trunk sales between them. They are largely dependent on the sale of trunk from BT. So, BT may well have its own good commercial reasons for keeping the price of trunk high, even though that means that the profits of its retail arm will be proportionately lower, and indeed they are proportionately lower than its wholesale arm, but that has no impact on the argument about the distortion of competition. Distorting investment decisions, we have set out the detail here and, again, there is no serious challenge to any of this material.

That brings me, then to the question of repayment. Mr. Saini has made the point that there was no challenge to Mr. Myers' evidence on repayment. Neither was there any challenge to Mr. Ridyard's evidence at paras.80-83 of his report on the question of repayment. Now, we also refer here to the statutory scheme, and we have set out the relevant provision at para.100 that:

> "<u>for the purpose of giving effect to a determination by Ofcom of the proper amount of a charge</u> in respect of which amounts have been paid by one of the parties of the dispute to the other, to give a direction … <u>requiring the payment of sums by way of adjustment of an</u> underpayment or <u>overpayment</u>."

So the purpose is not to compensate. The purpose is not to penalise. The purpose is not to deal with any questions of fairness. The purpose is to give effect to a determination of the proper amount of the charge. And we submit that on that basis, it is correct to say that the ordinary order or the ordinary direction which Ofcom ought to give in such a case is to order repayment of the full amount, because that is the obvious way that you give effect to a determination about the proper amount of the charge. This is about simply giving back to people money that they have wrongly overpaid, BT having wrongly demanded it in breach of the statutory condition to which it was subject. The way we put it is simply BT had no right to the money and therefore cannot expect to keep it.

It may be that there is a difference of emphasis between myself and Mr. Saini here, because Mr. Saini would contend for a broader discretion for Ofcom than we would accept on this point, because our submission would be that it would only be an exceptional case where there was clear justification consistent with the statutory purpose of giving effect to a determination of the proper amount of charge that Ofcom would even have the power to order repayment of less than the full amount, and we submit that would be a rare case. Not to say it might never happen. It is difficult to envisage the circumstances in which it might, but certainly we submit it would not be enough just to say, "Oh well, on this basis BT's overall returns look low", because of course that is a factor that Ofcom has taken into account when assessing the proper amount of the charge in the first place. And once Ofcom has assessed what is the proper amount of the charge, we submit there is really very little scope for not ordering it to be repaid to those who have wrongly had to over-pay. And we submit that that not only follows from the clear wording of the statute itself, but also from the underlying economic rationale that, where you have a company such as this with significant market power, which has breached its ex ante obligations and over-charged its customers by around £50 million, it is in the interests of competition and consumers that the money should be refunded, and we say that Ofcom's conclusions on that front cannot be faulted.

BT has sought to characterise this order for repayment as either being penal or as a windfall to the CPs, and we say that is simply unsustainable. There is no penalty to BT here, it acquired money it had no right to, so it has to pay it back. It is not a penalty. Equally, there is no windfall to the CPs. They should never have had to pay this money in the first place.

We then make the point that, even if we are wrong on our primary submission that there is really very little scope for any order other than for repayment, certainly on this case there is

no conceivable basis on which it would have been fair or appropriate to order less than full repayment. At para.105 we make the point that the DSAC methodology was extremely generous to BT; and you have already heard the figures for the very high rate of return that BT recovers on trunk, even when the trunk prices are cut to DSAC, more than four times its weighted return on capital. And that is the reason why the communications providers were not arguing for DSAC in this case, they were arguing for fully allocated costs as the appropriate level; because what the communications providers were saying is, "You haven't given BT an appropriate mark up for common costs, you have given it a massively excessive mark up for common costs which enables it to put a wholly disproportionate amount of its allocated costs into the trunk segment".

But it has lost that argument, and recognised that Ofcom made a regulatory judgment that DSAC was the appropriate level. Now, you could characterise that as arbitrary, but the Altnets more realistically characterise it as a permissible exercise of Ofcom's regulatory discretion and judgment, and that is the reason why they have not appealed it, even though they were far from happy with the result.

BT (this is para.107) has sought to present the amount of the repayment as being harsh by the same means that it has adopted throughout, by looking at its rate of return in aggregate. And for the reasons that we have already explored, that is simply impermissible in principle. But we submit that, even if it were permissible to look at its rates of return in aggregate, which it is not, BT's argument fails because the only way that it can come to a figure that is below its weighted average cost of capital, is by approaching the repayment on two false assumptions: first, that it was required to repay money for the year 2004-5 which it was not; and secondly, that it was required to repay money to its own downstream arm, which it was not.

And we say it cannot possibly be right for BT when assessing the fairness of the repayment, to operate on the basis that it is required to pay money that it is not required to pay.

We then make the point at 108 that in fact, if you are looking at fairness, there are significant losses that the CPs have suffered which are not addressed at all by this order for repayment, including the distortions to their investment decisions and distortions to competition. This order for repayment does not even begin to address any of those losses, and we submit in those circumstances it would plainly be unfair to cut the level of the repayment below its base level.

The final point we make is that there is no error of principle identified by BT here. On any view, either I am right that the normal order has to be full repayment or, if Ofcom has a discretion, it is an exercise of discretion which could only be challenged on the basis that there was an error of principle, that Ofcom had failed to take account of a relevant consideration, or taken into account something that was not relevant, and that, we submit, is a high test which BT has not begun to meet. Unless I can be of any further assistance, sir? (After a pause): I am asked to just say to the Tribunal, there are some references in this document to parts of the confidential transcript. We have been through them, but we do not think they contain any confidential information. But, just for your reference, they are at paras.86, 88, 91, 94 and 95. We do not believe any of the substance of the information there to be confidential.

If the Tribunal is content, and if nobody objects, we would like to be able to give this to our own clients; but we do not see any substantive problem with it.

MR. READ: I will have to obviously confer with those behind me as to whether or not they do think there is anything that might or might not be relevant within the material within it. But that obviously does not have to necessarily be done at present.

THE CHAIRMAN: Have a look over the short adjournment, perhaps, and —

MR. READ: On that subject, sir, there was a problem with my dictation yesterday, and it is still, sort of, in some disorder. I was wondering if we could rise until two, when I can try and get my typed closing submissions into some format that I can then put before the Tribunal. I can start, if you want me to, but I think you might, time would probably be better spent trying to make sure that the Tribunal has something in writing rather than disjointed material that is not in some —

THE CHAIRMAN: That would give us an opportunity to re-read Miss Rose's and Mr. Saini's submissions. I take it there will be no danger of you over-running into tomorrow?

MR. READ: I would hope not, although I cannot absolutely guarantee it, because the difficulty is that in opening, I deliberately did not deal with a number of the legal points which I feel I ought to go back and address in a bit more detail. And there are areas that I do not want to get forgotten about in the context of this appeal. In particular I am thinking about the dispute resolution because, however it is viewed in this context of this appeal, it plainly has knock-on effects with other appeals that are in the pipelines or potentially in the pipelines. And so for those reasons, sir, I may trickle over into tomorrow. But, we will see how we go.

THE CHAIRMAN: Very well. Two o'clock, then.

(Adjourned for a short time)

MR. READ: Sir, I apologise for the delay. There should be arriving imminently an aide memoir for you. It has got one particular section missing, but perhaps I can start by explaining what we have done. We have prepared a written aid. What we have actually done is also prepared some summaries on the witness evidence and what we say comes out of the witness evidence. We say it is quite important in this case that the Tribunal really does study what is, and has been, said by the witnesses, not only in the course of their cross-examination but also from the point of view of what was in their original statements. We have seen today a number of assertions being put in the written closing documents which we say do not fairly reflect the material that is actually there.

Sir, with that in mind and also with the qualification, I am afraid, that this is not going to be a complete document in any event because of the typing problems, you should have a bundle each.

I am told the aide memoir is at tab 2, sir, but can I just explain tab 1, which should be a table. You will recall that within the witness statements there are various references to the return on capital expenditure. We have tried in that table to set out, with all the references, the precise figures. We do say this is quite an important point. We are obviously looking at all PPCs. We do say it is quite an important point to see what is actually happening with those figures, and indeed the way that they have been presented by Ofcom originally in the final determination and indeed by Mr. Myers in the course of his evidence. As the Tribunal correctly ascertained, one of the figures in Mr. Myers' evidence did not really reflect the true position, and you can see that that is dealt with in Mr. Myers' amended statement in the right hand column. We hope that will be helpful, sir, in showing you the respective figures in one neat tabulated form with the various references to the texts available.

Sir, can I then turn to the way I want to deal with this matter. First of all, I want to start with three further introductory comments. Then I want to look – probably very briefly, because I am not sure how much is really in dispute between the parties now – at the question of the appeal on the merits. Then I want to turn and look at the issues of consistency, transparency, compliance with the statutory framework and legitimate expectation. I do say "compliance with the statutory framework", because this is one of the issues in this case that, following the preliminary issues judgment, has effectively gone on to the back burner. We say it is still quite a relevant factor when the Tribunal comes to analyse whether or not the final determination was, in fact, correct in the way it approached the matter.

MR. SAINI: Sir, I am sorry to interrupt, but I just noticed that one of the tabs actually still has some notes in it which are privileged, I am sure. They are, I suspect, between Mr. Read and one of his juniors. I was just going to point it out.

MR. READ: I am extremely grateful to Mr. Saini for that.

MR. SAINI: It is the document 8, which is a summary of Professor Yarrow's evidence.

MR. READ: We will update that in due course, sir, I am sorry about that. As we say, we hope that that material in the annexes to this aide memoir will, in fact, help the Tribunal in seeing how we approach the evidence, which is quite relevant, we say, when you come to assess what actually has been considered in this particular determination.

I then want to look at – which I think is probably, sir, a core concern of the Tribunal – how the cost orientation obligation should be interpreted, and also then to look at the effect of the burden of proof. I then want to deal with assessing the cost orientation condition. I should make a caveat here, sir, that unfortunately that section has not ended up in a finalised section within the aide memoir, for which I apologise, but I will do that in any event orally. Finally, we want to look at the s.190(2) powers.

Within the introductory section, it is fair to say that dispute resolution is mentioned there, but it is going to be dealt with slightly up the batting order. It is a factor, sir, that we say is still very important and still very live in this matter. It is live for this reason: the point that Mr. Saini has been making about a time limit of two months from the date that the decision to accept is actually taken, has significant consequences for other issues, other matters, that are now likely to be subject to an appeal. For example, there is one case, and this is all presaged in Mr. Tickel's evidence, because you will recall Mr. Tickel sets out the various disputes that are actually in train, that has been accepted by Ofcom. Ofcom have taken the view that they will wait and see what the judgment in this case is before they proceed with it. If Mr. Saini's time bar point is correct, then it certainly causes us some problems. So dispute resolution is still very much at the forefront.

Sir, can I now turn to the three introductory comments that I wanted to make. The first is to look at the dispute that was actually before Ofcom. You have seen the point already but it is an important point, we say. The disputing CPs, the interveners, quite plainly put their claim by reference to ROCE, the return on capital expenditure, and not by reference to DSAC. Indeed, one looks in vain for any reference within the dispute submission to Ofcom about BT's prices being in excess. You will recall that I put that point to Mr. Harding. Mr. Harding suggested that that was because they did not think BT's figures were very reliable. Sir, we say that that answer is really not credible, because even if the RFS were

inaccurate at the time they still show BT in excess of DSAC. Therefore, if the CPs had really believed that DSAC was the important test that they now suggest, one might well have expected comments very clearly along the lines of, "Whatever we think about the figures, it is still showing that BT's prices are in excess of DSAC". None of that was mentioned. We say that is a significant point.

Likewise, sir, we say that if you go back to that document, the original 25th June 2008 dispute reference, again the principal thrust of that document is that Ofcom should look at PPCs in aggregate. Sir, you have been taken to various parts of that document, and it is claimed on behalf of the interveners, "Actually, no, no, it does not mean what BT is saying". We say, if you study that document carefully, you will see that what it was actually looking at was terminating and trunk and it was being put on an alternative basis, if BT claimed that one should focus simply on the individual segments, which of course BT did not, and BT obviously, as you will appreciate from the way that this appeal has progressed, firmly says that is something you should not do, you should not take a market focus simply on one particular segment.

So if one looks at that document and reads it in what we say is the obvious construction of the original dispute resolution, we say it was clear, one, the claim was not being put forward in respect of breaches of DSAC, or indeed any indication that DSAC was bring breached; and two, PPCs were principally being considered in aggregate. We say that both of those points are very significant, firstly, on the basis of the approach that the industry understood as to how the cost orientation obligation should be dealt with; and secondly, how Ofcom approached this particular dispute.

It is quite clear also, sir, we say, that when you look at the material within the final determination, particularly paras.1.5 and 1.6, and that is set out in footnote 2 of the aide memoir note, p.3, in fact Ofcom did not give a clear hint as to the way they were to approach this. The question they asked is:

> *"BT has or <u>will have overcharged the parties for PPCs</u> …"*

although they do then go on to say in brackets –

> *"... (based on whether or not BT's charges for the underlying trunk and terminating elements <u>of those PPCs</u> were during that time, reasonably derived …)."*

It is set out at footnote 2 on p.3.

We do say that obviously BT fully accepts that a regulator is not simply acting as an arbitrator of a dispute, and that is clear from the original *H3G* decision back in 2005.

It has obviously to consider the matter on a regulatory basis as well, but we do say that you cannot completely ignore the dispute that was being put before it by the parties. We do say that that is something that the *TRD* appeal, as I think it has now become known, although the actual reference is *T-Mobile v. Ofcom*, was making fairly clear: that although obviously a regulator has to look at the dispute as a regulator, that does not mean that one has to go into a wide ranging investigation for the purposes of determining something that was not within what the original parties were putting before them.

The reason I say that is because it is quite clear from the paragraph that we quote there, para.180 in the *TRD* appeal – it is in para.5 of the aide memoir – that what was being said was, "Ofcom have got other powers to investigate, and it is always appropriate for Ofcom to ask itself whether there were grounds which would justify it exercising its power under the 2003 Act to intervene", in respect of in that particular case other aspects of the contract, but obviously, we would say, in respect of other elements of matters not raised by the parties.

The suggestion quite plainly being put forward, we say, in the *TRD* appeal was that if there is a problem that is, if you like, outwith the dispute put before it, then it is appropriate in those circumstances for Ofcom to consider using its other powers under the Act.

THE CHAIRMAN: Suppose one has a dispute where the parties to the dispute are each advancing extreme propositions at either end of the spectrum and the answer to the dispute lies somewhere, as it often does, in the middle, you would not be saying – I do not understand you to be going this far – that Ofcom could not say, "You are both wrong, the answer is the point in the middle of the spectrum"?

MR. READ: Absolutely, if the focus of the dispute was between two extremes. We say that was not really what the dispute was about. This dispute was about looking at PPCs and PPCs in aggregate. For that reason, for Ofcom then to focus upon particular segments and, in effect, carry out a cost orientation compliance investigation into those particular aspects was not something that was appropriate. We come back obviously to that point when we look at the question of the discretion of the dispute resolution powers. I do put that marker down, that if one goes back to the dispute as it was framed by the parties, it was not the dispute that Ofcom eventually adjudicated upon.

The second introductory comment that I want to make is that we consider that in the course of the case it became more and more obvious just how interlinked trunk and terminating segments actually were. Obviously I am not going to repeat the material that I took you through in the opening about the issue of the product, but you will remember in the course of cross-examination of Mr. Myers I did point out that the final determination itself at figure

A7 in annex 7 of the final determination on the evidence, and indeed upon the agreed material as to what a PPC was, was defective, because it overlooked the fundamental point that both trunk and terminating share the main link. This is something that was explained in Mr. Morden's witness statement.

That is quite an important point, in our respectful submission. It is all very well to say, "One looks simply at the economic logic of the situation", but there does actually have to be some reality, in our respectful submission, as to considering what exactly the product was and how exactly the respective parts of the product or the segments were actually using the common costs. It is a point that Ofcom actually make, albeit it in a different context. They point to the significant amount of common costs shared by trunk and terminating as a reason for rejecting BT's combinatorial testing, because they effectively say, "Look at the width of these costs and therefore we cannot do combinatorial testing". At the other end it is highly relevant when you come to consider the whole issue of cost orientation. If you have two segments that are sharing significant amounts of the same common costs then what precisely is appropriate for one segment or another segment to use or to have allocated to it in terms of those common costs is a highly significant question, we respectfully say. The example given by Ofcom is of course the ice cream lollies and the ice cream cones, or whatever the precise example is. One can make up fish and chips, or whatever one wants. The core point about that is, we respectfully submit, that it overlooks, it does not represent, the full fundamental sharing that is going on between trunk and terminating. Sir, we have set out the reference there to one of the points where one saw the very large share of common costs involved.

Having made those initial points, can I then briefly go back to an appeal on the merits. The starting point with this is that it is Ofcom which has raised the point where there is a finely balanced issue of regulatory judgment, and appeals against fine economic judgments where there could be one right answer demands a degree of deference to the regulator. That is the way it was put in the defence and you see that at para.10 in the aide memoir. We say that that is a not so thin end of the proverbial wedge by which effectively Ofcom is seeking to blunt the prescribed appellate function of the Tribunal, and that is for all the reasons that we have set out in our reply and skeleton argument.

I do not want to spend a lot of time on this point because it is a matter that has been, in part, ventilated by the 0800 preliminary issues judgment where, although it came up in a slightly different context, the issue of what an appeal on the merits actually meant was something that was specifically before the Tribunal on that occasion.

We set out in para.12 of the aide memoir the series of cases that we rely upon and how we rely upon them. Ultimately this actually comes back to one paragraph in the judgment of Lord Justice Jacobs, which we say (a) is correct in what it says – in other words, there has to be a material error. We are not saying that if there is some *de minimis* error on Ofcom's part that necessarily means that the Tribunal should overturn it, but we do say that if something material has gone wrong then Ofcom's decision is incorrect. What one cannot do is to start giving the regulator's decision a degree of deference, because the test ultimately is whether or not it has been made with appropriate care and attention and accuracy so that the results are soundly based.

You were referred in my learned friend for the interveners' closing document to the *TRD* appeal. We say again that one has to be extremely careful about looking at that. Perhaps I can just ask you to go to the authorities bundle 2, tab 34. One sees at p.37 of the judgment, para.82, which is the one that is relied upon. If one goes on to para.83, one sees what the Tribunal then has to say:

> "But the challenges raised by the Appellants in this appeal are more fundamental. It was not suggested by OFCOM that the points raised by the parties were points which it had not been asked to consider during the consultation process. The grounds of appeal go far beyond alleging errors of appreciation. This is not, therefore, a case in which the Tribunal needs to explore further the circumstances in which it is or is not appropriate for it to interfere with the exercise by OFCOM of its discretion."

Sir, we say you cannot gain anything in terms of the approach the Tribunal should take from that specific paragraph cited.

Sir, we set out in para. 12(f) what we say about Lord Justice Jacobs' *dictum*. I do not think, unless you wanted me to, I will take you through it but we say that it has to be read in its context.

Can I therefore move on to consistency, transparency, compliance, statutory framework and legitimate expectation. Sir, we think you correctly identified, in fact, in the letter yesterday, a number of matters as to the way BT's was put, but we do add this caveat that what is missing, in our respectful submission, from your letter is the points that are put forward at paras. 42 to 57 of BT's skeleton argument, which deal with the requirements for any rules or modifications to the SMP conditions to be transparent and follow the prescribed rules. I mention that because obviously this area was looked at in the preliminary issues judgment for the purposes of considering whether there should be a reference to the Competition

Commission but we still say there is an issue which needs to be resolved by the Tribunal, which is whether or not the methodology that Ofcom has actually used in the process of this dispute determination amounts to rules for the purposes of the Act under in particular s.87(9) and also the question of whether or not it alternatively constitutes a modification to the SMP condition. We think that is an important point because it should not be lost when one is coming to consider both the interpretation of Condition H3, but also whether or not it is proper for Ofcom to have made the determination it did in the way that it did. I will come back to that in a moment, because perhaps I can just, more briefly I hope, deal with the issues of consistency, transparency and fairness.

I do want to put this down very clearly because Mr. Saini on Day 2 said in several places that he talked about BT's case being one of legitimate expectation. Legitimate expectation is there but it is certainly not, and never did, in our respectful submission, constitute the primary way by which we say Ofcom's approach to Condition H3 was wrong. We say actually, and I think Mr. Saini got fairly close this morning to accepting, that the issue of fairness at the very least comes into consideration when you are considering the question of any repayment under s.190(2)(d). But, we say, it goes much further than that, because you cannot interpret, we say, an obligation without having regard to the fundamental principles of consistency, transparency and the need for fairness, because if a particular interpretation conflicts with what a regulator has previously indicated then we say that would breach the fundamental principles of the Act and, indeed, independently of the Act, both European and English law, and that that very factor must be an important consideration when one comes to the interpretation of Condition H3.

There are a number of Latin tags one can use in this context, but in particular the concept that you should not interpret a particular set of words which has the effect of rendering the underlying document illegal or void because the interpretation ought to be in accordance with a construction that is consistent with the duties imposed upon the parties to comply with the law. We say that is a fairly established proposition – certainly in contract. In any event, it would be an extraordinarily odd position that if a Regulator has given an indication that, in fact, a particular obligation means A and then it turns around at a later date and says "No, it means B", the Tribunal coming to consider it should effectively find that the Regulator itself has adopted an interpretation that is inconsistent with its previous conduct. So we say it goes to construction as well. It is a factor that plainly must be there when one comes to consider the precise description one puts upon that document.

THE CHAIRMAN: Mr. Saini was very specific about the materials that we could properly look at when construing the condition, Do you have a more wide ranging test as to the materials we can use to inform ourselves, or are you similarly confined as he is?

MR. READ: Certainly on our side we did not think he was quite as confined as we thought he was going to be. The core point we say, and in a sense it goes back to the horror that everyone had when *Investors' Compensation* first came out as a principle with the concept that you could refer to "absolutely anything" I think was the phrase used, "absolutely anything that is relevant to the question of construction". Certainly we are not saying that you can throw the kitchen sink in but what we do say, and we make this point later in the aide memoir if I can just briefly take you to the point, which is at para. 39, that the approach in *Investors' Compensation* – I think we saw this this morning from Lord Hoffmann's later comments in the *Attorney General of Belize* case - that in fact you can apply the issues of looking at a document in its context, and construing the document in its context. We say that that is a proper approach in this particular situation for a number of reasons and if you want me to I will deal with them now?

THE CHAIRMAN: No, no, I do not want to take you out of order. I will park my question until we get to p.16.

MR. READ: We will come back to that in a moment. Sir, I was talking about consistency, transparency and the need for fairness, and the fact that they must, in our respectful submission, have an effect on the way that you actually look at and interpret the obligation. But the principles are fairly clear, and I do not think Mr. Saini was necessarily derogating in any way from the position that they are important principles for any Regulator to follow, and we have set out in the aide memoir a number of points concerning consistency and transparency cases which have always been in the authorities bundle, but we rather think from the way it is actually being presented, or certainly not challenged that this is actually the correct application of the law that probably I do not need specifically to take you to it. Though we do make the point, which I think I made in opening very clearly, that if one looks at the *TRD* appeal, that is precisely the point that was being put down by the Tribunal in that case, the Regulator has to approach its dispute resolution powers consistent with its previous method of approach and dealing with matters.

Sir, shall I take you back to that? I do not know whether you still have authorities bundle 2 on the desk? If you go to tab 4 and p.48 in the judgment, which is at para. 108. What Ofcom was seeking to do in that particular case was to argue that because it had been consistent with a previous regulatory statement and indeed that there was going to be a

subsequent market review it therefore needed not to go any further. But the Tribunal makes this clear:

> "The Tribunal agrees that it is good practice for the regulator to be consistent in its approach to issues in the sector. This is recognised in s.3(4)(a) of the 2003 Act which provides that OFCOM must have regard to 'the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed.' Consistency is important because companies need to be able to plan their business on the basis of how they reasonably anticipate the regulator is going to act. But in the Tribunal's judgment OFCOM placed far too much weight on this need for consistency and fell into error in relying on the conclusions of the 2004 Statement …"

So it is a point being made in a completely different argument being put forward by Ofcom, but it is still, in my respectful submission, a very valid point both going to the question of the construction of Condition H3, but also as to how exactly Ofcom should have used its dispute resolution powers in this particular case.

Sir, perhaps while I have this open, and rather than unnecessarily ask you to look at it again, at p.74 there is the passage where the Tribunal sought to set out its approach to dispute resolution generally. We are not seeking in any way necessarily to derogate from what is being said there but what we do say is that obviously you do have to look at this approach in the context of the particular case that was being dealt with, where there was a very clear argument about prices, and people could not agree about them going forward and that as a result the matter was put to Ofcom for Ofcom to resolve the matter going forward. We say that is different from the situation you have here where effectively you have a breach of a compliance investigation, but having said that, sir, we say that they certainly provide some initial guidelines for the commencement for dispute determination.

Sir, the *Opel* case which we refer to in para. 20 in the aide memoir makes the point clearly as well. If you want me to I could take you through it, but the key point is that there is a need for advanced notification, particularly where the measure in question is likely to have financial consequences, and we say that is precisely the case here, that if there is a methodology that is being prescribed for a consideration as to how one adjusts prices in order to be cost orientated that really is something that ought to be given in advance and so we say it is a very clear case on point when it comes to the question of consistency.

In para.23 we also deal with the issue of transparency, and again it is all part and parcel really of the same thing that a Regulator needs to set out in advance the approach that it is

going to take to particular matters, if it is going to use a particular prescribed methodology. We heard yet again this morning, the contention that somehow or other that BT is putting the case that it never understood what DSAC was. We say that is wrong. BT accepts very plainly what DSAC was to be used for, which was a first order test. We could not have made this point clearer about how BT viewed the point. If one looks, for example, at footnote 36 of our original skeleton argument, it is laid out very clearly there, and rather than ask everyone to turn it up I will read it.

"BT contends that it had understood:

(i) from the 1997 Guidelines, that any complaint as to a breach of cost orientation '… *the primary focus of investigation … will however be the effect or likely effect on competition and consumers …*' that an unreasonable charge would be one '*… likely to be anti-competitive or exploitive…*' and '*… if asked to investigate charges Oftel will seek to analyse the effects of the charge in the relevant market*' ; and

(ii) from both those Guidelines and Oftel guidance when setting the PPC conditions, and subsequently, BT's charges should be below [true] SAC and if any testing was to be needed then that would be combinatorial testing:"

And then we set out the references there. It is on p.16 of the original skeleton argument, sir. We do find the suggestion that BT has not made it clear a little surprising and that BT somehow is suggesting that it never understood that DSAC was never to be used as a test, because even today, sir, you were being taken to documents that were showing that BT understood DSAC is a first order test. Yes, BT did understand DSAC as a first order test, the key point was what exactly a first order test meant. We say what has happened in the final determination is that from it being an initial screening test, it has moved on to becoming a presumptive test. There was, we say, obfuscation that there was in fact a presumption being placed against BT as a result of the DSAC test, and you will remember that I asked Mr. Myers several times in the course of cross-examination about what his counterfactual meant. Mr. Saini, in our respectful submission, put the matter absolutely bluntly and clearly on Day 2, p.29 of the transcript, lines 20 to 23. Where he said:

"Failing DSAC gives rise to, at the very least, a presumption that there has been an over-recovery of common costs."

And we say that is exactly what the final determination did do, is set a presumption against BT, if you like a double burden because it already says the burden is on BT anyway as a

result of Condition H3, I will come back to that in a little while. But that is precisely what it was doing in the context of the final determination.

We say you see that time and time again in the way the final determination is actually set out. I will possibly come back to that a little bit later. But it is that methodology, that presumption of charges in excess of the DSAC ceiling which is the inherent methodology that BT complains against. Effectively what Ofcom have done is that they have approached all other evidence on the basis of whether it rebuts that presumption and we say actually it is a fairly high presumption that is being put against us because it is the test of whether or not BT has exceptional reasons, and you will recall that that was the phrase used in the draft determination and it seems now to be accepted that it is a very significant consideration. That is the test that is being put on BT and being applied to BT, which we say was a test that was never, ever indicated; indeed, to the contrary the material suggested something very different, namely that, for example, the primary consideration would be upon an affects analysis.

My learned Junior has just pointed out to me that this whole point about how we approach it is set out in para. 101 of our skeleton argument, I do not know if you necessarily wanted to turn it up ----

THE CHAIRMAN: No, I will make a note.

MR. READ: Certainly, for your reference, sir. Returning to the issue of transparency, the critical issue is how well was that transparently made clear? We say it was not to the contrary. It is again quite interesting when you look at what happened in the Fixed Narrowband Services Wholesale Markets in 2009 where Ofcom specifically introduced a methodology for determining cost orientation in annex 14 of that document, and then subsequently withdrew it because it said there had not been sufficient consultation. We say that really illustrates precisely what Ofcom should have been doing under its obligation of transparency and, indeed, in that instance, it had not actually even been transparent enough because it had not given the parties an opportunity to consult on it.

So the principle way we say Ofcom's interpretation now of Condition H3 errs is that it is not consistent, it has not been transparent and it is not being fair. Legitimate expectation was really one element of the points that we were actually putting in the skeleton argument, but can I just ask you, sir, just to turn up BT's original 14th October 2008 response, which is in BT1 tab 7. I am going to ask you to go to para. 95 at p.34. It is a fairly clear exposition of precisely how we put our case on legitimate expectation and other Convention rights. Indeed, at para. 96 you see the question of estoppel by convention between the parties.

If you look at footnote 48 you see that we actually there refer to Lord Hoffmann in the *Reprotech* case that my learned friend took you to today. You will see that this forms part of section 3, which is at p.31, which deals with what we say is retrospective adjustment being precluded by Ofcom's previous stance.

All I would ask you, sir, is if you go back to tab 1 in this bundle I will show you it here rather than in the core bundle, but if one goes to para. 132 you can see there, it is part of BT complaining about the approach that Ofcom have taken to resolving this dispute. There it deals, in the circumstances obviously of its previous conduct, and saying in terms:

> "In those circumstances it is unfair and illegitimate for Ofcom now (retrospectively) totally to reject any consideration on the aggregate level at which the product is actually sold but instead myopically to focus on the granular component level. BT has referred to a number of the legal arguments supporting its position in Section III of its Response of 14th October."

THE CHAIRMAN: But that is referring to aggregation rather than the DSAC test and its use, is it not, at 132?

MR. READ: Sir that is right, although it is a point that is made frequently throughout the notice of appeal that one of the difficulties with this case is one is very conscious when one is settling the notice of appeal to look at the Tribunal's Guidelines on how you should actually approach it, and where you have a document which already runs well in excess of the suggested limitation one is very keen not to just repetitively keep repeating: "and we object because of this, and we object because of that".

THE CHAIRMAN: It was not in any way a criticism, Mr. Read. It is just that when one is looking at questions of construction, consistency, transparency, compliance with statutory framework, does one have to consider those tests both and separately in relation to the question of aggregation or granularity, whatever you want to call it, and distinctly the DSAC test?

MR. READ: Absolutely, sir. In one sense it is very difficult sometimes to actually divorce the different elements in the grounds of appeal, but there is no doubt that Ofcom has applied a DSAC methodology which BT says is inherently inconsistent with what it has previously done, and adopted an inherent approach to how you look at the product, which also we say again is inconsistent with the approach that has previously been adopted. We would also say that that is true of its approach in respect of economic harm, because of course we say that economic harm was one of the key factors for gauging and one gets this from the 1997 Guidelines, that effectively an effects based analysis is in fact one of the core ways of

actually trying to work out whether or not cost orientation obligations have been breached. We do not say it is the only way, because what we say ultimately a Regulator has to do is to look at all the evidence and weigh all the evidence, but where Ofcom start from is they start from a presumption against material because of the presumption that prices in excess of DSAC are overcharging.

THE CHAIRMAN: You will probably be coming to it, and do not let me take your submissions out of order, but it would be helpful to know the logic of the order in which we have to approach these questions, because it seems really that one has to deal with the question of granularity aggregation first in order to determine precisely which costs and prices are relevant before one then goes on to debate the question of what test one uses to ascertain whether there has been compliance with the cost orientation obligation. Then there is a third stage, your question of economic harm. Is that something you disagree with, or not?

MR. READ: Sir, I think what I would say about it is this: that one of the problems with the DSAC test is the more granular the focus, and we have seen this from the graphs, the wider the potential disparity and the greater the risk of anomalies actually arising. We say that this is one of the important distinctions between what was happening when the original PSTN Guidelines were being brought in and what has happened now, is because at the time the PSTN Guidelines were being brought in. First, one knew, because they had already been regulated the chances of widely divergent prices were less; and secondly, because the Guidelines were making it absolutely clear in terms that in fact you had to look at services rather than individual components, the individual components were only being used as a mechanism for ending up with an aggregated DSAC figure.

In one sense we do not disagree with what you have been saying, sir, because there may be an issue about the logical route you actually take on this because plainly one of our key complaints is the methodology that is actually being used, which of course we say is the primacy given to DSAC, and that is almost an independent element, although as I have already indicated it overlaps a lot with the issue of disaggregation and economic harm. I suppose the point I am really trying to make to you, sir, is it is actually quite difficult to say logically one follows before the other because in a sense they are different points but all being interlinked as to how you apply the test.

THE CHAIRMAN: I can see your point that the level of granularity may affect the rationale for adopting one test for cost orientation as opposed to another, I can understand that, but surely the first stage has to be to work out what particular prices have to be orientated before one then goes on to ask whether they are correctly orientated?

MR. READ: I think I would say that you have to understand what the obligation actually relates to first before you can then move on and make an assessment of how you apply the test, and I can see that. I was perhaps quailing slightly at the concept that the construction of the obligation is necessarily the same as aggregation, disaggregation, obviously it impacts.

THE CHAIRMAN: No, I am not suggesting that, I am simply suggesting that it is not the whole story of construction by any means, but as a question it is anterior to the question of the application of a cost orientation test.

MR. READ: Certainly, what exactly the obligation is must necessarily be anterior to any methodology although again we do make the point that the methodology may be linked into, because it becomes effectively a rule relating to the original obligation.

Sir, perhaps I can come back to the question of interpretation in just a moment. Perhaps I can first deal with this question of the compliance with the statutory rules, because as I indicated earlier on we are concerned that this point does not get lost in the welter of other detail that this appeal has actually indicated.

We have set out in our aide memoir the paragraph numbers where we have dealt with it in the skeleton argument, it is there set out at para. 26. Can I just develop that a little bit further? We say that the methodology that was actually adopted in this case was a rule about cost orientation. If I can ask you perhaps to turn up the authorities bundle vol.1 and look at the Act itself. You were referred to the Act this morning by Miss Rose, it is at tab 7 in the bundle. If I can take you straight away to s.87(9), because I think you had already seen the background to the imposition of SMP conditions which Miss Rose took you to earlier on. It is obviously, sir, something you are familiar with, because we had to look at this in some great depth in the preliminary issues. But, one sees from 87(9)(a) that it is dealing with such price controls as Ofcom may direct, and at 87(9)(b) such rules as they may make in relation to those matters about the recovery of costs and cost orientation. And it is clear, we say, that when it is talking about price controls, it is actually looking at the control itself, and that therefore as a result rules must encompass something different to the actual price control itself.

And we do gain some further strength and support for that from the Access Directive itself, and perhaps I can ask you just to turn back in the bundle to tab.1 and ask you just to look at Article 13, where it says in terms that:

> "A national regulatory authority may in accordance with the provisions of Article 8, impose obligations relating to cost recovery and price controls, including obligations for cost orientation of prices and obligations concerning cost

accounting systems, for the provision of specific types of interconnection [for specific types]".

And then, if one looks at recital 20, that sets out price control and regulatory intervention. The point we make, therefore, is that this is plainly dealing with the issue of the imposition of the price control in itself, and therefore it must follow that s.89(9)(b) ie the reference to rules, means something other than the actual price control costs orientation obligation itself. Perhaps I can then just take you back to the Act itself at tab.7 and ask you to look at 87(10). That in itself involves conditions requiring:

"The application of presumptions in the fixing and determination of costs and charges for the purposes of the price controls, rules and obligations imposed by virtue of that subsection".

So, we say that all of those things together make it quite clear that there is a difference being drawn very clearly between the actual control itself and any rules that relate to it, any particular rules relating to cost orientation. That is an important factor because if, ultimately, it is necessary to go through the prescribed process in order to set out a rule that does not form part of the price control itself, then plainly what one cannot do is several years after the event to effectively invent the rule that is actually going to be applied in those circumstances. And again, we say that one sees that Ofcom did understand the necessity for that sort of process from the fixed narrowband review where they came out with the annex 14 and then subsequently withdrew it because there were issues about whether or not there had been proper consultation on it. And we say the same is true even more so, when one comes to look at modifications, and those are permitted under s.47 of the Act, as one can see at s.47(1):

"Ofcom must not, in the exercise or performance of any power or duty under this Chapter —

(a) set a condition under section 45, or

(b) modify such a condition, unless they are satisfied that the condition or (as the case may be) the modification satisfies the test in subsection (2)"

And one sees in subsection (2) what they have to do. So again, if we are right and effectively what is being done here is that there is a clear-cut rule being laid down for how exactly you follow through the cost orientation obligation, then plainly you cannot have effectively an interpretation of the obligation that renders it inconsistent with this provision within the Act. We thought that that point had been conceded at the preliminary issues hearing, so that the only real issue between us was whether or not what Ofcom had

actually done in the process of the final determination was in fact a rule, or whether or not it was actually, as Ofcom maintain, simply a method of gauging whether or not there has been compliance with the rule. We thought that was the only dispute between us.

Now, it is not clear from the skeleton argument, it certainly has not been developed subsequently, so I am not going to spend a great deal of time on it, whether it is being suggested that, if we were right and it was a rule that had been imposed by the process of the final determination, whether or not it would still be lawful for Ofcom to apply it in that manner.

Now, it is a point that was made in the skeleton argument. It does not seem to have been pursued, so I am not certainly going to chase a rabbit out of a hat that may not actually manifest itself. It certainly has not manifested itself so far. But we do say that there is a very core battle line being drawn between Ofcom who says, "Well, this is all about the way in which you approach compliance with the SMP condition", and us, who are saying "No, no, you are laying down a very clear methodology which in the way you have applied it amounts to a rule which would have complied with the provisions of the Act".

And so, if we are right in that, we say that that really at the end of the day is a significant factor: (a) against the final determination; but (b) and anyway must be taken into account when you come to consider the obligation itself, because if the obligation itself should have been laying down the methodology as a rule, then what Ofcom cannot do now is effectively bring a rule in through the back door.

And it is quite, in our respectful submission, interesting the way that Ofcom has actually put this, because if one looks (sorry, I have managed to lose my reference again) I will not spend time hunting for the precise reference, yes, perhaps I can just briefly take you to it, it is in core bundle 1, tab.7. If I can ask you to go to p.174 para.119, this is where Ofcom deal with the point. And at para.121(iii) over the page it says this, "BT's relevant cost orientation conditions were not therefore modified", I am sorry, I think I must have a wrong reference, I am sorry, sir.

The point that I think is being made is that there was no formal modification of the relevant cost orientation obligation and therefore, as a result, yes, it is para.119, I was right the first time round, where it says:

> "The provisions of section 47 and section 88 of the Act apply to the setting of relevant SMP conditions. Further, section 47 of the Act also applies to the formal modification of relevant SMP conditions that have already been set".

Well, that is our point, that if you are going to make a modification to the way that the SMP condition has actually been set, it has to be through a formal modification. What you cannot have is an informal modification. And anything that constitutes an informal modification in our respectful submission offends the requirements within the Act for dealing with such changes.

Sir, can I take you on now to the interpretation of the cost orientation condition. First of all, I want to make some preliminary observations about this. And the first point, and indeed it really touches also on the point I have just been making, is that this obligation could have been so easily phrased in a way that made the obligation that Ofcom now says it entails perfectly clear. For example, and we have given two examples in para.28 there, where this is the way you could have done it if you wanted to make it absolutely clear how exactly you were to apply it, for example, that it is to apply to individual segments, the DSAC ceiling of each individual segment.

Now, there is, as we know, no reference within the obligation to the 1997 and 2001 guidelines themselves, but in any event over and above that, of course it is a point that you will have picked up in the course of the hearing, there is no actual reference to the 1997 guidelines and the 2001 guidelines in the leased line market review itself. And we say that is a very significant factor. Nor is there anything within it to suggest that the previous regulatory framework by which the offer of PPCs was required no longer had any application. Again, the leased lines market review is silent on both of those features. Now one can try, as my learned friends have sought to do, to say, "Well, you look at the leased lines market review and it's telling you this and it's telling you that", and for a number of the reasons that I have outlined in opening, we say that is not actually what the leased line market review is about. But the one thing one can be quite categoric about is that nowhere in the leased line market review does it say the 1997 guidelines and the 2001 guidelines will apply and they will apply in this way; and nor does it say at any particular point that in fact, "Oh, and by the way, please forget anything we said previously when introducing the cost orientation obligation, because that no longer is apposite or in any way important when you come to consider cost orientation" and you will have all the points, they are laid out in footnote 7, we say particularly the documents I took you to in opening, National Leased Line Competition Review, the Direction under Condition 45(2) and the Phase 1 Direction and the Phase 2 Direction. None of those were in any shape or form the approach that was being adopted and then none of them were rejected. And indeed we say further than that, that all the materials that were available at the time pointed to an understanding that BT

would have a latitude to recover common costs on PPCs from the trunk segments, and it is a point that Professor Yarrow made, in the manner in which they set the charges. And, of course, it is not only the manner in which they set the charges whereby BT was effectively tightly constrained on terminating but also had much more latitude with the costs orientation obligation on the trunk; but it also has to be seen in the context of the regulatory information that Ofcom had at the time, and in particular the regulatory financial statements for 2003 and 2004, because, as you have been shown a number of times, it is quite clear that the terminating prices were being set well below, or had been well below DLRIC for a number of the terminating segments.

And we know that when the price cap was imposed it was actually the terminating prices stayed still, so they did not, it is not a question of Ofcom adjusted the terminating prices to take that into account, it left them at the same prices knowing full well that they had previously been well below the DLRIC floors. Now, we say that such approach is entirely consistent with all the stated aims in respect of the trunk market and particularly that the level of competition within the market was going to be a key parameter, you will recall — I do not want to take you back to them, but all of those four documents referred to in para.7 all came out with the same point that where you were looking at a market that was prospectively competitive, Oftel would apply a different approach to cost orientation than one would have if it was a more tightly constrained non competitive market.

Now, we say nothing changed between when that was being said, when it was plainly said on the documents themselves, that trunk was prospectively competitive, and what happened in 2004, because what happened in 2004 was it was still considered that over the span of the market review period, trunk prices can be constrained by competitive forces. And that was a point that is clearly, we say, made in the final determination itself, and it is a point we say that has also been made elsewhere, and at para.32 we pick up a point that Miss Rose made on the second day of the hearing which is that trunk prices were not expected subsequently to be prospectively competitive — subsequently competitive — and there we have set out the paragraphs from the final determination; and indeed what Mr. Ridyard's understanding was, and you will remember I cross-examined him on it, and there is his answer set out.

So, we say that the logic that had been applied in the Phase 1 and the Phase 2 Directions, as to how Ofcom would actually approach the costs orientation obligation still applied when you came to the 2004-2008 period.

And as a result, sir, we say very clearly that, given that there is nothing within the leased lines market review document itself to suggest the contrary, that Ofcom cannot now say that the approach that its predecessor Oftel had adopted in 2002-2001 was supplanted and completely replaced with a new test.

Mr. Bolt, you will recall in cross-examination referred to an obligation being on both sides to clarify what exactly a regulatory obligation involved. Now, we have some doubts about that if it is actually a regulation being imposed by an — an obligation being imposed by a Regulator. But in any event, what we say is it is very very clear that BT itself was trying to clarify precisely the position with Ofcom, and they did so by the letter of 12th August 2005 and in para.33 of the aide memoire, we have set out the quotation from para.26. We do say, sir, that that is a letter that needs a considerable amount of attention because it quite plainly sets out BT's understanding at the time, and although we fully accept it has references to DSAC in it, you would have also seen from the letter that: first, it was making distinct reference to the previous regulatory regime. You will recall that in the annex those are the references to the Phase 1 and the Phase 2 Directions, secondly, it was setting out, if I can put it like this, a number of different approaches to the possibility of cost orientation. It was not hanging its hat solely on one item, thirdly, it was plainly addressing as the primary focus trunk segments in aggregate with PPCs; and finally, sir, it was actually making it clear, and this was actually part of the letter I did not take you to it. (I will not take you to it now) but I do say that it should be read in full. If you go to one of the attachments to that document, you will see that BT itself was setting out in very clear terms how it perceived the split had been between terminating and trunk segments. Again, very illustrative, we say, of showing how BT was making it quite clear to Ofcom that it was looking at these matters in the round and that accordingly, an approach now that is different to that is really, we say, grossly unfair on BT itself.

Sir, I do not know whether that would be a convenient point if anybody wanted to stretch their legs for a few moments?

THE CHAIRMAN: How are we doing, Mr. Read?

MR. READ: Sir, I fear I am going to probably just trespass into tomorrow. I hope it will not be more than about half an hour, three-quarters of an hour, but I do not know how late the Tribunal wants to sit tonight.

THE CHAIRMAN: We would be minded to (we will discuss it when we rise) but we would be minded to try and sit later if we can finish it today.

MISS ROSE: You have already heard my submissions on the costs to my client, each extra day, so I am sure you know what my view will be.

THE CHAIRMAN: We will mention it when we come back. We will rise for five minutes.

(Short break)

THE CHAIRMAN: We will endeavour to finish tonight and we can sit until reasonably late, by which I mean six o'clock or 6.15.

MR. READ: Sir, can I just make clear, which has been pointed out to me, that there is some material within the documents that have been lodged with the Tribunal that refer to confidential figures. Those have all been clearly marked, but it does mean that obviously the material that has been circulated does need to be kept within the confidentiality ring. I just wanted to make that point clear, so there is no misunderstanding.

THE CHAIRMAN: I understand.

MR. READ: Sir, I was just dealing with the last point, I think it was, as a preliminary before turning to the question of construction. I wanted finally to comment on the knowledge of DSAC and Ofcom saying that BT's accounting material showed that BT must fully have understood that DSAC was the ceiling for what I will the individual segment component as the service rather than elsewhere. Sir, even here there is an element of inconsistency in the way that Ofcom itself has approached the level of granularity that it wants to focus upon. It was indeed actually sending out quite contradictory signals as to what exactly BT should be focusing on. In one sense, of course that does not present a huge problem if DSAC is only being used for what BT understands to be a first order test – i.e. an initial screening test. Of course, obviously if you place a much higher primary reliance upon it to the exclusion of any consideration of looking at PPCs as a whole, then it becomes a very important matter. Again, we say far from it being quite as clear and obvious as Ofcom has actually suggested, if one looks at the material, for example, the review process itself in 2004, part of that whole market review process included the imposition of regulatory financial reporting obligations on BT. As part of that very process, as we have seen in the 2005 Regulatory Financial Statements, Ofcom itself expressly required a much less granular requirement of reporting in the RFS. You will remember you were taken to the 31st March 2005 documents in opening which showed that they were focused on the trunk market as a whole and not on any individual segments. That was subsequently varied, we fully accept that, but it does mean that when you come to assess what was it Ofcom believed the obligation actually meant in 2004, their conduct in actually setting that market review process and setting the obligations that went with that process is inconsistent with the way they now say

that you have to read that obligation, because they were focused not on the individual granular trunk segments but on the reporting on the trunk market as a whole.

Can I ask you to look at one further document very briefly, which I do not think you have looked at before, which is in DF2, tab 10. DF2, tab 11, is what you were taken to earlier today, but in fact what is in the bundle before that at tab 10 is the document that it is responding to. I would just like the Tribunal to see how in May 2006 Ofcom were reporting the matter. I say that because you will recall that in the course of opening Mr. Saini took you to the primary accounting documents for 2005 to demonstrate that everyone must have known the importance of DSAC and in particular DSAC on the individual trunk elements.

If one goes in this document to p.50 (p.49 internal numbering), one sees at 6.26 and 6.27 Ofcom's view at this time:

> "To date, Ofcom has considered that this information provides a useful first order test to ascertain whether there appears to be *prima facie* evidence of compliance with cost orientation obligations. Nevertheless, Ofcom recognises that there are limitations on the reliability of some of this information and that the value of publishing first order tests based on LRIC floors and SAC ceilings may also be limited."

So again, not entirely as clear cut, one might think, as is now being suggested.

I started touching upon the question of construction. What we say is that the principles that one sees in *Investors Compensation v. West Bromwich* are not really, at the end of the day, that seriously different, albeit we fully accept that you are looking in the context of obligations that actually apply to a wider public rather than simply to the individual parties to a contract. Even in *Investors Compensation* it is important to note that this was not simply a contract. This was actually a notice under a prescribed statutory process, because, in fact, as the title indicates, in the *Investors Compensation Scheme*, a scheme had been set up under s.54 of the Financial Services Act, and the question turned on what was the effect of the notice that had been served under that particular Act.

I am not saying they are necessarily identical to the SMP condition that has been imposed in this case, but what I am saying is that there is not any form of major divide between the way you should approach construing, say, a contract in the *Investors Compensation* approach and the way you approach construing this SMP obligation. In particular, we say you are fully entitled to have regard to the contextual material behind the imposition of that obligation.

THE CHAIRMAN: When one is looking at a contract, the contextual material, the material that is reasonably available to the parties to the contract, such that they would have it in mind when negotiating their agreement and concluding it, you would accept, I take it, that what is contextually relevant depends upon the nature of the instrument that one is construing?

MR. READ: Absolutely, but if one looks at the key documents that underpin what it was all of them are in the public domain anyway, the 1997 Guidelines, the 2001 Guidelines, the 2000 National Line Leased Review, the March 2001 Direction, the Phase I Direction, the Phase II Directions in 2003, the Regulatory Financial Statements, and so on and so forth. None of the material we have been discussing has actually not been in the public domain. That is why we say at the end of the day we just do not think there is any real issue about this.

Indeed, even when you come to construe a statute, for example, it is clear that you can apply contextual material. This is obviously somewhere in between the contract between two parties and a Parliamentary document. We say the position has got to be absolutely *a fortiori* when it is Ofcom, itself, which is seeking to rely upon the documents pre-dating the obligation. It is one of the oddities in this case that Ofcom says that it is able to rely upon the 1997 and 2001 Guidelines in order to demonstrate the primacy of DSAC. If that is the position then certainly when you come to consider and interpret the cost orientation obligations, it would be an extraordinary proposition to say that you must reject any other material within those documents for construing those obligations, and indeed can reject other material that follows after those guidelines and therefore may have a bearing on how those guidelines should be interpreted.

In particular you will recall, and I do not think I need to turn this up, in the 2001 Guidelines there was reference to the fact that PPCs were to be introduced. I think you were taken to that. As a result of that it concluded by saying that Ofcom was considering how it was actually going to deal with it. We say that how Ofcom actually dealt with it is set out in the Phase I and Phase II Directions.

To try in any way to interpret how condition H3 should be applied by excluding some of the very documents that come out of the 1997 and 2001 Guidelines upon which Ofcom itself relies is simply not a proper way to approach it.

Again, one cannot ignore the fact that Ofcom was looking at this obligation in a particular economic context. Obviously the Regulator has to impose it in the economic context of the market as it finds it in the 2004 Review, so again one cannot exclude what was going on and how it was perceived at that time from an economic point of view as well.

I do not think at the end of the day – I did not apprehend – there was going to be a great deal of difference between Mr. Saini and myself on this point, and perhaps therefore I do not need to take the matter much further.

There is one further point that I would make about the obligation and how one construes it, which is that obviously if Ofcom ultimately gets the construction wrong, or it has a construction placed upon it which it does not like, there is, as we have already seen, a power fully for it to modify the condition than actually impose the condition that it would like to do, albeit that it has to go through the transparency and other hurdles set out within s.47 onwards.

I do make another point when one comes to actually construe this, which is that one does have to consider the question of ambiguity. If, at the end of the day, there is an ambiguity in the construction of condition H3, then plainly that ambiguity, in our respectful submission, ought not to be used in a way that prejudices BT – in other words, there is, if you like, a *contra proferentem*, or some other form of restriction, on applying the obligation, if there is ambiguity, in a way that harms the party that it is actually being imposed upon. We say that that comes out of the consistency, transparency, proportionality points that I have already alluded to.

At para.40 of the aid we have therefore set out some of the evidence where it is made absolutely clear the way the two regulatory experts actually viewed it, namely that what you could not do with regulation would be to invent retrospective tests which applied to the past. Sir, we say that is a factor that obviously applies when you come to construing the matter. We say that also one has to take into account the established rights that BT would have in any question of construction. This is an important point. Can I take you very briefly to the *Vodafone v. BT* case, which is in authorities bundle 2, tab 49. I am not sure it was the final act. I think the final act may still be in process. It is at tab 49, but it certainly was one of the more penultimate bits of the mobile termination rates issues arising out of the 2007 market review. What had happened was that BT had appealed the original market review, had succeeded through a fairly lengthy process in both this Tribunal and through the Competition Commission and, as a result of that, the Tribunal had then effectively re-set the charges at a level that affected 2009. In other words, the appellate process ends in 2009 and the Tribunal says that these are the charges that should have applied in 2007. The mobile network operators appealed it on the basis that the statute did not allow the Tribunal to do it.

I will not take you at any great length through the judgment, but can I ask you to look at para.40, p.1041 of the report we have actually got where it is talking about the modification under s.45(10)(e):

> "… [It] is necessarily subject to the same constraints, and has to be exercised for the same purposes, as the power to set conditions in the first place. By the terms of the subsection, the power to set a condition 'includes' power to modify the conditions for the time being in force. The provisions that qualify the power to set a condition therefore also qualify the power to modify conditions. If the power to set conditions is a power to set conditions with prospective and not retrospective effect, then the power to modify existing conditions is likewise a power to modify them with prospective and not retrospective effect.
>
> Mr. Anderson [who was then appearing on behalf of BT] submitted that the revisions directed by the Tribunal and given effect by Ofcom in this case were retrospective only in the sense that they 'touched on the past'. In my view, however, they were truly retrospective (or retroactive) in character, purporting to alter the content of past obligations; they did not merely refer to past events in order to determine the content of future obligations. They amended for each of the four years 2007 – 2011 the terms of a condition that, by s.45(1)(a), was *binding* on the MNOs to whom it was applied. I do not see how breach of a binding condition could be anything other than a contravention of that condition for the purposes of the 2003 Act. If, therefore, the amendment was valid, its consequence was that MNOs who had complied with the condition in the first two years of the four year period became retrospectively and unavoidably in contravention of the condition in respect of those two years, which, in turn, brought them within the scope of the enforcement provisions of ss.94-104, albeit Ofcom might be expected to exercise in their favour the various discretions it enjoys under those provisions.
>
> If such a surprising result had been intended, I would have expected clear statutory language to that effect."

Again, we say that it is quite important when you come to consider what the obligation was. If, in effect, there has been a retrospective alteration to the approach that is going to be taken to these conditions on the construction contends for, that, in itself, is a reason for saying that that ambiguity ought to be construed in favour of BT.

Sir, I think that is all I need to say on that case.

Sir, against that contextual background and, we would say, the principle as to how you should actually construe the obligation, if one looks at the obligation, and I will not take you to it *per se*, because I think you have probably in sufficient detail both today and during the course of this case, there are three factors that we say are relevant in this matter. The first is that it specifically includes the words "reasonably derived" and "an appropriate mark-up for the recovery of common costs". We say that is quite the opposite of placing any limitation on the material that could be taken into account in order to form any assessment of whether BT had to comply with its obligations.

We fully accept, as I hope I made clear on day 1 when Mr. Saini was raising the point, that this condition H3 is imposed in the context of the trunk market. When you come to look at the terminating market, as Miss Rose pointed out, G3 was imposed as an obligation in respect of that market. We do not dispute that the obligation is actually focused on a particular market, because that is the process through which the imposition of the condition actually has to go. That does not mean that when you come to actually construing what H3 allows you to look at, you ignore everything other than that respective market. We say that you can gain very clear guidance of that from the words "reasonably derived" and "an appropriate mark-up", because in order to determine what is reasonable and what is appropriate you are entitled to look at all the surrounding material that relates to the charges that are actually being set. That is particularly so given the nature of the costs that are involved here. As I think has been explored in great depth, there is no clear-cut demarcation as such as in, for example, the ice lolly or cones case, between trunk and terminating. You will recall Mr. Morden's evidence, and I made this point earlier on (para.9 of this aide memoir), that trunk and terminating actually use the same bit of wire on numerous occasions.

THE CHAIRMAN: When it says "each and every charge", what "charges" is it referring to?

MR. READ: We say it is the charge relating to the network access. That is moving on to the third point that I want to make about this, which is that network access, Mr. Saini said that it was all very clear-cut from ----

MR. SAINI: Sir, I am sorry to interrupt, but is access covered by condition H1.

MR. READ: What one has to do, in our respectful submission, when you are approaching this cost orientation obligation, is to look at what the nature of the network access is that is actually being sold. Once one looks at the nature of the product that is actually being sold, you then focus the attention on what is happening with the trunk element, but you do not exclude all consideration of the product that is actually being sold. We say otherwise that

that creates an artificial construction to the meaning of network access, and it certainly produces a restrictive interpretation of what exactly is an appropriate mark-up for the recovery of common costs, because you cannot gauge what is appropriate without reference to how the product is actually being sold.

Again, in construing this, you cannot, in our respectful submission, ignore the economic reality of how this trunk market is actually operating. It is operating only in connection with terminating segments. There is no other way that trunk provides a network access. It provides the network access solely in conjunction with the terminating segment. Therefore, to prescribe that in looking at the charge that you are putting forward, or charging, proposing, for that network access, without having regard to the actual common costs that are involved and whether they are appropriate and whether they can be reasonably derived, artificially restricts the consideration of that particular obligation.

I come back to this point that if at the end of the day there was an ambiguity about it, if it really is as Ofcom now suggest, and that was the approach, plainly we say there was ambiguity about it because of the way the disputing CPs put it forward and because of various other factors that we rely on for saying that people did not appreciate that this interpretation of H3 was clear cut and obvious. If there is ambiguity about condition H3, as we say there was – we do not say there is, we say that is our fall-back position, because first we say it is obvious that when you look at it it does allow you to have an overall consideration of the product that is actually being sold. Even if we were wrong about that, then it is still plainly ambiguous, and it is certainly not right, in our respectful submission, retrospectively to impose an obligation that works such a large detriment to BT as this final determination has.

Sir, can I briefly deal with Network Access. You can see that it has got a capital N and a capital A, so it would have been possible to actually give it a precise definition as to what it meant. Mr. Saini was suggesting that ultimately you can see all of this from the Act itself. I think it would be quite useful to actually look at the Act on this particular point. It is s.150, and I think one finds that in bundle DF4. It had not actually made it into the authorities bundle. We have to go to DF4, tab 5, in order to see that. It starts at p.21, and 23 is where "network access" is defined.

What Mr. Saini did was take you to sub-para.(4), and saying that all the things that are defined in sub-para.(4) and necessarily must be a service for which trunk is provided. If we actually look at sub-section (3), you can see that:

> "In this Chapter references to network access are references to –

(a) interconnection of public electronic communications networks; or

(b) any services, facilities or arrangements …"

In other words, in our respectful submission, if it is interconnection you do not get to sub-section (3)(b). If one looks above in sub-para.(2) you see:

"In this Chapter references to interconnection are references to the linking (whether directly or indirectly by physical or logical means, or by a combination of physical and logical means) of one public electronic communications network to another for the purpose of enabling the persons using one of them to be able –

(a) to communicate with users of the other one …"

That is what has happened in this case because that is the nature of interconnection. That is clear, in our respectful submission, because if you go back to Phase I and Phase II you will recall that it was specifically based on the Interconnection Directive that the obligations were actually being imposed.

We have interconnection there, and we say what is being interconnected is the joiner of the CPs' network to our network and the use to which that is put.

MR. SAINI: Sir, I may be able to cut this short. If my friend accepts that this is interconnection, which is network access, then the point really goes nowhere. It is network access of a different type. That point is accepted and I am content to put it on that basis.

MR. READ: It is network access of a different type, it is interconnection, we absolutely agree on that, but it is what the consequence of that actually is. We say that you come back to what actually is the network access that is one is looking at. We say the network access is the joinder of the CP's network to BT's network for the purposes of providing the PPC. Trunk is never sold without terminating. It goes back to the way we say that the product is actually sold.

So each of those factors, we say, is sufficient to get us home in the sense that if we are right about it it demonstrates that what you do not do is exclude for the purposes of considering what exactly is the focus of the SMP condition. Let me put it another way. Ofcom and the interveners are effectively suggesting that the construction of condition H3 is sufficiently narrow that you must exclude from any consideration the effect of trunk with terminating. That is demonstrated by the final determination where the point is made.

We say that, yes, the obligation of H3 is focused on the trunk market, but it does not exclude any consideration of trunk and terminating together. We accept the focus may be on the trunk segment, but that does not lead to the fact that you exclude any consideration, as Ofcom did in the final determination of the associated costs with terminating. We say

that is clear, but even if it was not clear we say it is ambiguous, and for those reasons it really would be wrong to construe H3 in the way that Ofcom now says it should be construed, particularly against the factor that Ofcom have never previously, we say, given a clear indication as to how they were approaching the construction of H3.

Sir, I hope that that summarises our contentions of the construction of H3, and can I briefly end with the question of the burden of proof, which has come on regular occasions against us.

We obviously accept, because it says so, that there is a burden upon us. We do suggest that as this is an *ex ante* obligation for prices going forward there may be less of a weight placed on it when one is looking at it from the point of view of *ex post facto* competition law or dispute resolution. Effectively, it is a forward looking issue in that there is a logic to that in the sense that it is one thing to tell a provider to make sure its prices are all right going forward, but if you are effectively starting a compliance investigation whether that necessarily leads to the inalienable conclusion that at all times BT must defend itself is a different matter and we say the reason for that is because, of course, when you are looking at a compliance investigation that there are different issues involved.

However, there are, on any view, limits on how much weight you can put on the burden of proof in this case. First, we say that in order for the burden to be on BT it has to know the principles by which it is going to be expected to meet the cost orientation obligation. So one cannot, in our respectful submission, simply criticise BT because it has not done something, proven something, if BT does not know in advance the process by which it is supposed to demonstrate to Ofcom what exactly it is that it is supposed to be proving. We see that particularly, for example, with the issue of combinatorial testing, because plainly, it is one thing to say to BT you should have done combinatorial testing in order to do this, but BT needs to know in advance the primacy of the methodology that is going to be applied by Ofcom. What has happened in this case is that Ofcom has effectively placed upon BT a primary obligation by means of reference to the DSAC ceiling, leading to a series of assumptions against it.

Mr. Saini very openly admitted, in the course of his opening on Day 2, that breaching the DSAC ceiling gave rise to the presumption that there was overcharging, and actually we say that is entirely consistent, he is right to make that observation, or make that submission because that is what the final determination did in a number of respects, the first of which is, for example, the economic harm, and the other of which – you will recall I took Mr. Myers to this – is the question of international benchmarking. There is an assumption of

overcharging because you have gone through the DSAC ceiling which then leads to the rejection of other evidence, whereas what we would say is the position is you should not start with the presumption of overcharging, but look at all the evidence in the round in order to decide whether there is overcharging taking place. In effect, there is almost a double presumption being put upon BT because in a addition to the burden of proof, BT being told that the burden of proof rests upon it, BT is also being told: "Oh, by the way, you are presumed to be overcharging if you have excluded the DSAC ceiling unless you have exceptional reasons" and we say that that the scale that is being put on BT is far, far, too strong in that regard.

Going back to the point that BT has to know what it is it actually has to meet, we would refer again to the August 2005 letter, because you could not have had a clearer instance of BT setting out (a) its approach as to how exactly you go about demonstrating cost orientation or not; and (b) in particular an opportunity for Ofcom to be clear about how it was expecting BT to satisfy the burden of proof which it did in either case.

The burden also means that BT has to be given a proper opportunity to discharge it and we do rely upon that in respect of combinatorial testing. I will not necessarily take you through all the correspondence again at this stage in the afternoon, but you will have very much in mind the number of times BT said to Ofcom: "What tests do you want us to do?" and Ofcom rejected them. Now, they say: "There are other reasons why we rejected them because combinatorial testing is too many tests", so on and so forth. But if Ofcom are going to try and rely upon a burden of proof against BT it has to give BT the opportunity to meet the criteria, or produce the evidence to demonstrate it is compliant, and that is not what has been done through the dispute resolution process.

THE CHAIRMAN: Leaving on one side for a moment what Ofcom contends BT's obligations are under the cost orientation obligation. If one is trying to articulate in two or three sentences the target that BT set for itself when it was trying to meet its obligations, how would one put it?

MR. READ: We think Mr. Morden put it quite properly, which is that first of all it would look, on return on capital expenditure through its internal management accounts because that is the material that is most readily available, and which it can respond to most quickly. That is important, obviously, in the context of this problem that the Regulatory Financial Statements only come out nearly two years after the charges are actually being set. So that would be the first thing.

THE CHAIRMAN: And looking at these figures on the basis of trunk and terminating in aggregate?

MR. READ: I think that that is primarily correct, but I would also make the point that if you go back to the 2005 letter it was quite clear that it was an alternative on an alternative. BT did split out part of the trunk and terminating separately, but I do not suggest that BT completely ignored the question of looking at trunk and terminating separately because that is not what they did in their letter of August 2005, but I do accept, because that is what Mr. Morden said, that the primary focus would have been on the overall rate of return on capital expenditure for PPCs as a whole on the product actually being sold. So that will be, I think, the starting point. Obviously there will be other issues, and one of the issues will be what is happening in the market place. If one goes back to the 1997 Guidelines, and I will have to take you back to them, because Miss Rose referred to them earlier on, but if you go back to those guidelines we say it is quite clear that it is saying you look at the effects basis. My learned friend took you today to the confidential pricing paper, JM7. Now one of the things, and obviously I do not want to go into matters that are confidential, but that paper does require careful consideration because if, for example, one looks at I think it was paras. 1.2, 2.1 and I think it was 5.1, you will see that the primary issues being discussed for the purposes of reducing the price was BT wanting to make its prices competitive in the market, it was losing business effectively. So I think perhaps I ought to ask you to turn it up. It is BT2, and JM7 was the tab.

What I do say, and I will not say anything more about it because it was obviously in the private session, but what I do say is that one needs to examine very carefully what Mr. Morden said about this document in that material. Then if one looks at p.3 one sees at para. 1.2 and 2.1 various material setting out the parameters of what is about to take place.

Then at para. 5.1 and 5.3 and 5.4 one sees the sort of issues that BT is taking into account, and we say that that is quite an important focus as to how exactly BT was approaching matters. I fear I cannot say much more about it.

I do say that one needs to read the whole of that document in context and not seize upon specific passages which are there, we do not deny they are there and Mr. Morden dealt with them in his evidence, but it is not, we say, the picture that Ofcom paints as a result of it.

That is quite relevant when we come back to the question of proof because one of the things that is one of the oddities in this case is that we say, despite BT complaining at great length in the documents that it submitted to Ofcom about no evidence of actual economic harm, no material was put forward by the CPs, despite the fact that BT was shouting from the

rooftops “No evidence of this”, “No evidence of this”, none was put forward by the CPs at that stage. One of course has had limited amounts of material put forward now, and we do emphasise the word limited because, in fact, when you come down to the specific examples, they do not really demonstrate any great actual harm at all, indeed, you have from the private session, my cross-examination of Mr. Harding on various points, so I will not say any more about that.

But if the primary focus of an investigation is to be the effect then we say BT is entitled to actually say to Ofcom: “Look, there is no material being put forward”, that in itself tells one something about whether we really are in breach of the cost orientation obligation.

I think I ought to perhaps give you some short references. The documents that I referred to are in BT 1, and I took Mr. Harding to paras. 88 and 89, p. 47 of the document, at BT 1, tab 5.1. There was then a response at BT 1 tab 5.4 and I took him to p.6 of that document at 3.1. I think in re-examination Miss Rose took him to other parts in the document where they refer to the potential for an economic harm which, of course, is what Ofcom refer to in the final determination, “potential”.

But that is not the same, we say, as actual evidence, because if there were truly serious breaches of the cost orientation obligation going on, as Professor Yarrow indicated with some force, you would have expected some form of detriment along the line and he obviously very heavily relied upon what he said was the clear economic understanding that if you are carrying out an investigation into a breach of cost orientation obligation then one of the primary things you have to look at is the effects and in particular the effects on competition.

That is a point, we say, that is important when one comes to look at the burden, that actually BT was saying very forcefully, where is the evidence of actual harm? None was produced. So when it comes to burden we say that that is a factor that we can rely heavily upon for the process of dealing with the burden under the cost orientation obligations.

Sir, can I turn now to the issue of dispute resolution, and I want to deal with four points about this. The first is Ofcom’s new limitation point, because it is new – it has only been raised in the skeleton argument before. Secondly, the discretion that s.185 and s.190 confer, thirdly, Ofcom’s inappropriate use of that dispute resolution process; and fourthly, how Ofcom could have approached the discretion it actually had.

Can I ask you to go to the authorities bundle 1, at tab 30? I have to say I was slightly surprised by what Mr. Saini said when dealing with this point in his closing submission because he seemed to infer that Ofcom thought the position might not be correct. If I can

ask you to look briefly at para. 110, you can see the position of all parties in that hearing, which included Ofcom, Mr. Roth (as he then was) for Ofcom was urging the Tribunal to try and find a way of preventing the need to lodge precautionary appeals.

I do not think it is challenged – one has to exercise a little bit of care with this decision because it is talking about jurisdiction. In fact, it is clear when you look at what was actually involved, it is also dealing with discretion and if I can ask you to look at para. 122 you see that very clearly.

I think to be fair that in that *Orange* appeal the terms "jurisdiction" and "discretion" did not quite have the nuanced terms that have come out of the preliminary issues hearing in this case. If you look at para. 122 you see Mr. Roth was dealing specifically there with the exercise of Ofcom's discretion under s.186(2), and the Tribunal, as you can see, then goes on to deal with that discretion, expressly in terms of 186(3) which, of course, is the alternative means ground, and making it quite clear that there is no distinction between a situation under s.185 and 186(3).

It is right to say they do go on to say there is a practical difference and again, one has to look at that in the context of the particular appeal it was dealing with, because of course there what you had was two parties, or a number of parties disputing prices going forward where there was no agreed or no price that had originally been fixed rather than having an investigation looking backwards over many years, and so it is quite right, the logic of what is said there, that if you have someone saying, "I would like this to go to mediation", Ofcom says "No, I'm accepting the dispute", unless they do act quite quickly, then Ofcom will have come up with their answer and mediation will be completely irrelevant. Of course, that is different where, as here, we are saying Ofcom should have used the discretion in a different way, namely to have moved the matter off to a compliance investigation, so although on the face of it that may not look a helpful passage as far as BT is concerned, we do say that if you confine it to its proper circumstances, then it does not actually lead to the conclusion that Mr. Saini suggests, but in any event what is absolutely clear from that is that the Tribunal was considering whether the two month limitation period applied to arguments about Ofcom's use of its discretionary powers under s.185-186 and reached the conclusion, as one sees from para.125, that there was not the limitation that required effectively protected appeals to have to be launched. Sir, this is actually a very important point as far as BT is concerned because, as I have already indicated earlier on, there is actually a dispute that Ofcom has accepted but has effectively said, "Well, we will await the judgment in this case before determining it".

Now, the problem for BT is that if Ofcom is right in this contention, BT should be issuing a protective appeal now because it will be otherwise precluded from taking the point at a later stage. So, if it is at all possible for the Tribunal to give separate from its main judgment a preliminary indication about this as swiftly as possible I think — certainly from my client's point of view — we would be very happy because otherwise, I am afraid, the Tribunal is probably going to get a protective appeal put in on the basis. So, I put that plea. I do not know how feasible it is or otherwise for the Tribunal to comply with it.

Can I therefore move to the points of substance about the discretion under s.185 and 190. Can I make two initial points? The first is that it is quite clear that Ofcom itself recognises that there is a discretion which it can use to avoid dispute resolution if there is another more suitable regulatory process, and you will recall on the first day I took you to the letter about the *Unicom* dispute which we have given you the reference for.

And, secondly, Ofcom freely admits in this case that this was essentially a compliance investigation and we set out the reference in the framework Directive, and we say, "Well, there is very clearly an alternative regulatory mechanism there available", and one we say is far better, namely s.94 and onwards which, of course, Lord Justice Richards referred to in the *Vodafone* case in the Court of Appeal which we saw earlier on.

Now, we say s.94 is the more appropriate way to deal with it for a number of reasons. And they are set out in our skeleton argument. We say that there are three distinct ways in which Ofcom could have turned round and said, "Well, we are not dealing with this issue under our dispute resolution powers because we consider that that is to be better dealt with under the 2003 Act and contained in s.94". And I will just summarise them. I will not take you through them in any great depth but, No.1 they are the use of the alternative means under s.186(3). Ofcom seeks to contend that this is restrictive in its matters to the matters like mediation and so on and so forth. We find that contention slightly surprising given what they did in the *Unicom* dispute, but in any event we say it is not actually consistent with the proper interpretation of the statute, and we have given the reference to the reply there where we set out our contention on that. We also say there is an innate discretion as how to deal with the dispute once one has been accepted, and there is reference in the *TRD* appeal to the fact that effectively Ofcom may, we would say, summarily dismiss; but in any event there is actually a power under section 188(3) for Ofcom to take its own procedure in regulating the dispute. So, it would have been perfectly open for Ofcom to have said simply, "Not going to deal with this because we have got a better regulatory method for dealing with it under s.94". And finally, of course, there is the power under s.190(2)(d) because they could

have simply turned round and said, "We're not going to make a direction under that because actually we're going to use our other powers to investigate this matter in a different way". So, the discretion is there, we say, and we say it is inappropriate, and we have set out five factors there.

The first obviously is the fact that the dispute resolution process is intended to be swift. Now, the point was made, I think, in the preliminary issues judgment that, "Well, actually there is a one month period under s.94 for parties to have to respond to Ofcom's notifications". I will not take you to it, sir, because I think you are probably familiar with it, but it does have an express power to extend that power if and in so far as it is necessary. So, in other words, it is not the same constrained time limit that is placed upon Ofcom in the context of the dispute resolution under s.185 and 186. And we say that is quite an important factor because it does mean that if, for example, BT wanted to do combinatorial testing it could have been done through that process.

The second point we make, it is a further point that we want to make about that, which is of course we are now being criticised for saying, "Well, it's unattractive of BT to criticise Ofcom's handling of the disputes as being too detailed and too assiduous". Well, to be clear, we are saying it is precisely the problem in this case that Ofcom has actually fallen between two stools, because on the one hand it is undertaking a massive accounting — arcane, we say — accounting exercise of re-allocating costs, we have seen it in s.6 of the final determination over the period, and taken a huge amount of time, and indeed time that has come to the attention of the European Commission. But at the same time it has actually excluded BT from doing other things that it said, "Well, we can do this", ie the combinatorial testing. So, there is, it is not BT who is making a bad point about this, it is Ofcom that has actually fallen between two stools. It excluded combinatorial testing, for example, precisely because of the supposed short time period of the dispute resolution process, but at the same time extended it so much by this massive investigation that it has actually undertaken. So we say that is a very important factor, that this was not the appropriate regulatory methodology for resolving this type of issue.

Secondly, we say that Ofcom's own guidelines recognise the distinction between dispute resolution and compliance complaints. Again, I will not take you through the bundle. I am not sure Ofcom's July 2004 guidelines have made it into the bundle, but they are set out in our notice of appeal at para.48 and the references are given there. And we do say that merging the appropriate way for resolving this type of dispute, ie merging a compliance complaint into the dispute resolution process, is a wrong use of the discretion. We also say

that the restraints in the DR process are counter-productive for assessing SMP compliance, well, again, that is the point we have made about things, for example, on the combinatorial testing. But also if one looks at, for example, the framework directive, transparency is specifically excluded. The need to consult is specifically excluded from the process of the dispute resolution process, and that is obvious because if it is going to be a swift process, you will not have the opportunity to consult. That is in para.70(ii) of our note, so it is set out there, sir. But we say that is a factor that is important.

Likewise, we say that — and this goes back to the point I was making earlier about established rights — Ofcom say, "Well, effectively, if you are looking at the decision in *Napp* that was completely different because it was a competition dispute and there was not the burden on BT. But what the *Napp* case recognises, in our respectful submission, is that there are established rights you have to go through if you are to effectively subject parties to allegations that they have actually breached orientation obligations and therefore have laid themselves open to penalties and the like. There is no getting away from what Ofcom's decision in this case has actually done is to say that BT has breached its SMP obligations in a process that does not give the same procedural safeguards that we say a s.94 process would have allowed. We also say that compliance obviously with SMP conditions is an issue that affects and concerns all industry participants. That is quite an important point, we say, sir, because as you will have appreciated from the Act itself, the decisions in s.190(8) the decisions only bind the parties to the dispute. It does not bind non parties, and yet in this case you have Ofcom effectively trying to circumvent that by a, we say, rather clumsy attempt to impose an expectation on BT which is set out in the final determination at paras.128 and 7.16.

I am told, sir, that in fact although we made reference to them in our notice of appeal at para.48 of our notice of appeal, the guidelines actually are in the bundles. They are in the intervener's bundle 1 at tab.4.1.

So, that then leads us to the question of, if the way Ofcom have handled this dispute is inconsistent or is an inappropriate use of dispute resolution, how then should Ofcom have exercised the discretion? We say this is quite important because obviously what it is not trying to do is to say that they should not have done it like this. We are saying that there were coherent reasons why Ofcom should have exercised the discretion it had to refer the matter over to an alternative regulatory method, and we set them out at some length there in paras.73 and 75 of the aide memoire. I am not going to rehearse them, sir, at this time, but I will push on with various other points.

Sir, if I can now pick up on four points that Miss Rose made in the course of her submissions, because actually they illustrate what we say is quite a relevant point when one comes to consider the evidence in this case and the way that it has been presented.

Firstly, she relied on the Competition Commission determination. Three points about that, firstly, these comments that are in the Competition Commission are entirely in the context of price cap regulation, not in the context of cost orientation.

Secondly, the Competition Commission's determination relates to a completely different period, and indeed what the Tribunal in this case is actually trying to assess is Ofcom's approach in the final determination to over-charging in an earlier period and therefore we would respectfully submit that whatever the Competition Commission may have intended, and we say it does not have the meaning that Miss Rose bears upon it, well, this Tribunal has to exercise its wholly independent judgment on assessing what Ofcom did in the period 2004-2008. And it is Ofcom's, we say, quite clear view in any event from the Competition Commission's determination, that BT was not recovering a proper amount on the 2 Mbit terminating segments.

Finally, sir, I do want to look at my learned friend's, Miss Rose for the intervener's argument because she quotes, I think it was at para.64 of her submissions, a passage from Professor Yarrow making what obviously the interveners consider to be a big forensic point, saying, well, he had misunderstood what was going on and therefore his evidence could not be relied upon. And you see there is a quotation set out from the transcript at some length and supposedly making this blockbuster point. But in fact we say you have to exercise care, very careful care, when these parts of the transcripts are referred to – do you have the transcripts available to you?

THE CHAIRMAN: Yes.

MR. READ: Can I ask you to look at — I should perhaps have made the point, sir, that they quote in para.64 part of his evidence, and then in para.66 they make the point, "Well, he didn't understand what was going on". But then again, if one goes on to that day five at p.10 one sees at line 19 he actually adds a further point. And he is making the quite clear point, and it is set out at p.10:

> "My understanding [this is line 29] you will correct me if I am wrong, Miss Rose, is that in the 2009 price control there was about £55 million worth of rebalancing. So that was reflecting this adjustment that was being taken".

And there he sets out the further position. So, again, I do submit that this is one of the instances where it is very easy to look at a submission like this, but you do actually have to look in the context of what he said later in the evidence as well.

The second point that I want to deal with is the Royal Mail case. I only want to say three things about that. The first is, unless I am not mistaken, it was a judicial review case and not an appeal on the merits.

MISS ROSE: Statutory appeal, in fact.

MR. READ: I see, well, unfortunately the judgment is not very helpful at saying what the basis of the statutory appeal actually was, and whether it is akin to judicial review or whether it is akin to an appeal on the merits. But in any event — secondly, it was dealing with a fine, and certainly not dealing with gauging whether a breach has occurred in the first place, because if you are assuming likely loss for the purposes of a fine that is one thing; but if you are using an analysis of the effects for the purposes of deciding whether or not there has been a breach in the first place, that is a completely different matter. So BT would say, well, this is an effects-based analysis and one of the key things one has to look at in an effects-based analysis is what is actually going on and what is the actual evidence of the position, and if no evidence is being produced it is not going to the issue of a fine as it was in this case, it is going to the issue of whether there has been a breach in the first place. So, we say it is one of these cases where superficially it may look as though it is an attractive point, but the reality is that it is very far removed from the present case.

Thirdly, and again this is a partly evidence-based point, it was I think suggested at one point in my learned friend's submissions about the efficiency point. The point was being made against me that Mr. Ridyard's evidence was only challenged on one particular point in his report, and that was not challenged by cross-examination.

Well, sir, the first point I would make is that there has been an awful lot in this case that has not been challenged by cross-examination – we would certainly have exceeded the time estimate if we had. I am sorry, sir, can I just find the correct reference in order to make this point?

MISS ROSE: Paragraph 60.

MR. READ: I am grateful, yes, para. 60: "BT's approach would also undermine the regulation… As Mr. Ridyard explained …" and so on and so forth. "The only challenge to this evidence was Mr. Read's suggestion that BT made efficiency gains …" Again, that simply does not actually do justice to what was the position, because if one goes to Mr. Budd's second statement, which is in core bundle 1, tab 11, at p.359 Mr. Budd deals with price cap

incentives at some length and, indeed, at p.361, para.51, specifically comments on Mr. Ridyard's approach, and we say does a very credible explanation of why the point being made is not a correct point. I may be wrong but I cannot recall that point ever being cross-examined on Mr. Budd's part. If I can say it is a forensic point that is not particularly well made and we say again you need to read all the evidence in this case carefully before making the assumptions that are contended for.

Sir, I want now to return very briefly to the issue of the use of DSAC. There are six propositions which I do not think anyone in this case disagrees with. The first is, is it possible for a charge to be below DSAC but still be cost orientated, and that is a point accepted at para. 5.61 in the final determination but is illustrated at numerous points in the evidence by the various examples put forward.

Secondly, one can pass all DSAC tests and still be over recovering fixed and common costs on a fully allocated basis. My first proposition is that you can be cost orientated above DSAC ceiling, my second proposition is that you can be below the DSAC ceiling and still be over recovering and in breach of the cost orientation obligation. The third point is that the DSAC ceiling entirely depends on how one allocates the costs and, in particular, on which components you actually fasten your attention.

Fourthly, we say that it is accepted by everyone in the case that the allocation can be arbitrary, that point is made clear in para. A11.6 of the final determination itself.

Fifthly, we say that the more granular the focus the more problematic the allocation tends to become, and we saw that, in my respectful submission in the Ofcom May 2006 methodology document I took you to earlier in my submissions.

Finally, DSAC is plainly a totally unique test. No one in this case has identified anyone else using the DSAC test and we say Mr. Bolt's attempts to suggest that one can gain comfort from the examples he gave really do not actually reflect the reality of what the material says. You will recall he relied on three things, only two of which he produced the document for and those documents in our respectful submission do not make the point that is anything near analogous to the DSAC test. So it really is a test on its own.

That in itself, in our respectful submission, should set the question marks ringing if you are to start using it as a presumptive test of cost orientation.

We do say that that is precisely what Ofcom have done in this case. For example, we say it is clear from the final determination at para. 7.34 and on to 7.36, including the heading above 7.38, what Ofcom were actually doing when it came to consider economic harm was to consider the potential for economic harm on the basis that the price above DSAC gave

rise to overcharging, so they started from the presumption of overcharging by being above the DSAC ceiling.

Just commenting on the evidence, it is in the material, but Mr. Myers did seem to dress this point up somewhat by saying it is a counterfactual when, in reality, as Mr. Saini openly, and correctly in our respectful submission, conceded. It is the presumption that if you have failed the DSAC test you must necessarily have a presumption against you that you are overcharging.

Secondly, sir, you can see it also in the context of the international benchmarking. If you remember I took Mr. Myers to that in the course of cross-examination and I think it was at para.7.150. You recall that it said in terms:

> "The fundamental point however is that faced with actual cost data that indicates that BT has overcharged for 2 Mbit/s trunk services."

that means that there is a presumption being made here that something above DSAC is overcharging and therefore when one comes to consider the international benchmarking data one does not give it any weight for the reasons, obviously, that Mr. Myers was very keen to explain when he was in the witness box, but it does really come back to is this a half pint full or half pint empty situation. Yes, everyone agrees that international benchmarking is not of itself conclusive in this case but it does provide some evidence, and so what we say Ofcom has actually been doing in the course of the final determination is dismissing that evidence on the basis that anything over DSAC is presumed to amount to overcharging, which again is really the point that Mr. Saini openly and clearly conceded.

Could I ask for a very short adjournment of about five minutes, what I want to do is to try and make sure I cut my submissions down rather than go over points that I do not think are necessary to address the Tribunal with. I will be finished by 6 o'clock, I can assure the Tribunal on that.

THE CHAIRMAN: We will rise for five minutes in that case.

(Short break)

MR. READ: Sir, I am grateful for that. Can I ask you to turn to a piece of evidence that I do not think you have probably looked at in sufficient detail. It is in BT1 at tab 5.1, which was BT's 5th June 2009 response document. If I can ask you to turn to p.34, the numbers are not very distinct but it is at para.57. This is BT's circuit analysis, it has obviously been referred to at various places during the course of the hearing, but you have not had an opportunity of considering what exactly it is that was done in this analysis. What BT actually did is look at the charges for the individual PPCs purchased by each of the disputing CPs and compared

each circuit against the proxy benchmark that Ofcom has selected, namely, the DSAC ceiling and you see that from para. 60 for example.

Obviously I am not going to go into the figures because they are confidential, but you can see that table D.1 looks at "Revenues minus DSAC for all PPCs". BT has put this forward on a number of different bases to give what we say is real actual evidence of what was going on.

The next category, as you can see, is "PPCs including trunk", so in other words it is excluding from the equation any circuits that only have terminating elements, and the results for that are at table D.2. Again, I am not going to refer to the figures but one sees very clearly the results, we say, that show in our respectful submission that the actual data about the circuits actually purchased was not suggesting anything near an over recovery by BT, it was actually suggesting the reverse, there was no over recovery.

Then as you can see from para. 67 BT looks at a further element of the actual circuits sold. These were the ones where the circuits were over DSAC. As you can see from para. 68 BT makes it clear that it:

> "… does not advocate such an approach because it is not fair to exclude from the consideration the fact that most other PPCs have been sold below DSAC. Nevertheless, the analysis is revealing in demonstrating that the Ofcom's proposed resolution of this dispute is, on any view, quite inappropriate and rewards undeserving CPs."

It is set out there and again you can see the figures which I will not refer to. I should perhaps indicate that what was done was three years were taken, 2005/6, 2006/7 and 2007/8 and then a total was actually supplied which is in D6, and I think that is for the three year period from the title at the top. This is explained I think in one of Mr. Budd's statements – certainly from the figures in his statements – that in fact D6 should be just the total for the three years.

Then there is an analysis done in order to bring it up to the three and half years, which is the D7 table. This is summarised in Mr. Budd's first statement, but I think it is quite important, sir, that one does focus on it, because first, this is one of the few pieces of actual evidence as to what is going on that there is, as opposed to assumptions about potential harm or whatever.

Secondly, we say it is very important when you come to consider the question of repayments, because plainly this is ending up with a completely different analysis as to what the repayments should be, and the one that Ofcom adopted itself. We also say that this

is another core example of the way that Ofcom just rejects anything that does not fit in with its approach to the cost orientation obligation. It dismisses this in two paragraphs within the final determination simply by saying first, that these figures are circuits so in other words there are trunk and terminating elements together, but they are the actual circuits that are being provided; and secondly, they say that in any event it shows, if you look at these last set of tables, D3, D4, and D5 that, in fact, there was some excess over DSAC which, of course, is what you would expect if you are only looking at circuits that are above DSAC. The core point is, we say, that that typifies Ofcom's approach of rejecting real evidence in this case, and real evidence because it does not fit in with the neat categorisation that they say should be adopted. We say heavy regard ought to be had to that piece of evidence, certainly if you were conducting any form of effects analysis, and also when you come to consider whether or not to use your power under s.190(2)(d) in the way that Ofcom actually has.

Can I come back again to the question of the effects analysis, because it is a point that obviously, as you will appreciate, Professor Yarrow spent a lot of time dealing with, but it is perhaps worth turning his report up and just looking at one of the footnotes to it at tab. 25, p.670. You will see there is a footnote there actually explicitly referring to the Commission Guidelines on SMP, this is footnote 14. They are saying in terms that you look at the same methodologies as you would under competition law. It is what Ofcom completely failed to do in this case. Instead they simply relied upon accounting material as the primary methodology for determining breach of the SMP conditions.

There are two other points I want to make about DSAC. First, that DSAC has no track record or solid foundation in economic theory. That is quite clear from the way that Mr. Myers now puts it in his witness statement. You will recall that in the draft determination there is the reference to proxy which he now says is a practical simplification in his witness statement, and that the word "proxy" was a mistake. We do say that one of the key problems with using a test that has no foundation in economic theory is that however easy or straightforward the practical testing may be for the Regulator to apply it simply may not yield the correct results if you apply it as a determinative test.

BT has no problem with the idea that it operates as a screening test, but if you start giving it the presumptions and the weight that Ofcom has in this case the very fact that it is not founded upon the bedrock of some established economic theory in our respectful submission makes it a very problematic methodology for tackling breach of an SMP obligation.

The other point that I want to make about DSAC is of course that it does actually rely on effectively a single combinatorial parent, and the allocation methodology for allocating costs between them. We say that that is highly relevant in two ways. The first is that obviously you have immediately come up with one single allocation methodology because it is based on the combination.

That is particularly true when you are using a combinatorial that obviously is not the whole of the group, it is actually more focused on one particular area and that particular area has large common costs with other parts of the business.

The second point that we say about it is that actually this draws a lot of the sting out of the number of points that are made, for example, about combinatorial testing because what is said against BT is that the combinatorial testing did not look at sufficiently wide enough groups. If that is the case put against combinatorial testing, it is a point equally against the way that the DSAC test has been used in this case.

Likewise, we say that again criticisms made of BT's combinatorial testing on the basis that it should be efficient costs and not incurred costs, and yet DSAC itself operates on incurred costs.

The summary, in BT's respectful submission, is that what Ofcom has actually done is it has taken a single test and it has effectively applied that single test to the exclusion of all other evidence because of the presumptions it has applied for DSAC. Of course, we fully accept that the material is discussed in the context of the final determination, which I think was the point that was being made, but one has to look at the reality of how Ofcom was considering that other material and we see, for example, from the circuit analysis that it is rejected in two paragraphs in the final determination because of this concern that crosses across two segments, and because of this concern, well, in any event it may be higher, completely disregarding in our submission important evidence on the basis of this presumptive test. To use the phrase in the draft determination, BT has to be below the DSAC ceiling unless there are exceptional reasons, and that does not seem to have changed in our respectful submission much because Mr. Myers himself calls it a "very significant contribution."

The result of all of this is there is a host of other evidence that is present that simply gets shunted to one side because of the way that Ofcom has actually used this test. That includes the return on capital expenditure, it includes the circuit analysis, it includes the combinatorial testing. It includes the international benchmarking and any consideration of the effect of the efficiency gains, and it particularly disregards the economic harm and the effects. We say that that is just topsy-turvy because what effectively Ofcom has done is

ignore the evidence that was there in preference to this test that is actually applied, DSAC, in the way that it has applied it, and we say that is simply wrong, as you appreciate, for all the reasons we have given.

As regards aggregation and disaggregation I think I have probably dealt with quite a few of these points as I have actually been going through, but each of the points that Ofcom has raised in the final determination really seems to us to be a blinkered way of approaching what we say is relevant material for determining whether or not there has been a breach of the cost orientation obligation. We are not saying that you ignore any focus on trunk at all, that is not BT's case. BT's case is quite clearly that what you do not do is focus exclusively on the trunk element, excluding any material relating to how the product is sold, and the effects on the market. I could, but I think I probably will not at this stage, take you through each of the matters that Ofcom rely upon in the final determination. They are dealt with in our skeleton argument, and the notice of appeal and I think probably at this time it would be repetitious for me to go through that.

Economic harm – I think I have made most of the points I want to make about economic harm. There is one point that I do need to address which is this, even if Ofcom were to be right that in fact there is a distinction between investigating cost orientation and investigating competitive effects in the market place for the purposes of competition investigation, and we are not saying that in the context of a dispute resolution you would have to go through the full blown competition complaint process, but we do say that that is a factor that may be relevant when you come to the use of the dispute resolution powers. We are not saying that that is necessary but we do say that you do need to focus on the actual effects on competition and consumers. If nothing else there is a regulatory reason why one has to do that, which is that in carrying out the task of dispute resolution it is a task that has to be performed in compliance with Article 8 of the Framework Directive which, of course, specifically requires in carrying out that task reference to be made to the benefits to consumers, and the effects on competition, so we say that Ofcom cannot escape an economic investigation.

We say what it has done in reality is it has looked for potential, theoretical distortions in the competitive market. Of course, one can always say in this context there is a potential for this or there is a potential for that. There is potential for an elephant to be out in the waiting room out there, but I doubt very much whether there is!

The key point, in our respectful submission, is whether there was actual evidence of that effect, and if there was not evidence of that effect, then really one cannot leap to the

presumption that there must be an effect simply because there are theoretical potentials for problems to have arisen. I make the point that I made earlier that there is a distinct lack, in our respectful submission, of any actual evidence on economic effect, apart from, we would say, the circuit analysis which does tell you something about the way that the product is actually being sold.

I want to come back, as I said I would do earlier on, to the 1997 Guidelines, because Miss Rose took you to a particular passage in them. We do not say that there are not different nuances that can be taken from different parts of these guidelines (BT 3, tab 12.1). We do say that the general purport of these guidelines is, as indeed it says at para.3.5: "the effects or likely effects". You have seen that several times, but we fully accept that all it is saying is "effects or likely effects". We are not saying that one has to have absolutely black and white indisputable evidence that cannot be refuted, or is 100 per cent certain to stand up, but "likely effects" does not mean potential effects. The passage that my learned friend took you to, which is at para. 4.22, is quite illuminating in itself because she read you the first two sentences in support of her proposition that you do not need to have effects or likely effects, and she said that all had to be read in the context of Chapter IV.

If one notices in the next sentence:

> "Oftel will give as much guidance as possible, as it begins to deal with new cases under the new system about what is and is not reasonable."

What is absolutely clear is that no one on that side is saying that there is any other document that is relevant other than the 1997 and the 2001 Guidelines. We on this side say there is actually more documentation which is highly relevant to this, which is the way that the approach was to the grant of PPCs in the first place. But if that is a point that is being taken against us then it has to be read in the context of what was being said, that there would be more guidance.

However, we say that if you go back to para. 4.12, for example, you see that these guidelines are not necessarily having the force that my learned friend puts on it because

> "Oftel will generally regard a charge to be unreasonable if it is or is likely to be anti-competitive or exploitative."

So again we are back to the issue of anti-competitive.

> "Oftel's approach to assessing prices for the purpose of judging whether they are anti-competitive is set out."

Then it goes on to say the "first order test", well no one denies about the first order test. The point is it is actually, at the end of the day, coming back to whether or not this is an

anti-competitive test and that is, we say, the fundamental that Ofcom never really conducted in this case.

Sir, can I now turn very quickly to the misuse of powers? I am going to finish by coming back to your questions from yesterday and just summarising where I am on them. As regards the misuse of powers – this is the power under s.190(2)(d) – the first point we make is that it was accepted by Ofcom, although the intervener seems to take a slightly different stance, that there is a discretion contained in that power, and that one of the considerations that has to be taken into account is the question of fairness, particularly in respect of past conduct. If Ofcom's past conduct led to a certain state of affairs being assumed we would say that that is quite an important consideration when it comes to the issue of repayment. There is an authority which we have referred to – I do not necessarily think it is relevant to turn it up – it is referred to in the notice of appeal in any event. I seem to have lost my reference, but we say that in the case of a Regulator whose conduct has been complicit in allowing a state of affairs to continue, certainly this Tribunal has taken into account that, for the purposes of a fine, when it comes to some sort of fine under the Competition Act, and we say the principle is the same here, that if Ofcom's conduct led BT into a position where it was actually in breach of its SMP condition but in fact it got into that state because of Ofcom's conduct then that factor ought to be taken heavily into account for the purposes of considering any mitigation.

We say that is particularly true when we deal with ----

MR. SAINI: *National Grid*, core bundle 1.

MR. READ: I am grateful to my learned friend – he is doing fine homework. It is set out in paras. 224 and 225 and there is the reference to the *National Grid* case. I am very grateful to Mr. Saini.

Secondly, we say that another important factor that needs to be taken into account when looking at this is the issue of proportionality. In fact, we say that proportionality needs to be considered throughout all of this because it is obviously an obligation upon Ofcom in the way it actually intervenes in any given matter. We have set the arguments out on that at paras. 53 to 58 of the skeleton argument. They are, in our respectful submission, quite important points but again at this time of the evening I am not going to take you to them, but I do ask that the Tribunal considers them in full along with the authorities, and I think have the authority bundle references in, they may not but in any event they will be in the authority bundle.

The starting point with all of this is that Ofcom has made the assumption that everything in excess of DSAC was something necessarily amounting to overcharging, and we say that that is a flawed position to take when you come to the question of repayments without doing any further analysis, particularly analysis on BT's overall business, and the effects generally throughout the market.

The application of the principle of proportionality means that they have to consider that whether or not the regulatory intervention is necessary and appropriate in the given circumstances. Obviously we rely on the fact that the PPCs in aggregate show that we were under recovering for the terminating segments, and over recovering for the trunk, so you do end up with this anomaly that when BT was setting its prices it was actually doing so on a basis whereby it was effectively charging the CPs less for the terminating elements, and said the CPs actually have a positive benefit from lower terminating elements, but it still ends up having to make this extremely large repayment as a result, and we say that that cannot be right.

We also say, sir, that the circuit analysis does play quite an important part in this. It is one of the questions that is put on the basis of, I think, question 6 in the questions you asked, about how, if DSAC is the appropriate first order test: "to what extent could the sums ordered be paid be adjusted to reflect other matters." We say "yes" because that is the inherent nature of the power under s.190(2)(d). You can take other matters into account and the other matters quite plainly, we respectfully say are (i) the fact of the under recovery on the terminating segments, but also (ii) the actual evidence under the circuit analysis of what the losses suffered by the individual CPs actually were. We say that is something that can and should be taken into account when considering the use of the power.

Although the point is dismissed, we do also say that obviously in considering this you also have to consider if there was overcharging then BT itself was heavily overcharging itself. It is said that this is a paper transaction. What we say you cannot do is completely dismiss that element when it comes to considering how much, if any, should be repaid to the CPs, particularly, we say, when you look at the ROCE figures and you see that BT was effectively buying the majority of the trunk, the longer segments of the trunk so the return on capital expenditure was actually even less for the external CPs than it was for the overall effect. Sir, I think the rest of the points on the misuse of powers are made in the skeleton argument and the respective pleadings. Again, I am not going to repeat them at this stage.

Can I finally then return to the questions and just briefly run through them?

THE CHAIRMAN: Yes.

MR. READ: Sir, as regards "1", I have probably dealt with that at some length and so I will not go through it again. As regards "2", estoppel again we say is perhaps a slightly Delphic reference in the footnote. We were not saying that Ofcom is estopped, it was the reference to the effect between the CPs and BT, which was set out in the 14th October response that I took you to.

THE CHAIRMAN: I see.

MR. READ: What we do say, though, sir, is missing from your analysis in "2" is the failure to comply, we say, with s.87 regarding rules and also the effect of a modification under s.46. So we do say that that needs to be added into your list with arguments we advance.

THE CHAIRMAN: Yes, this was not intended to be comprehensive.

MR. READ: No, I appreciate that, sir.

As regards "3". Sir, one comes back essentially to the interpretation of the cost orientation obligation because we say that "3" is a step ahead, because "3" relies upon you having decided the cost orientation obligation in a way that does not take into account the points that I have been urging upon the Tribunal today. So at that stage we say there is almost a pre-supposition within that because you pre-supposed that the obligation means something and obviously, you pre-suppose that the obligation means something then you have gone against a number of the points that we have advanced on lack of consistency, lack of transparency and so on and so forth, because we say that they have to be taken into account when considering the cost orientation obligation. Whether, having made that assumption, you then apply consistency, lack of transparency, etc. at the stage of considering whether there has been a breach – so in other words, you have interpreted the cost orientation obligation one way, you are then faced with a finding that there is a breach. In making that finding we say that the arguments we have advanced about consistency transparency and fairness etc. etc., apply equally there, because obviously Ofcom is carrying out a regulatory function in the dispute determination process itself, and so therefore all those principles come into play in the actual orders that it makes under the dispute determination because, as you will recall s.190(2) is not just about subsection (d) and repayment, it is also about whether or not to make the determination in the first place as to what the prices are or should have been, and we say that they come in that way.

As regards "4", the obligation is put upon BT, therefore if there is ambiguity for all the reasons we have urged earlier on, it is BT that should get the benefit of that ambiguity because it is the one that is subject to the potentially effective obligation. In other words, if you apply the obligation in a way that is contrary to what BT expected, BT is the one that

then becomes in breach of the cost orientation obligation with all the consequences that that involves under s.94 including fines, etc.

So if one is looking at an evaluation process as to how exactly one should analyse and assess the operation of the cost orientation obligation then the approach should be to the result that does least injustice to BT, because it is BT that is the one that is affected by the potential penalty consequences under s.94. We do not say that others in the market cannot also have a concern that Ofcom should act in a consistent or transparent way, because plainly consistency/transparency does not just apply to BT, it also applies and should apply to others within the market. But when one gets to that stage one then has to step back from this and say: "What did the CPs themselves think and assume about it and, of course, for all the reasons I have indicated right at the start of this submission, when the CPs put in their original complaint, they were putting it in, in our respectful submission, on an all PPCs basis, and they were putting it in on a ROCE basis, and so it cannot now be said in our respectful submission that they have a legitimate expectation that Ofcom should have approached it with DSAC methodology and on a disaggregated basis on the construction of H3 that Ofcom now contends for.

As regards "5", I think I should briefly deal with this as to how BT suggests a superior alternative; I think it has been implicit in what I have been saying earlier on. We say it is a weighing factor, a weighing of all the various different pieces of evidence that are there. We say that first and foremost one obviously looks to the effects or the likely effects within the market, because that is (a) what the original 1997 Guidelines actually said; and (b) for all the reasons espoused by Professor Yarrow that is the approach from an economic perspective that is to be preferred.

We say that over and above that BT did have a proper expectation that if there was going to be any further testing to be done then they would and should have the opportunity of doing it like vis-à-vis combinatorial testing. So we do say that combinatorial testing is relevant here, and we fully accept this point. Professor Yarrow is not a keen fan of combinatorial testing because he really is not a fan of contestable market theory much at all. But, having said that, it is clear that certainly others within BT considered this to be a correct approach and it certainly was an approach that was being suggested between the original Phase 1 and Phase 2 directions. So we do say that BT should have had the opportunity for actually dealing with combinatorial testing.

But, at the end of the day as far as "what does BT say should have been looked at?" we say effects based analysis first, and we say other alternatives, such as combinatorial testing, such as international benchmarking, should be weighed into the process as well.

I hope, sir, that that has dealt with question 5.

THE CHAIRMAN: Yes, that is very helpful.

MR. READ: As regards question 6, I think I have probably already dealt with that. Can I just double check?

THE CHAIRMAN: Please do.

MR. READ: (After a pause): Yes, I think I have probably captured all the points that I was being told to capture.

Sir, that actually concludes my submissions.

MR. SAINI: Sir, may I just mention one point, I do not want to try your patience at this hour. It relates really to the annexes to the submissions that Mr. Read has presented, these are the summaries of evidence behind there. While Mr. Read has been making his submissions I have had a chance to flick through these. Can I just make two very brief points concerning those? First, we submit that they are highly selective and inaccurate summaries of the evidence. The Tribunal having heard the oral evidence and having considered the witness statements will form its own view. Secondly, and more importantly, we respectfully submit there are certain comments made about the witnesses in these summaries, in particular in relation to Mr. Myers, which are completely unjustifiable and, quite frankly, offensive.

Our position on the evidence is that every witness that appeared before you, both the expert witnesses and the factual witnesses were honest – that is BT's, Ofcom's and the interveners' witnesses. All of them were seeking to assist the Tribunal. It is highly inappropriate to suggest that any of the witnesses – certainly from our perspective – were not completely frank in their approach. I just put that down as a marker. I know the Tribunal will form its own views about the witnesses ----

THE CHAIRMAN: Yes, indeed.

MR. SAINI: But I did not want to leave the point unaddressed.

THE CHAIRMAN: No, that is helpful. As I say, we have not had the opportunity to read these, we will obviously read them, but I strongly suspect we will be attaching primacy to the transcript evidence and the witness statements themselves.

MR. SAINI: I am obliged, sir.

THE CHAIRMAN: Any other points? Any questions?

MISS ROSE: Just I think three very short points. The first is that Mr. Read referred to the Access Directive. We would invite the Tribunal to read the whole of Recital 20 where we submit that it is clear what a rigorous obligation cost orientation is intended to be. We also invite the Tribunal to read Article 2 of the Access Directive where there are definitions of network access and interconnection, and we submit it is clear that the services that are the subject of this appeal are forms of network access not interconnection – not that it makes a great deal of difference.

The second point relates to the annexes. There does not appear to be an annex dealing with Mr. Harding. However, in relation to Mr. Ridyard at para.5 it is said that Mr. Harding ----

THE CHAIRMAN: Which tab is that, Miss Rose?

MISS ROSE: I beg your pardon, tab 10. Paragraph 5 in relation to Mr. Ridyard, it is said that

> "Mr. Ridyard accepted that he relied significantly on Mr. Harding's statement, but very fairly accepted that Mr. Harding's evidence had, essentially, been admitted by Mr. Harding to be wrong."

We submit that that is clearly not what happened in relation to Mr. Harding. There was one minor issue about BT's use of 155 Mbit/s trunk, that was the only issue, and we submit that in fact the overwhelming majority of Mr. Harding's evidence was never admitted to be wrong, and of course it is also not correct that Mr. Ridyard said that he had relied on Mr. Harding.

A final point is in relation to repayment where Mr. Read relied on the principle of proportionality. The Tribunal will bear in mind that the issue of proportionality depends first on the identification of the objective and then the question that the means must be no more intrusive than necessary to meet the aim pursued. As we have seen from the Statute the aim pursued by Ofcom when considering whether to order repayment is to give effect to its determination of the proper charge.

THE CHAIRMAN: Mr. Read?

MR. READ: Sir, all I was going to say is I thought I had made it clear that the evidence really needed to be considered from the transcripts and obviously what has been said in the submissions is our take on the evidence, but ultimately the transcript is the best place to resolve the matter and the court can draw its own conclusions from the witnesses it has seen.

THE CHAIRMAN: Indeed, I think that is clear. In that case we have nothing further. I am sure I speak for everyone in wanting to say thank you to the court staff for enabling us to sit so

late to finish early, and can I thank you all for the considerable assistance you have given the Tribunal and obviously we will hand down a judgment as soon as we possibly can.

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