IN THE COMPETITION APPEAL TRIBUNAL

Victoria House,
Bloomsbury Place,
London WC1A 2EB

1 February 2008

Before:
VIVIEN ROSE
(Chairman)

ANDREW BAIN OBE
ADAM SCOTT TD

Sitting as a Tribunal in England and Wales

BETWEEN:

1083/3/3/07

HUTCHISON 3G UK LIMITED
("H3G")

and

OFFICE OF COMMUNICATIONS ("**OFCOM**")

AND

1089/3/3/07

T-MOBILE UK LIMITED ("**T-MOBILE**")

and

OFFICE OF COMMUNICATIONS

AND

1090/3/3/07

BRITISH TELECOMMUNICATIONS PLC ("**BT**")
and

OFFICE OF COMMUNICATIONS

AND

1091/3/3/07

HUTCHISON 3G UK LIMITED ("**H3G**")
and

OFFICE OF COMMUNICATIONS

AND

1092/3/3/07

CABLE & WIRELESS UK & OTHERS ("**CABLE & WIRELESS**")
and

OFFICE OF COMMUNICATIONS

HEARING DAY SIX

APPEARANCES

Miss Dinah Rose QC and Mr. Brian Kennelly (instructed by Baker & McKenzie) appeared for H3G.

Mr. David Anderson QC, Mr. Graham Read QC, Miss Anneli Howard, and Mrs. Sarah Lee (instructed by BT Legal) appeared for BT.

Mr. Jon Turner QC and Meredith Pickford (instructed by Regulatory Counsel, T-Mobile) appeared for T-Mobile.

Mr. Matthew Cook (instructed by Olswang) appeared for Cable & Wireless.

Miss Elizabeth McKnight and Mr. Stephen Wisking (Partners, Herbert Smith) appeared for Vodafone.

Miss Marie Demetriou (instructed by Field Fisher Waterhouse) appeared for Orange.

Miss Kelyn Bacon (instructed by SJ Berwin) appeared for O2.

Mr. Peter Roth QC, Mr. Josh Holmes and Mr. Ben Lask (instructed by the Office of Communications) appeared for OFCOM.

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Transcribed by
Beverley F. Nunnery & Co.
Official Shorthand Writers and Tape Transcribers
Quality House, Quality Court, Chancery Lane, London WC2A 1HP
Tel: 020 7831 5627 Fax: 020 7831 7737

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THE CHAIRMAN: Good morning everybody. Mr. Read, we start the morning with your appeal in what has become known as the TRD cases. One point I just want to draw to your attention - I am not necessarily saying that you should deal with it now, but at some point during your submissions - is to raise the issue of the relief that is sought in para. 115 of your notice of appeal. So that we can be absolutely clear at the end of your submissions exactly what issues you are asking us to decide, and how those relate to the issues in the price control matters in your MCT appeal, perhaps we can just turn up para. 115 of the notice of appeal in Bundle D1, Tab 3, p.110 of the standard numbering. Looking at that, it is not clear to me whether, for the purposes of this appeal, BT is accepting that there should be a 3G component in the rate which reflects higher 3G spectrum costs, and how that relates to your case in the price control matters. I know it is a different team working on that, but hopefully you are liasing with each other. Just generally, what, if anything, are you asking us to decide in this TRD appeal in relation to what the rate should be or what costs should be taken into account if it should turn out that it is appropriate to have a cost base charge, or, if it is not appropriate, whether you are asking us to decide in the context of this appeal whether the overall blended rate should be no higher than the regulated 2G rate in this period, which is the period covered by the TRD appeals, the whole of which is before the MCT statement comes into force. As I say, we do not want you to turn to it now, but just so that we can be clear at the end of your submissions.

MR. READ: It was, madam, the last thing I was actually going to come to, which may be advantageous because no doubt those behind me connected with the market review appeal can tell me over the short adjournment exactly what they think I should, and should not, be saying on that point.

THE CHAIRMAN: Just to be clear also, your submissions are expected to take us through to three o'clock this afternoon. Mr. Cook, in your absence yesterday, you were committed to limiting your submissions to one and a half hours thereafter. Thank you.

MR. READ: Madam, on that point about timing, could I make three points from the outset. The first thing is that we adopt what we say in the notice of appeal and the skeleton arguments, and the witness statements. I am not going to take you to every single point that is in there in order to try and keep the time down. But, of course, we do rely on each of those points that are actually made, and it should not be assumed that because I simply have not referred to them, that they are not being advanced as part of our argument.

The second point is that in our skeleton argument we have made reference to the point that Ofcom have raised about the precise jurisdiction of the Competition Appeal Tribunal in

reviewing a decision, and, in particular, whether or not errors of appreciation, as they say, are matters that are within their remit and should not be, in effect, challenged; the general scope of the jurisdiction of the Competition Appeal Tribunal in reviewing - I will use that word neutrally - the decision of Ofcom. I am not going to address that point in oral submissions. We have made the points in our skeleton argument. I apprehend that probably both Mr. Cook and Mr. Turner will perhaps develop those a little more. I will leave them alone. Obviously, I do reserve the right if Ofcom say anything in response, to deal with that matter in reply if we feel it is appropriate.

The third point that I want to make about timing is that I am going to try and avoid taking you, as much as possible, to any of the documentation. If need be I will simply quote back to you what I am relying upon. Rather like we apprehend Ofcom, we had not thought that you will be assisted by any more paper in the form of a speaking note, as such, but we feel that it may be - and we will look at the transcript afterwards - sensible, if, having gone through it, we cross-check that we have given all the correct references. It may be that over the weekend we simply do a reference note so that the points can be easily ascertained where the references are and are not. I will try and put the references in as much as possible for the transcript, but sometimes, obviously, they get overlooked. That is what we will address, if need be, with a further note.

So, can I then turn to the TDR appeal itself? Can I make two introductory points in addressing this? The first point is that Ofcom suggest in their skeleton argument at para. 43 (Bundle A, Tab 2, p.15) Ofcom suggest that all the appealing parties essentially come down to a single complaint - namely, that Ofcom should have exercised its dispute resolution powers in such a way so as to reduce the disputed charges. Can I make clear that BT does not accept there is a single complaint for two reasons: (1) that although we accept that a number of the grounds that BT has put forward are inter-related, they are separate and independent grounds. For example, dispute resolution powers will obviously have some bearing on the issue of the gains from trade test, but we say that even if Ofcom were right in their approach to the dispute resolution powers then it still would not justify the gains from trade test which we say is an inherently flawed test to apply in these circumstances. So, they are independent grounds, and from that point of view we say it is not a single complaint - there are four separate and distinct complaints. Therefore, we ask the tribunal to address each one of those because we say we can succeed in this appeal, even if we get home on simply one of those grounds.

The second point I want to make in connection with this is that although they talk of a single complaint, BT's concerns go further than simply this particular dispute - in particular, as you are probably already aware from the documentation, the gains from trade test has certainly been deployed in at least one other dispute resolution process (namely, 0870 numbers), albeit in a slightly different format which we will touch on a bit later. We do say - and this is one of BT's concerns about this, that at the end of the day we do want to ensure that a proper analysis of the whole remit of the dispute resolution powers is considered by the tribunal and dealt with in four separate components.

So, that is going to be the structure of my submissions today - to deal with each of the four separate components, and then come finally back to para. 115, not least for the reasons you have already addressed.

Can I then make the second point about this appeal, which is to point where BT sees itself in this context. It sees itself very much in the middle of the approaches taken on the one side by H3G and, on the other side, by Ofcom. BT, looking at it from the outside, so to speak, seems to think that there is a rather trenchant position being adopted by both parties because of the respective stances they are taking in the market review appeal. What BT considers is important is to ensure that there is a sensible pragmatic Framework laid down for these dispute resolution processes. If I can give a sort of high level overview of how exactly we see it, firstly we agree with Ofcom that the dispute resolution is about achieving a practical solution between the parties involved. It is not a substitute for market reviews and the imposition of SMP conditions. For all the reasons you have already heard, it would otherwise render the SMP parts of the common regulatory Framework and the 2003 Act irrelevant. It would, to a degree, be inconsistent in any event with the four month timeframe that is imposed for coming up with the dispute resolution.

The second point is there is a parallel regulatory purpose. I do not think I need to take you to it, but that is clearly what the first H3G case has established. Because it is a regulatory process, under the common regulatory Framework it is subject to the regulatory objectives and, in particular, what we say is a very real mandatory Framework imposed under Article 8 of the Framework Directive. The next point we make in this respect is that we say Ofcom cannot try and short-cut dispute resolution by constraining how it resolves disputes. We say it is wrong for Ofcom to rigidly tie itself to decisions it may, or may not, have taken several years previously. Each dispute is obviously going to depend upon the context of that dispute. In some disputes the numbers of parties involved are going to be small - perhaps just the two. The information is going to be relatively limited. In achieving a

practical solution between those two parties there are likely to be different needs and resources necessary or involved. If I can give just one example of this: obviously, if you have a dispute between two smaller communications providers without SMP Ofcom is going to approach it from a very different perspective to the situation it has found itself in with these disputes, which effectively include all the mobile termination industry. We say that, in fact, Ofcom obliquely recognise this in the BT determination because if one looks at para. 4.63 of that determination (Bundle B, Tab 4, p.29) Ofcom recognised explicitly that in the context of these disputes in which the charges of all five MNOs are in dispute, Ofcom did not consider that comparisons of the charges of other MNOs against each other provided useful benchmarks. So, in other words, Ofcom are recognising that one of the tools that might be used in resolving a dispute - namely, to try and benchmark the level of charges against somebody else in that field - simply cannot work in the context of a dispute where you have got, effectively, an industry-wide dispute going on.

We say that that is very, very important when one comes to consider the context of these particular disputes, which obviously were not only being seen in the context of all the MNOs being involved in it, but also the context of the market review process going along alongside it, and Ofcom already having a lot of information there.

In para. 17 of our skeleton argument (Bundle A, Tab 9, p.17) we have highlighted six speeches which we say are quite important and crucial when considering the dispute. I do not think it is necessary to actually turn the bundle up, but if I can summarise them it might be useful to identify what those features actually are. Firstly, we say that they do all concern the five MNOs and BT's fixed and mobile transit operators.

MR. SCOTT: It may be sensible if we do look at it. Can you give us the reference again?

MR. READ: Perhaps I am trying to go too fast, bundle 9, tab 9, p.7. We make the point in para.17 at the start that the objectives are going to necessarily vary according to the particular factual circumstances of the dispute referred. We make the point that I have already made about it is not merely a bilateral process in this instance. We then identify the six items set out in (a) to (f) as to why this was particularly important. So you have got in (a) the fact that you have got all the five MNOs and BT is involved in the dispute. Then obviously the effect on prices would be across the board for the whole industry.

Secondly, each of the MNOs have already been adjudged to have had SMP in their own markets. That plainly is an important factor when you come on to look at the objectives of Article 8 of the Framework Directive.

Thirdly, we say that BT had no real commercial alternative to accepting the price other than to refer the disputes to Ofcom. That really was a point that was picked up in the Orange preliminary judgment when it was being suggested, if you recall, that the nature of the disputes was, in reality, about disconnections, whereas in fact the tribunal correctly identified that there was no real possibility of disconnection. What would actually happen was they would be referred.

Fourthly, we note the operation of the end-to-end connectivity obligation on the sole party within the telecoms market, ie BT and how that was operating.

Fifthly, we note the specific point that Ofcom noted and relied upon in the market review statement in 2007, namely that BT's price was crucial within the market and effectively set the rates for other people.

Sixthly, we note the point that I have already touched, which is that Ofcom already had a considerable amount of information as a result of the 2007 market review. This, at the very least, provided a litmus test basis through which you could gauge the reasonableness of the charges involved. We do say that that is what makes this case particularly special, those speeches.

Other disputes are obviously going to have different features, but we are looking at the context of this dispute, and that is why we say these things have to be borne very much in mind.

Can I turn now to the first of our grounds of appeal, which is the wrongful appreciation, as we say, that Ofcom had of its dispute resolution powers? Can I try and narrow this down by concentrating on what we are three basic flaws in Ofcom's approach to those powers? We do not say those are the only areas, and we will touch upon one or two of the other points as we go along. We do say that these are the fundamental errors that one can identify from the outset in Ofcom's approach.

THE CHAIRMAN: Given what you said right at the outset, you need to be very clear if there is something in your skeletons or whatever that you are not wishing to pursue, otherwise we will assume, as you said, that everything that you raised is still in dispute.

MR. READ: Absolutely, madam, and that is why I am trying to do it in this fashion, to, if you like, take the headline points and say there will be other little bits dotted around and I am not going to waste my time getting too stuck into those because they are already in our notice of appeal or our skeleton argument.

Can I then look at these three headline points? The first is that Ofcom's adopted approach that makes the principal focus of their dispute resolution virtually exclusively dependent on

the existence of any ex-anti obligations that have been imposed and of course in this particular case the end-to-end connectivity obligation. We have obviously got separate complaints about the way they interpreted the end-to-end connectivity obligation, but we say that one of the fundamental flaws when you are looking at our first ground of appeal was the fact that their principal focus was on that end-to-end connectivity obligation.

The second headline error we point to is the way that there has been an almost total relegation of the importance of the EC policy objectives clearly mandated in Article 8 of the Framework Directive.

The third headline point is Ofcom's focus on maintaining what it calls consistency and certainty with previous regulatory decisions, and in particular the almost complete subjugation, as we say, of the dispute resolution power for the decisions that Ofcom took in the 2004 market review. If one wants to see an example of that, that is in para.6.4 of the determination. Madam, the way I am going to deal with it is to effectively go through looking at the first two, a degree because they are interlinked, together and then come back to the third, ie consistency with the 2004 decision at the end of this section on dispute resolution powers.

Can I first look at the underlying logic of the determination in respect of Ofcom's intimately tying their focus to the ex-anti regulatory obligations. Ofcom stated its approach in para.2.7 of the BT determination at – and I do not ask you to turn it up but I will reference for the transcript – bundle B, tab 4, p.6. Ofcom said this:

> "In considering the appropriate determination Ofcom will consider all relevant regulatory obligations in place in order to ensure regulatory certainty and consistency in the way Ofcom exercises its different powers."

Then a little later:

> "Ofcom considers that the end-to-end connectivity obligation is relevant to the determination of a dispute which involved the purchase of voice call termination by BT as it relates specifically to such a situation."

So that was the focus they identified.

This then led them to the view that in respect of the period post 13th September 2006 the principal focus should be on the end-to-end connectivity obligation. In respect of the period before 13th September 2006 the only ex-anti regulatory obligation that Ofcom said was in play was the 2G price restraint. Thus – and I am going to quote this next bit, para.4.23 of the BT determination, bundle B, tab 4, p.23:

"MNOs are therefore able to set such blended rates as they consider appropriate, subject to competition law."

In other words, there was effectively no better rate the MNOs could set in the absence of the ex-anti regulation of the end-to-end connectivity obligation. I think that was put even more starkly in para.4 of the defence at annex B, which is D3, tab 8, p.95. The MNOs were free to determine their 3G rates and set such blended rates as they considered appropriate provided the 2G rates were compliant and subject to compliant and subject to competition law. In other words, the focus was exclusively on the end-to-end connectivity obligations and without that basically the MNOs could set whatever prices they liked. We say that this emphasises just how much Ofcom's tied its dispute resolution powers to this question of whether it had imposed an ex-anti obligation or not. They were focused on the ex-anti obligation and in the absence of the ex-anti obligation they effectively gave free range to the MNOs to set whatever price they actually considered appropriate.

That singular focus on ex-anti obligations we say appears to have mutated slightly by the time we come to the defence because they seem to have split it up into two questions, namely whether or not there was an existing ex-anti obligation or some other overriding policy objective. I will come back to that point a little later. In any event, the principal focus remains on this question of the ex-anti obligation.

We say that it is wrong for two principal reasons. Firstly, it imposes constraints on the dispute resolution process that are not mentioned in the 2003 Act or the Directives. Indeed, we say it runs contrary to what is actually within the Directives. Secondly, and this is how it links in with the second point that I mentioned at the outset, it completely ignores, or at the very least drastically relegates, the policy objectives that are specifically placed on Ofcom when it considers and determines the dispute. In particular, we say, it led Ofcom to pay scant attention to the effects of Article 8 and Framework Directive, and indeed Articles 4 and 5 of the assets Directive.

Can I make one point clear though in making these submissions. BT is not saying that Ofcom in coming to its determination should ignore the end-to-end connectivity obligation completely. We are not saying that, we are not saying it is not a factor that should not be taken into account. We are simply saying that it should not be the exclusive focus of the dispute resolution powers, which is the way that Ofcom have in their various passages seem to have accepted it. It is one factor to be taken into account when assessing the very clear objectives that we say the Directives have laid down. My focus on this point, I would not want it to be thought that we are saying you are can just push the end-to-end connectivity

obligation out of the door, you cannot. It is a factor, but we say it should not be, in the way that Ofcom have done, the principal factor. We say it, in effect, gets close to the exclusive factor.

Can I start, in analysing this, by looking at the basis on which the disputes were actually referred. BT referred the disputes under s.185(1) of the 2003 Act, which relate to disputes about network access. It is not specified in the determination which provision of s.185 Ofcom considered that the dispute was being dealt with. However, it is clearly, certainly by the time we have got to the Orange hearing, that Ofcom considered it was under s.185(1) because it related to a dispute about access. Thus, they plainly accepted it was a dispute falling within Article 5.4 of the Access Directive.

I do not want to spend time going back to the Orange hearing, but if I can summarise it thus: Ofcom also accepted that there was an overlap with Article 20 of the Framework Directive. We are not absolutely clear what is being said, whether or not they are saying all aspects of BT's determinations fell within Article 20 of the Framework Directive and Article 5.4 of the Access Directive, or whether they are actually saying they only fell into Article 20 of the Framework Directive in so far as the period of the end-to-end connectivity obligation was imposed on BT. So there are to period points. We are not quite sure what they are saying for the period before 13th September. We do not think a great deal is going to turn on this, but in fact our analysis is that there is a wide overlap between Article 5.4 and Article 20 of the Framework Directive because of the effects of Article 4 of the Access Directive which of course, as you will recall, is the obligation imposed on undertakings when requested to negotiate over interconnections. I will take you back to it. We say that is an obligation that is imposed under Directives themselves and hence it is capable of falling within Article 20 in any event because it is an obligation arising under the Directives to sales, and hence it is capable of falling within Article 20 in any event, because it is an obligation arising under the Directives involved. So that is how we see it.

Quite how the drafting all intermeshses is probably not a matter that needs to be dealt with for today's purposes because everyone accepts that on any view Article 5(4) of the Access Directive plainly applies here.

Can I start then with looking at Article 5(4) (bundle H1, tab 4), the first point about it is that nowhere within it is there any mention of any need first for there to be an *ex ante* obligation necessary for the reference of a dispute, nor any reference that the dispute must be judged by specific reference to that *ex ante* obligation. In other words, there is nothing at all within the wording of 5(4) that says, or leads to the assumption that the focus in exercising dispute

resolution power should be on existing *ex ante* obligations. Indeed, we say to the contrary what 5(4) does do is tell you exactly what you should place at the heart of the dispute resolution powers, namely the references to Article 8 of the Framework Directive.

There is nothing, in our respectful submission, in the wording of Article 5(4) that supports in any way this concept that it has to focus principally on an *ex ante* obligation when resolving a dispute; indeed, to the contrary the wording suggests otherwise.

Perhaps I can also then take you to Article 20 if the Framework Directive, and briefly look at that. It is in the same bundle at H1, tab 6. Of course, here we do get a specific reference to obligations. But it is necessary to look at the wording: "In the event of a dispute arising in connection with obligations arising under this Directive or the Specific Directives …" so that of course includes the Access Directives between undertakings", so that of course includes the Access Directives:

> "… between undertakings … the national regulatory authority concerned shall, at the request of either party, and without prejudice to the provisions of paragraph 2, issue a binding decision to resolve the dispute in the shortest possible time …"

So, pausing there, there is undoubtedly within Article 20, if you like, a jurisdictional gateway that you have to go through in that it has to be a dispute arising in connection with obligations. But that is not necessarily, we say, synonymous with *ex ante* obligations imposed by Ofcom. So it does not just include things like the end-to-end connectivity obligation. It also includes any other obligations that are put upon the national regulatory authority by the Directors themselves, and we say that is quite important when you come, say, to look at Article 4 of the Access Directive, which says in terms that there is an obligation to negotiate interconnection if requested.

So when one is looking at this phrase: "arising in connection with obligations under this Directive or the Specific Directives …" it is not exclusively saying that it has to be an obligation imposed by a national regulatory authority, or at least that is the reading that we think that it involves.

THE CHAIRMAN: But it would not cover obligations imposed on the NRA ----

MR. READ: Absolutely, we fully accept that.

THE CHAIRMAN: It has to be an obligation on the undertaking.

MR. READ: Absolutely, because it is actually one of the things we get criticised about in Ofcom's defence, and we say actually we never made the point, because there is a very clear distinction, it seems to us, drawn between tasks and requirements, which are what are imposed upon National Regulatory Authorities, and obligations, which are what are

imposed on undertakings involved in the electronic communications' field. Perhaps, while we have this file open I could just make the point that if one goes back to Article 8 in the Framework Directive, one sees the heading to Chapter 3 is " Tasks of National Regulatory Authorities" and as one sees from Article 8(1): "Member States shall ensure that in carrying out the regulatory tasks …" so in other words, if I can put the word in inverted commas, "obligations" upon National Regulatory Authorities, they seem to be referred to throughout as "tasks", whereas the word "obligations" appears to be used in the context of undertakings and the requirements on them.

THE CHAIRMAN: Well I take your point, although what one always has to be careful with, just focusing on the English version of these documents, when we do not really know whether, in the other languages there is a difference in wording – but I do not think you necessarily need that point for your point on Article 20.

MR. READ: No, I am getting slightly out into a discursive discussion about the interrelationship of all of this, which academically may be very interesting but is not actually forming part of the principal point. I would just say though that my very learned linguistic Junior has actually checked and made sure that there is no cross-over in the other languages between obligations and tasks, so we do think that that is a right point, that in fact "task" is confined to the NRAs.

But, as you rightly observe, I am beginning to get into an academic discursion which perhaps I do not need for the purposes of this appeal. But, I do come back to the wording that is actually used in Article 20 of the Framework Directive, arising in connection with obligations. Now, we do say that those are wide words. They are not as constrained as they could be by a more rigid use of the language to suggest that you have to focus your dispute resolution directly upon what is involved in the obligation itself. "Arising in connection with" are fairly wide liberal words and we say that in effect it creates a jurisdictional gateway. If it arises in connection with the obligation there is a referral and thereafter different parameters come into play for the purposes of the dispute resolution powers that Ofcom have to actually undertake.

MR. SCOTT: Just one point, recital 32 -----

MR. READ: I was coming to that.

MR. SCOTT: Does actually ----

MR. READ: I will come back to that in a minute. You have a point because it is one of the points that Ofcom do rely on, and I promise I will come back to that in due course. What we say is that once you have gone through the jurisdictional gateway, and I think Ofcom

actually accept this because they do accept that they had the power to, for example, impose cost pricing on this dispute but say now that in the exercise of their discretion they will not use that power, so I think they do recognise the distinction between, on the one hand, jurisdiction to get the dispute before them, and on the other hand the exercise of their discretion and how the obligations already imposed on undertakings actually comes into play.

We say that it is important, because we do say that the words of themselves in Article 21 do not focus the dispute resolution on the obligations, subject to the point that I will come back to in due course.

What they do do, and they do this very clearly in Article 23, is again tell us what exactly should be one of the principal objectives in resolving the dispute and that is the reference again to the objectives in Article 8 of the Framework Directive. So we say there is a fair degree of symmetry between what Article 5(4) of the Access Directive does, and what Article 20 of the Framework is doing. Namely, there is not a constraint as such; there is a jurisdictional gateway you get through. In the case of 5(4) it has to be a dispute relating to access or interconnection, in respect of 20 it has to be arising in connection with an obligation, and once you have gone through that there is nothing within the language itself that constrains the dispute to be resolved by principal reference to the *ex ante* obligation. To the contrary, there is a very, very clear parameter laid down that when you resolve the dispute you do it by looking at the objectives primarily of Article 8 of the Framework Directive.

Can I just at that stage mention one further point in all of this, that it should not be overlooked – and I do promise I will come to recital 32 directly – it is clear from recital 32, we say, that the parties have a right to have their dispute resolved. Again, we say that is a factor we strongly pray in aid for saying we cannot just wrap it up by saying "We focus on the *ex ante* obligation and achieving that *ex ante* obligation" as Ofcom do. We say it must be something wider, which is consistent with the wording, the objectives of Article 8 and, we say, with the right of the parties to have their dispute resolved.

I think in this connection, I will just mention one further point because it is really the point that Ofcom appears to equate regulatory obligations when it is talking about it in the determination, with meaning obligations that Ofcom itself has imposed upon the parties under the various mechanisms, the SMP, the price conditions, etc. I would particularly point to the fact that when they were looking for the period prior to 13th September 2006 of course they said there is no obligation there, so therefore we just have to look back to the

previous obligation and that was certainly concerned with 2G. Again, we said that there are various parts in the determination itself which highlight this, para.420 at B, tab 4, p.23 is another instance where they appear to equate regulatory obligations with Ofcom imposing regulatory obligations.

We do not think at the end of the day that a great deal may turn on this but I do want to flag it up, which is the point that I have already touched on, which is Article 4 of the Access Directive itself imposes an obligation on the undertakings to negotiate interconnection. Indeed, as I think suggested in our skeleton argument, we make the point that as this was a dispute over the price at which interconnection should happen and was therefore part, if you like, of the negotiation process, we see this being a dispute about an obligation arising under Article 4, certainly for the period prior to 13th September 2006 and therefore Article 20 of the Framework Directive is engaged in any event.

As I say, at the end of the day, not a great deal may turn on it, but we do think that this gain is indicative of perhaps the slightly woolly thinking that Ofcom exhibited in the determinations by focussing, it seems to us, primarily upon obligations Ofcom has imposed, rather than looking at the wider context of the whole matter, but it is difficult to actually draw that out for the simple reason that Ofcom never identified in the determinations precisely what jurisdiction they were relying upon in determining the dispute.

In any event, we say that what this must mean is that either Ofcom understood and believed when it was saying what it said, that regulatory obligations directly equated to obligations that Ofcom itself had imposed, in which case we say that is wrong because it leads out of the count Article 4, or if they did assume that regulatory obligations could include Article 4 of the Access Directive they did not deal with that anywhere in the determination itself in any event and we say that necessarily means that in allowing, as we identified earlier, the MNOs to effectively set any price for that period they have completely ignored the duty to negotiate, the obligation to negotiate under Article 4 of the Access Directive. We say there is nothing in the wording Article 5(4) or Article 20 to conclude that that, as Ofcom suggests, should be the principal focus of the dispute resolution process.

Can I now return to Recital 32? It is something that Ofcom do pray in aid for this approach. But, when one looks at Recital 32 we say it is saying nothing more, at the end of the day, than, "Well, if you have an *ex ante* obligation imposed on the parties, one must take that into account in resolving the dispute". BT is not in any way challenging that because we do say that if you take the example of the end-to-end connectivity -- Perhaps I should have read the full wording of Recital 32.

> "In the event of a dispute between undertakings in the same Member State in an area covered by this Directive or the specific Directives, for example relating to obligations for access and interconnection or to the means of transferring subscriber lists, an aggrieved party that has negotiated in good faith but failed to reach agreement should be able to call on the national regulatory authority to resolve the dispute".

That is where we say that it is plainly right.

> "National regulatory authorities should be able to impose a solution on the parties. The intervention of a national regulatory authority in the resolution of a dispute between undertakings providing electronic communications networks or services in a Member State should seek to ensure compliance with the obligations arising under this Directive for the specific Directives".

These appear to be the words that Ofcom rely upon for saying, "Well, this means that you should be focussing on *ex ante* obligations". The first point I make about it is that it leaves out of account Article 4 of the Access Directive. I think there has been a slight debate amongst this particular team of BT whether or not Article 4 is actually an *ex ante* obligation, or whether it is actually an ex post obligation in the sense that it only arises when there has been a request to negotiate interconnection. I do not think a great deal is going to turn on that. But, certainly it is not the focus of regulatory obligation, as we say that Ofcom appear to have been using it - namely, an obligation imposed by Ofcom itself. Article 4 is plainly an obligation that is caught within Recital 32, but which is not obviously one that is imposed by Ofcom. It is imposed directly the Directives themselves.

So, that is the first point.

But, the second point, as I have already indicated, is that that says nothing more than obviously if you in the process of resolving a dispute, you do not leave out of account the fact that there is already an existing *ex ante* obligation. We fully accept that. But, what it does not do is allow you to turn it into a mantra for saying, "Well, we have to resolve this dispute predominantly, or exclusively by reference to the *ex ante* obligation we have imposed on the parties, and if we have not, we effectively let the MNOs have whatever price they want. We say that you cannot spell that out from Recital 32. There is obviously the other point that if there was an inconsistency between the Articles and Recital 32, then the Articles have to be given precedence - which I think was the point that we raised in the Orange preliminary hearing case. I do not think, at the end of the day, anything turns on that because we say, "Well, Recital 32 is completely consistent with the scheme that says,

‘Take it into account, but not as Ofcom suggests. Make it the principal focus of how you deal with it’”.

Indeed, the critical point, we say, in that respect, as I am being reminded, is that if it was right that all Ofcom should be looking at in this context is ensuring that existing *ex ante* obligations worked, well arguably there is a separate method for dealing with that in any event by enforcing compliance with *ex ante* obligations under s.45 and s.94 of the 2003 Act. So, there is a process there. If this was simply a question about an *ex ante* obligation not working, well, there is a method for dealing with that in any event. But, of course, that is not the reality of what these disputes are, because this dispute is not about whether BT physically interconnected, or not, with the MNOs - it was about the price at which they were going to interconnect. There was never any real danger that the end-to-end connectivity obligation from the point of view of a physical interconnection was ever going to fail because the party was simply going to shove the point off to Ofcom and say, “Well, look, we can’t agree about price. Please sort it out for us”. That is the reality of the situation.

So, that is how we deal with Article 32. Perhaps I should have said this from the outset before getting on to Article 32 too quickly. We think, although it is not very clear, that Ofcom are trying to rely on three principal focuses for this construction that they came up with in the determination. The first is the Article 32 point, which I have dealt with already. The second is, if you like, an overall overview of the common regulatory Framework, which effectively starts from the premise that the parties should be free to negotiate; therefore Ofcom should not place any constraints on it unless there is some other regulatory reason for doing so. That seems to be one of the ways that they put it forward.

The final point, it seems to us, that they rely upon is the issue of consistency and certainty. As far as we can see - and no doubt I will be corrected on Monday - those are the only three coat hooks upon which Ofcom seem to be able to hang this focus on the *ex ante* obligation. So, I have dealt with Recital 32.

Turning to this implicit scheme of the common regulatory Framework that requires overriding emphasis to be placed on the ex ante obligations imposed by the regulatory authority, the consequence - and, we have to say, it is rather an unattractive consequence - is that effectively Ofcom says, “Well, the parties should be left to their own devices. If there is not this *ex ante* obligation imposed upon them, then we can almost take a Pontius Pilate approach to this and leave them to get on and do what they want to”. Of course, that is all very well, but, as we have seen here, what Ofcom seems to have taken that to the logical

conclusion of saying is that the MNOs can demand whatever price they want without having any regard to the objectives that are plainly mandated.

What we would say about this is, firstly, that it ignores completely the explicit constraints on Ofcom's approach to the dispute resolution which is mandated by the Directives themselves, in particular Article 8 of the Framework Directive. Secondly, we say that it places on the Directives a rigid interpretation that is simply not there. We, of course, accept that the common regulatory Framework was trying to impose a harmonised Framework for the electronic communications sector. We do not dispute that. But, what we say is that Ofcom is trying to spell out an explicit approach on this principal focus on *ex ante* obligations that you simply cannot derive from the Directives themselves. I think Mr. Roth himself accepted on Day 2 (p.3, l.19) that the Directives are not always clear why a particular provision is in one place and not in another. We do say that there are problems with the Directives. It is the point that we made in our skeleton argument. But, we made it not to pour scorn on the harmonised nature of the regulatory Framework, but simply to say, "You, Ofcom, are trying to spell out a coherent restraint on your powers from what you say is the correct interpretation of the Framework, which we say simply is not there". It is simply not a clear enough structure for you to be able to say, "Well, effectively, the objectives under Article 8 of the Framework Directive take a much lower predominance than the reference to the *ex ante* obligations which we have singled upon in reaching this approach". So, we say there is nothing in the Directives that spells this out, and that one can get into this rather discursive discussion about how the various parts of the Framework Directive and the Access Directive fit in with each other; why, for example, parts of it do not always seem coherent. For example, I took you to Article 8 and the heading 'Tasks'. That was Chapter 3 of the Framework Directive. One finds that the dispute resolution under Article 20 of the Framework Directive is in fact in a separate chapter. So, one might have expected that as Article 20 is plainly a regulatory task ----

THE CHAIRMAN: We will have to do our best to try and make sense of that.

MR. READ: Exactly. The only point that I really draw from this is a rebuttal point to Ofcom, to say, "You cannot say that it is such a coherent scheme that necessarily you can override what seems explicit from the wording of Article 5(4) of the Access Directive and Article 20 of the Framework Directive.

The third point that we identify is this question of regulatory certainty and consistency. Now, what we do say about that is that, yes, again, we accept these are obviously factors to be taken into account. Ofcom do not anywhere, as far as we have identified so far, and

certainly not in the determination, explicitly say where they are getting these from. But, we apprehend it must be a reference to s.3(3) of the 2003 Act which talks in terms of regulatory activities should be transparent, accountable, proportionate and consistent, and targeted only at cases in which action is needed.

However, we say, "Well, hang on a minute. You can't elevate this, and use this as a tool for building this edifice of principal focus on ex ante obligation". Firstly, consistency is only one element in the whole package. Indeed, if one looks at s.3 one sees the scheme of s.3 is that the principal duty on Ofcom is to further the interest of consumers. That is s.3(1) where it says, in terms, that that is the principal duty. That is expanded in s.3(5) of the 2003 Act. It simply expands what the interests of consumers are - namely in respect of choice, price, quality of service and value for money. In other words, it is a very clear principal duty that is being laid down there.

Secondly, Ofcom cannot use this as a basis for effectively relegating Article 8 of the Framework Directive down the batting order, because it is quite clear when one looks at the Act that if there is a conflict involved, then Ofcom has to give primary consideration to those regulatory objectives laid under the Directives (s.3(6)) which makes clear that if there is a conflict with community obligations, those obligations take precedence.

In any event, none of this was discussed in the determination. If one goes to s.3(7) of the 2003 Act, that makes clear that if there is a conflict between the various duties involved, then there is an obligation to secure that conflict is resolved in the manner they think best in the circumstances. There is no discussion at all about that in the BT determination. There is no suggestion at all, "Well, actually we have looked at Article 8, but we don't think that it's appropriate to apply these objectives because of (a), (b), (c), and (d). We're more concerned with applying consistency and certainty as a result of these following factors ---- " None of that. None of that in the determination at all. We say you cannot simply approach it in this manner. To the contrary, what the determination does say - and if one wants to pick this up, one can see it from para. 4 of Annexe B to Ofcom's defence at D3, Tab 8, p.95 - in terms is that 'the MNOs were free to determine their 3G rates and set such blended rates as they considered appropriate provided the 2G rates were compliant and subject to competition law'. Nowhere, anywhere, do they explain that startling proposition, having gone through the tests that they are required to have gone through in resolving their duties. In other words, they do not say, "We reached that conclusion that they can set virtually any price they want to under 3G prices because we think the interests of consumers regulated for the following factors". It is a startling conclusion that they actually come out

with in saying that the MNOs can set any price. It is even more startling when you realise that they have not given any consideration at all to what we say are the primary focuses of the dispute resolution process.

MR. SCOTT: Just one small point there. You mentioned both certainty and consistency. You have drawn consistency out of the Act. The legal certainty presumably comes from European principles which run right the way through consideration of the common regulatory Framework?

MR. READ: I think that that is probably correct. I have not been able to identify specifically certainty as a particular factor that explicitly needs to be taken into account, but I think we would accept that obviously in this context achieving certainty is a factor to be taken into account. We think it is a principle that is certainly required under EC law. Of course, you have to balance it against all the other factors that are involved. So certainty is there, but in the same way that we have dealt with consistency we say you cannot just focus on that without at the very least giving some explanation as to how you deal with all these factors between them.

Can I just check on one point, and it is a point that I should have made when dealing with this question of the approach to the Framework and this concept that the parties should be free to negotiate unless there is some form of restraint on it. I do want to make the point at this stage that of course we accept that recital 5 of the Act says the Directive talks in terms of no restrictions on negotiation, but it is, if one looks at it, said in express terms in respect of an open and competitive market. If one looks at H1, tab 4, recital 5, it does say that in an open and competitive market there should be no restrictions that prevent undertakings from negotiating access and interconnection agreements themselves. That is talking about an open and competitive market. Here we have the complete antithesis of this, in that every single one of the five MNOs who BT was in dispute with have been designated as having SMP. We could not think of a clearer example of an instance where it is not open and competitive market and therefore that is a particular reason why you cannot spell out a scheme that says the parties should be free to negotiate whatever price they want.

Madam, can I now briefly touch on Article 8 of the Framework Directive directly and make a few points on that. The first point we make is that you do not just look at Article 7 of the Framework Directive, you have to look also at Article 7, which specifies how Ofcom should carry out their tasks under the Directive and the specific Directives. It makes clear that national regulatory authorities shall take the utmost account of the objectives set out in Article 8. In other words, it is not simply that you have to have to regard to them, you have

to take the utmost account of them. You could not have a more explicit indication within the Directives of the priorities that Article 8 requires you to follow.

If one then moves to Article 8.1, one sees that, in carrying out the regulatory task specified in the Directive and specific Directives, the national regulatory authorities take all reasonable measures – all reasonable measures – which are aimed at achieving the objectives set out in paras.2, 3 and 4. Obviously such measures have to be proportionate to those objectives, but it still has to take all reasonable measures. Again, it is making the clearest sign of how important the objectives in Article 8.2 of the Framework Directive actually are.

Then when one looks at Article 8.2 itself one sees that the national regulatory authorities shall – not "may" or "might", but "shall" – promote competition in the provision of electronic communications networks, electronic communication services and associated facilities by:

> "(a) ensuring that users, including disabled users, derive maximum benefit in terms of choice, price, and quality;
>
> (b) ensuring that there is no distortion or restriction of competition in the electronic communications sectors."

We say that the wording of Article 8, particularly when taken in conjunction with Article 7 of the Framework Directive, is about as forceful language that you could ever use in this context of saying, "Look, this is what is important". Given that dispute resolution is one of the tasks that this specifically applies to, you could not have a clearer parameter to say, "Look, you must make sure that there is no distortion in competition and that there is maximum benefit in terms of choice, price and quality for users of the service".

Users does not just mean end-users, the consumers, it means the immediate parties down the line which of course in transiting of calls is quite important, because you can have quite a long line at the end of the day. It is absolutely fundamental, we say, that Ofcom should have put Article 8 up there as the absolute priority in resolving the disputes.

At this point I would just like to touch upon one or two points of what actually happened in this and where we say that Ofcom's dispute resolution has actually ended up. I am going to give the references. I do not want to unnecessarily take you to the evidence, but I just want to make the point that para.14 of BT's notice of appeal, which you will recall is in D1, tab 3, sets out a series of factors that we say have resulted as a result of this. One of them is plainly, we say, the distortion of competition for BT's position in the transit market. In particular, there is Mr. Amos's evidence at paras.45 to 47 at D1, tab 4, p.125. He also

makes the point in para.48 on the same reference that there has been a reduction in transit volumes as customers move business. So these are the real effects that we say are happening.

Ofcom in their defence seem to suggest that perhaps they are not as bad as BT are saying, perhaps they are exaggerating the case, as you would expect an appellant to do. Even if they are, we say, firstly, that has not actually been challenged by any evidence to the contrary, leaving that aside, even if they are slightly higher than they might be they are still very important factors and show just how the objectives in Article 8 have not been followed through.

We say that is even more true when you come and look at some of the evidence that the other parties have actually served in this case who, of course, are BT's users. In particular one thinks of the Altnets. One can almost just pose the point, "Why are the Altnets here if it was not actually having a radical impact upon their business, a radical impact on the benefit for users?"

One also sees in T-Mobile's evidence as well, T-Mobile being unable to pass on losses that it has already billed customers (Mr. Miller, para.11, bundle D3, tab 2); has put T-Mobile at a commercial disadvantage (Mr. Miller, para.14); Cable & Wireless (Mr. Harding at para.3.2, bundle D3, tab 4, p.94) are unable to make allowances for charges and cannot pass them on in all cases; Cable & Wireless did not pass through rates prospectively, but lost customers (Mr. Harding, para.4.4 and 4.13, pp.95-96). They then go on to deal with the retrospective charges which was a different point, but we still say is irrelevant to this, although I will not spend any time today dealing with that obviously (Mr. Harding, paras.5.2 and 5.4, D3, tab 4, p.97); Mr. Granberg indicates that Opal have an inability to pass on charges on the Access and Billing Directives. These are all having effects on our users. They are our users down the line.

THE CHAIRMAN: This is not limited to the retrospective?

MR. READ: No, it is prospective. It is one of the points that Ofcom keeping say, "This determination is actually on retrospective, it is only looking backwards". There are two elements in this, one, the retrospective charging under the SIA, and two, the other point, which is ----

THE CHAIRMAN: I meant the first point.

MR. READ: They are not just confining to the retrospective charges, they are also saying this has had an effect on prospective charges as well, and they draw the distinction – certainly Mr. Harding I think does – between prospective charges and then retrospective charges.

Of course, there is another feature to this which I do want to make quite clear here, which is that Ofcom is saying, "This is all okay because it all got sorted out from April 2007 by the market reviews". These determinations have an ongoing effect. The charges only came down when OCCNs were ultimately served to reduce the prices in order to be consistent with the glide effect. The actual result of the determination is carried on. Indeed, I think in Vodafone's case – I think it was Vodafone – it knocked through to October 2007. In other words, the prices only came down from this determination in October 2007. Mr. Amos sets this out in para.31 of his statement in this appeal (volume D1, tab 4, p.121).

MR. SCOTT: Mr. Read, this goes to the relationship between the TRD appeals here and the other matters that we need to consider in relation to SMP and whether price control should have been imposed. You have said that these TRD appeals, because they involved all the parties and at the time all the parties had a finding of SMP against them, including H3G.

MR. READ: I suppose one should put a caveat on H3G saying subject to this appeal.

MR. SCOTT: Absolutely, but in the context of the H3G appeal on the other matter we are going to have to consider the forward looking prospects for TRD and we are going to have to imagine a situation in which one party has not had a finding of SMP made against it and what would then follow, including the question of the equity as between MNOs if four of the MNOs are price constrained and one MNO is not constrained by an SMP condition but only by the prospect of TRD. Leaving aside for a moment what we decide about all of that, what I raise is, and you may want to consult the other team on this, we are going to have to give our consideration at some stage as to how far what we are asked to say in guiding Ofcom is going to be of general relevance to TRD considerations and how far it is going to be very fact specific to the past TRD. I am not inviting you to make submissions on that at this moment but in due course it may be helpful if you consult with the other team and see whether any part of that forms your submissions at the end.

MR. READ: I will, but obviously in this sent the TRD appeal you are deciding now is historic in the sense that by now we have actually moved away from it. I think the more general point I understood you to be making, sir, was how the overall resolution of dispute resolution powers that I am asking you to deal with in this determination, to what extent that might be impacting on future disputes and therefore have a trailer effect into the market review and H3G's SMP.

MR. SCOTT: Absolutely correct, it is that distinction between matters which go to the overall use of Ofcom's powers and matters which go to the very specific use of Ofcom's powers in the factual matrix that applied both before and after 13th September 2006.

MR. READ: Yes, and I apprehend that that is also the reason why you are particularly concerned about para.115 of BT's notice of appeal and the precise declarations that we are actually looking for at the end of it.

MR. SCOTT: That is correct.

MR. READ: I will no doubt be told the answer.

MR. SCOTT: Thank you.

MR. READ: Can I now turn to Ofcom's approach to Article 8 of the Framework Directive and the objectives that are involved. I want to take this in two stages, because I want to look first at the determination itself and how Article 8 was dealt with in the determination itself, and then I want to look at how the cases develop subsequently in the way that Ofcom is putting its case now.

If one starts with the determination, as far as we have been able to see Article 8 gets only one explicit mention in the whole of the determination, and that is at para.4.49 of the determination which is in bundle B, tab 4, p.27 and it may be useful to look at that briefly.

> "The approach that Ofcom took in the draft determinations for resolving these disputes reflects the purpose underlying BT's End-to-End Obligation and also the six Community requirements to give effect to Article 8 of the Framework Directive (as implemented in section 3 of the Communications Act), and also Ofcom's duties under Section 3 of the Communications Act."

We would say that that is simply parroting the language of s.3 of the Communications Act itself. But it is all, it is actually said, specifically about Article 8 of the Framework Directive. Nowhere in the rest of the determination is there anywhere set out at any stage a consideration of what the effects may be on distortion of competition and what the effects may be in terms on end users, certainly in terms of ensuring that they derive maximum benefit in terms of choice, price and quality. Indeed, as I will show you in due course when we say they have done the complete antithesis here, they have basically said that any price at which BT makes a profit can be passed on, which we say is the antithesis of giving any consideration to the benefits of end users.

THE CHAIRMAN: You have said that Article 8 only gets one explicit mention, of course Article 8 was incorporated into domestic legislation by sections in the 2003 Act, so I think in making your point you would have to lump together, would you not, the domestic implementation of Article 8 rather than just focusing on how many references there were to Article 8 itself?

MR. READ: Yes, but I think the key point is that I am not simply looking at it from the point of view of "did they explicitly say Article 8 in terms", but whether or not there is anything in the determination that suggests they went through the policy objectives, and considered it. Indeed, that is the point that I was making earlier, that we believe that the gains from trade tests actually is the complete antithesis of considering it.

THE CHAIRMAN: Yes, you are coming to that.

MR. READ: I will come to that in due course. Continuing with the determination, specific points were raised by the parties as to how Ofcom's draft decision was consistent with its duties, and I will not take you to all the responses because I think that will certainly start burning up my time in a way that I do not need to. We see the response of Ofcom to this at para.6.23 one sees effectively the answer that Ofcom gives:

> "BT and H3G have stated in response to the draft determinations that Ofcom does not set out why its application of the End-to-End Obligation (and its decision not to set cost based termination charges) is consistent with its duties."

To be fair, BT was not specifically asking for price, the decision had to be set by specific reference to cost base termination charges, simply that we said why did you not use this information in reaching your decision, but anyway that is a minor point.

You can then see the response:

> "In resolving these disputes, Ofcom has taken account of its explicit policy decision in 2004 with regards to the regulation of 3G termination and does not propose to act in a manner contrary to the position adopted. To the extent that the MNOs have set a blended charge for mobile call termination on their respective networks which include a 2G element and a 3G element, only the 2G element is regulated, and neither the 3G charges nor those blended charges were subject to regulation during the periods covered by the disputes."

As you can see Ofcom then goes on to specifically consider the position of SMP held by all the providers in 2004, and considered it was appropriate to impose SMP conditions on 2G but not 3G. I do not want to take you through all the paragraphs here, but you see the approach that Ofcom have taken in their determination, they are saying: "How are you putting it in your regulatory duties?" First and foremost is the reference to 2004 in the determination, recognising the fact that there was already SMP in place for the providers on 2G, then mentioning the end-to-end, but at no stage going back and actually considering, in terms, distortion in competition or the effects on end users. So there is nothing in the

determination that explicitly deals with how Ofcom has approached the regulatory objectives that it is required under Article 8 of the Framework Directive.

As far as we have been able to identify, there are only two specific mentions of competition specifically, and those are in para. 6.17 (slightly earlier) ----

THE CHAIRMAN: Just looking a little ahead in 6.26 and 6.28 there are references ----

MR. READ: To competition.

THE CHAIRMAN: No, to the statutory duties under s.3(3)(a) and 4(3).

MR. READ: That is right, I was trying to identify the passages because I was talking about 6.17 and 6.28 is another one of the passages where they actually do talk about competition, and the duties under s.4(3) of the Act. But it is key to note the context in which they are talking about that is that:

> "… The application of the End-to-End Obligation is specifically concerned with the promotion of competition in allowing all Communications Providers active in the UK to be able to interconnect both with one another and with fixed and non-geographic numbers."

The point I am making is that we accept there is a very limited reference to competition within the determinations and that is derived from 6.28 and earlier, 6.17, which I do not think we need to go back to.

The point I am making is that nowhere do they deal with the other objectives under Article 8, and more to the point – and this really is the focus of it – what they are actually doing is putting consistency ahead of what we say are the much clearer Article 8 objectives they should have dealt with. They are looking at the question of the promotion of competition in the context of physical interconnect, but we have made this point several times in our skeleton argument. Physical interconnection at any price does not equate as a benefit to end users. It is not benefit to end users, and certainly no maximum benefit to end users to interconnect at an exorbitant price, and we have made that point several times in our skeleton argument. That is how we say they have got their parameters for addressing the Article 8objectives completely the wrong way around. We say in effect it is because they did not go to the heart of the issue and look at Article 8 directly but only considered it in those limited contexts, that we say there were the problems in termination.

I think I have made these points, and I do not think I need necessarily take you back to them, but it is important to look at two examples of how Ofcom have really failed to address these fundamental requirements, because at para.4.44, (bundle B, tab 4, p.26) they say in terms: "… a reasonable charge for BT to purchase MCT with a view to ensuring end-to-end

connectivity may be at a price appreciably above the competitive level." So they are accepting there that the price may well be not just above but "appreciably" above the competitive level. Again, we say nowhere is there an explanation as to how that marries with the objectives within Article 8.

Secondly, when dealing with the gains from trade test at 6.12 and 6.13 in the determination (bundle B, tab 4, p.47) it says in terms:

> "BT also states that the gains from trade test provides no protection for retail customers, given that BT will always pass the costs of increased termination charges through to its transit and retail customers.
>
> 6.13 Ofcom considers that the gains from trade test provides protection … in relation to the aims of the End-to-End Obligation which are to ensure that customers of Communications Providers are able to connect to customers of other Communications Providers. Appropriate protection of retail customers … is addressed under market reviews and SMP conditions."

So you have actually there a complete refusal to deal with the objectives under Article 8 because they say in terms: "This can all be dealt with in market reviews" and I will come back to that point in a minute. We say that in the determination it is quite plain they never addressed Article 8.

In the defence Ofcom have come up with a very clear way of putting it and it may be worthwhile looking at one particular paragraph which has been highlighted in T-Mobile's skeleton argument, we say quite correctly, because it is fundamental to the way that Ofcom are trying to now portray their approach to dispute resolution. One sees para.23 in bundle D3, tab 6, at p.116. At para. 23 it makes clear:

> "Ofcom has a discretion as to the manner in which it resolves disputes. In exercising that discretion, Ofcom is guided by the basic principles that undertakings should be free to negotiate and set the terms and conditions (including prices) on which they transact."

Pausing there, of course what Ofcom interprets that as meaning is that the MNOs can set the price that they want to.

> "This freedom is subject to two regulatory constraints: (a) *ex ante* regulations imposed in accordance with the CRF …"

And this is where we say quite clearly Ofcom are showing that this is one of the principal focuses that they come down on, namely, what are the *ex ante* obligations that have been imposed?

"… and (b) *ex post* competition law under Arts. 81 and 82EC and the 1988 Act."

Again we say, and it is dealt with in our skeleton argument that that is the wrong approach as well.

"in considering a dispute Ofcom therefore identifies the relevant regulatory framework and, in particular, any existing *ex ante* obligations applicable to the parties."

I have dealt with that point already.

"The methodology applied by Ofcom seeks to ensure that the parties' freedom to determine their price is curtailed only insofar as necessary and proportionate to fulfil the objectives of any such obligations."

I will come back to that point when I am dealing with the end-to-end obligation because, of course, the way the determination has actually come out is that the MNOs can basically set whatever price they want so that when one is looking at imposing a price under the dispute resolution powers, Ofcom appear to be looking solely from the point of view of imposing it on one party and not the other side of the equation. I want to come back to that when dealing with end-to-end connectivity.

Finally, they come out with their two regulatory constraints, i.e. *ex ante* obligation and Articles 81 and 82 under the competition law. Ofcom will also consider whether there are any overriding policy objectives which should be taken into account. So, they seem to have a two-fold approach to this: principal focus on *ex ante* obligations and the Competition Act, but also whether there are any overriding policy objectives which will be taken into account. We do not accept that that is the way that in fact it came out in the determination. In fact, we say - and I am not going to take you to it - that what Ofcom actually did was look at the regulatory obligations as being the overriding policy objective. I will find the reference in due course and come back to that. However, even if that is right, even if they actually did do it in this specific two-way process, we say it is a completely wrong way of approaching it because what you have done is to have elevated the whole question of *ex ante* obligations to the top of the pack, and you have ignored the explicit issues of Article 8. So, para. 23 does not actually explain how Article 8 is supposed to fit into this framework. We only finally see the way that Ofcom is dealing with this when we come to their skeleton argument. I will give you the reference, but I will tell you how it is done from looking at this - para. 32 of their skeleton argument, at Bundle A, Tab 2, p.12. The explicitly say that Article 8 for the Framework Directive is given effect through the second element there - namely, whether there are any other overriding policy objectives which should also be taken

into account. It is quite interesting to see the way that Ofcom have actually developed this argument, but that is where they seem to come out to - that Article 8 is taken into account, but it is taken into account by considering overall whether there are any other overriding policy objectives involved.

We say that that is completely the wrong way of actually looking at it. It is rather looking at it the wrong end through the telescope.

THE CHAIRMAN: This is the same point. You say that you do not think they did do that, and even if they did, that is doing it the wrong way round.

MR. READ: Yes. But, I do want to make the point that this, if I can put it, ex post facto rationalisation of the way they approached it is not, in our respectful submission, sufficient to restore correct the original determination. One can develop authority on this if one wants to. In fact, we say it is fairly clear from *Napp Pharmaceuticals*, which is one of the cases I think you were taken to on Tuesday (H3, Tab 1). That was a case involving evidence. We accept it involves evidence. What the Court of Appeal was saying there was that the Director-General could not use material subsequent to the determination as a means of effectively shoring it up and allowing it, in effect, to restore the determination by saying, "Well, actually this is the way we were looking at it, and therefore we were right to do so". I fully accept that that was a case dealing with evidence. There are, we believe, cases that will deal with the point otherwise. If it becomes an issue, then maybe we will have to look at it again, but I do not want, at the end of the day, to spend a great deal of time getting involved in that. The references to *Napp* are, in particular, paras, 79 and 80 in the report that is in the bundle (I think there may unfortunately be a difference in paragraph numbers with some other versions of the reports). Those two references are explicitly to Bundle 1 and not any others that you can find on Lawtel, or whatever. That is the first point.

The second point that I do want to make is that actually when you go through the determination you see very little mention at all of the question of discretion. It is not simply whether they are explicitly dealing with Article 8. They did not explicitly deal with the whole issue of discretion at all. So, we say the way they are developing their case at the moment is inconsistent again with the way they are putting it forward.

There is a danger in me repeating my points, and I do not want to do that. There is one point that I do want to make: insofar as it may be said that somehow or other Article 8 can be relegated in this way down the batting order, we say that that would actually be inconsistent in any event with other duties to apply EU requirements - in particular, we think here the factor raised by the Altnets in their notice of appeal about Article 10 of the

Treaty, that Ofcom is obviously an organ of the State and therefore it has a duty to comply with the requirements.

THE CHAIRMAN: Nobody is arguing that Article 8 has not properly been implemented by the 2003 Act.

MR. READ: No. But, it has to be applied. That is the point we are making.

THE CHAIRMAN: You say it is a directly applicable duty on Ofcom from Article 8.

MR. READ: Absolutely. If, as a result of the purported exercise of a discretion you end up effectively relegating it down, and that was an otherwise lawful approach, we would say that that is wrong. Of course, I suppose the same point applies in respect of the tribunal. Just because the tribunal is caught by Article 10 as well, as a further organ of the State, in its approach to it. At the end of the day I do not think a huge amount is going to turn on this, simply because we say that Ofcom's approach is so fundamentally flawed that it does not, at the end of the day, probably add a great deal.

The final point I wanted to make in this respect is the effect of Article 3 of the Access Directive. Article 3 is dealing with the general framework for access and interconnection. This is H1, Tab 4.

"Member States shall ensure that there are no restrictions which prevent undertakings in the same Member State or in different Members States from negotiating between themselves agreements on technical and commercial arrangements for access and/or interconnection".

We accept that that is obviously the starting point in the communications industry - that there ought to be restrictions avoided. We say that that is exactly what Ofcom is actually doing in this case by the way that it is emphasising that absent the E-To-E obligation, there is no restraint at all on the prices that the MNOs can set. We say that particularly when you come to look at the end-to-end connectivity obligation as well, that is a fundamental error that effectively Ofcom have put a constraint on BT's ability to negotiate.

That has really covered Article 8 and the focus on *ex ante* obligations.

Can I turn finally, on this dispute resolution part, to the issue about the 2004 market review? We have made clear from the outset that dispute resolution cannot, and should not, act as a substitute for market reviews. What we say Ofcom has done is to shackle itself to a decision it took nearly three years earlier. Ofcom may seek to deny it in their defence, but we say that is precisely what they did, and you can see from some of the passages I have taken you to - particularly those ones on 6.18 - that the key point that they looked at was this fact of achieving consistency with the 2004 market review. Other references can be seen at Bundle B, Tab 4, p.23, para. 4.20 and para. 6.24 and 6.25 at pp. 45 and 49.

Can we start by looking at the status of the 2004 review? What it concluded was that there was no specific regulation of 3G voice call termination -- any need for 3G voice call termination services at present is required. I will just give the reference: para. 5.32, Bundle F1, p.123. In other words, Ofcom was certainly not ruling out the need at some stage in the future to reconsider 3G voice call termination charges.

That position was adopted at the time because then there was only one MNO actually providing 3G - and that was H3G. There were a limited number of subscribers. We understand it was 0.75 percent of the total mobile subscribers in the UK at that stage. The other point was that, of course, at that stage they did not have any cost information relating to the 3G voice termination because it was at a very early stage and they were unclear.

As it happened, the European Commission disagreed with Ofcom's assessment as to termination, and that can be seen, I think, in the 2004 market review at paras. 5.40 to 5.42 in Bundle F1, pp. 124 to 125.

Then Ofcom observed this,

"It is possible that during the period of the next formal review of mobile voice call termination markets 3G voice call termination may establish itself to such an extent that Ofcom may need to reconsider its position subject to satisfying the relevant tests, such as s.47(2). Ofcom retains the power to impose an SMP condition to address concerns with 3G voice call terminating charges at a point after the publication of this statement".

That is para. 5.47 at F1, p.125. The point, we say, is that it was very clear in the 2004 statement that Ofcom were recognising that 3G was a market which could expand, which they may have to review, which was not necessarily going to stay the same. As a result of that, we say that that is a very important factor when you come to consider why you should tie yourselves into something which you recognised at the time was not going to be at all set in stone, and likely, in fact, to change over the following years in any event.

As it happened, of course, events overtook the matter because, of course, the next price review was scheduled to be completed in March 2006, but in fact it was extended and, as a result, as we now know, it was not actually concluded until 2007. Of course, as it happens, these determinations all arose in that extension period. Can I make one point on this just to illustrate how we are adopting points in our skeleton argument which I do not necessarily want to spend time going through. One of the jibes that Ofcom makes is that none of the parties objected to the extension at the time - 2006 - 2007. We say that that is a complete non-point: (a) it does not affect the position in resolving the disputes; but (b) in any event, why on earth should people necessarily assume that what might, or might not, come out of a

2007 market review should affect their position when it comes to dealing with dispute determination? In other words - to use the phrase that was thrown about last week - it is a Jury point, in our respectful submission.

THE CHAIRMAN: At the time that the decision was taken to extend it for the year, were the 2G/3G MNOs charging blended rates?

MR. READ: They were charging blended rates, but of course, as you may recall from the Orange case, was had actually happened was that Vodafone had started this, there had been an issue about how they were doing it because nobody had actually cottoned to this, so Ofcom, I think it was in January 2006, said that Vodafone had got to circulate the information round. It was only, as we know from the Orange preliminary issue, that it is in May and June of that year that the price rises start coming in from the other MNOs. It is, in fact, at that period that it starts to rear its head. If you recall, there was that period in July 2006 when first BT first accepted Orange's OCCN and then it rejected it because it had just been hit from T-Mobile and O2. So it is July 2006 that it comes into focus. As far as I am aware, that was after the extension had already been made for the market review period. We will check on that but I am pretty certain that that is the case.

MR. SCOTT: The date of 16th December 2005 is the extension statement, and 26th May 2006 Orange serve their OCCN on BT, 10th July BT accept the Orange OCCN, 19th July BT serves OCCNs on Vodafone and Orange.

THE CHAIRMAN: At what point did it become apparent to everybody that Vodafone was charging a blended rate?

MR. READ: I think it is January. It was January that they were actually blending their rates. I think Ofcom required them to send a letter out in January, or it may have been an email, 2006. That is the first time that the parties become aware of this potential problem. Of course, at that stage it is not entirely clear, because of the fact ----

THE CHAIRMAN: Just remind me what reason was given for extending it for the extra year?

MR. READ: I think the problem was the question of obtaining the costs information. Perhaps we can check on that and come back to you.

THE CHAIRMAN: Yes.

MR. READ: In any event, we say there was nothing within the 2004 review. We do say that that is really, in reality, a jury point. It is one thing to say that the parties may have, if you like, not pursued their rights in respect of a prompt market review, but that does not actually necessarily mean that they are saying, "We want to restrain our rights if we actually have to

come back to you under dispute resolution powers in dealing with that". We do say that that is a jury point. It would be pursuing it on a hypothetical basis, in effect.

It is important then to focus on the factors that have actually changed since the 2004 review and we do ask the tribunal to read again Mr. Budd's evidence on this where he sets out four very cogent reasons for saying that there has been a substantial change in the market since then. I will just identify them with the references rather than taking you to them. The first is that there has been an extensive increase in 3G network coverage because, as you will recall, there was only one MNO at the time of the 2004 review, but by 2006 there was something approaching 50 per cent national coverage with 3G having 90 per cent national coverage. That is what he says in paras.15 to 18 (D1, tab 5, p.275-276).

Secondly, he indicates that the customer base seems to have radically increased from 0.75 per cent in 2004 to 7 per cent by 2006, which is a point he makes in paras.19-24, pp.276-79. He says that that is actually a 1,750 per cent increase from what it was previously, if that is the correct way of applying the percentages.

THE CHAIRMAN: Let us hope we do not have to decide that.

MR. READ: He also makes the obvious point that whereas there was no costs information in 2004 there certainly was by 2006, because that is the very process that Ofcom were going through in the market review. He makes that point at para.27.

At paras.28 to 38 he makes the points, and I do not want to take a long time on this, but whereas the adverse effect on customers was likely to be small in 2004, by the time you come to 2006/2007 it could have an enormous impact on the end user's position. We say that that is obvious if one just stands back and thinks about it. We know that 3G rates were, on average, about two and a half times higher than for 2G, and in this regard we think that is confirmed – I will not take you to them because they are confidential documents but I will just refer to them – by the figures that are annexes 1 and 2 of Altnets, or Fixed Network Operators' skeleton argument. It does make the point that, whereas in 2004 it was not likely to have a huge impact on consumers, by 2006 it was going to have a very substantial impact on consumers.

THE CHAIRMAN: I can see those arguments might be in favour of having a further MCT review, which is in fact what happened, but the only change in the market is only relevant to this dispute in so far as it is reflected in the charges which the MNOs are seeking to impose.

MR. READ: We say, madam, the reason why it is relevant in the context of this dispute is because of the way that Ofcom approached it. They tied themselves to the position they had taken in the 2004 market review. Plainly, when you look at both the 2004 market review,

what it said at the time, and what has happened subsequently, in our respectful submission it was a nonsense to have done that. It simply was not looking at the same playing field, let alone the same goalposts.

Perhaps I can tackle a point that I think may have been in your mind, madam, which is the suggestion in Ofcom's skeleton argument that, in effect, BT is trying to fill the gap between market reviews by using the dispute resolution process as a method for ensuring that prices can be kept under control. We say that is turning it on its head. Ofcom cannot turn round and effectively fetter its approach by saying, "Market reviews can deal with any problems to end users or distortion in competition", particularly when there are going to be long gaps between those market reviews from one market review to another. It is a point that Mr. Richardson makes very clearly in his witness statement at paras.45 to 48 (bundle D2, p18). We say that that is an answer both to this whole question about tying yourself to the 2004 review and also the Competition Act complaints as well. Again, that is just not a process that is designed for it. Why, at the end of the day, when one is confronted with problems over competition and advantage effect in the context of the dispute, should one say, "We are going to take a Pontius Pilate approach to this and wash our hands of it because we can deal with that either under the market review or in the context of a Competition Act complaint".

I am getting requests, madam, as to whether we could have a very short adjournment for five minutes?

THE CHAIRMAN: Yes, of course.

MR. READ: I am up on my clock.

(Short break)

MR. READ: Madam, we will now move on to the End-to-End Connectivity Obligation and you will be glad to hear this is going to be a lot quicker. Can I make clear from the outset that BT is not arguing that the End-to-End Connectivity Obligation is *ultra vires* or liable to be set aside because of incompatibility, which we apprehended, at least in the alternative, that might be part of H3G's argument. We are not saying that, we are simply saying that the actual wording of the End-to-End Obligation with the reasonableness proviso is perfectly adequate to secure the CRF objectives and what BT says is that Ofcom is simply wrong about the construction it put upon it, and that is a constructional problem on Ofcom's part, not any inconsistency of it with any of the Common Regulatory Framework. I wanted to make that clear from the outset.

So can I look at the starting error that we say Ofcom made in looking at the End-to End Connectivity Obligation. We say that what they did was to function on the bare

functionality of the requirement on BT to purchase interconnection, as divorced from the price at which the interconnection was offered. That led Ofcom to view the issue of imposing any regulation under the dispute resolution powers, as falling solely on BT, and therefore left out of the equation the MNOs. It was not regulating the MNOs, this is Ofcom's approach, because the only thing Ofcom was looking at was BT providing physical interconnection. We say that is illustrated in para.4.42, for example, of the determination, (bundle B, tab 4, p.26) and I will read it, if I may, madam:

> "Ofcom expressed its views in the draft determinations that the proper construction of what constitutes a 'reasonable' charge in the context of a dispute about BT's End-to-End Obligation requires consideration of the purpose of that obligation. The End-to-End Obligation as imposed on BT to remove the risk of a potential market failure from BT refusing to buy call termination."

And that approach of focusing on the refusal to buy the interconnection, as opposed to any dispute about the price itself, that leads Ofcom in the determination itself to treat, for example, BT's rejection of the price that Orange and Vodafone wanted BT to purchase at, as being a refusal by BT to purchase at those prices, and that is clear from para.4.13 for example of the determination (tab 4. p.22).

We say that that is simply the wrong way of looking at it because we say that there was no real risk of market failure in this connection. There was a dispute about the price but the reality was that there was not going to be a failure in the market because the matter is going to be, as it was, referred to Ofcom. We say that that has been explicitly accepted, in the context, certainly of the Orange OCCN, and BT's response to it, in the Orange preliminary ruling, para.87, where it is made pretty clear that the dispute was about price, it was not actually about whether or not the physical interconnection would break down. It was not necessary to establish that the party subject to the obligation felt sufficiently strong about the subject matter of the dispute that it would have considered that it was or might be entitled to terminate the E2E connectivity. We say that is an absolutely realistic approach to this, because this was a spat about price, it was not a spat about people refusing physically to interconnect, and indeed, one cannot help but notice that in the period before the E2E Obligation was actually imposed in September 2006 the market still did not fail because everyone assumed that would carry on interconnecting, so we say the reality of the situation is that this was a dispute about price.

Indeed, we think that Ofcom may actually have conceded that in reality the dispute was about price because of something that Mr. Roth said at day two (p.9, lines 21-22) because he accepted that a dispute over price was the most likely source of the dispute.

MR. SCOTT: Just to clarify one point. There is a provision for terminating these agreements and, as we understand it, nobody gave notice to terminate it.

MR. READ: Absolutely, and of course the termination period is 24 months, so it would have been a very long period to have to wait in order to actually physically terminate it. So that is another key feature, as you rightly observe, as to why in reality this was never actually going to be a dispute about the physical interconnection, merely about the price. It is that focus on the physical interconnection, we say, that leads Ofcom to the assumption that it is only focused on the regulation of BT and not the MNOs.

Paragraph 6.3 of the determination at B, tab 4, p.45, Ofcom say this:

> "The End-to-End Obligation is one that applies to BT and should not be used as a means of effectively imposing regulatory burdens on other providers who are not subject to the End-to-End Obligation (including suppliers of termination)."

So there we say you have Ofcom identifying the regulatory control being solely on BT and in the end nothing on the MNOs, so in other words it is balanced, focused, entirely on BT. We say that is wrong because H3G (1) makes clear that in resolving a dispute Ofcom is acting as a regulator (para.138(b)). Thus in the context of a dispute about price, the price is being imposed on both parties, and therefore there is a regulatory obligation as a result being imposed on both parties. We say that it absolutely flows from that, that once one gets to the stage of accepting that price is a two-way thing, you have both the issue someone paying for it, and somebody demanding it. In other words, it is a price that affects not just BT, but affects the other party, then that is almost the complete answer to why Ofcom's focus in this dispute resolution was wrong, it was not looking at the consequences of regulating the other side of the equation on the MNOs, it was solely focusing on regulating BT. One identifies this particularly, for example, at footnote 5 of Ofcom's skeleton argument (A2, tab 2, p.13):

> "There is nothing in those provisions, or in Art.20 FD and Art.5(4) AD that requires Ofcom to *adjust* disputed charges in order to resolve a dispute."

But if you agree the price that the MNOs have asked then you have adjusted the price, you have adjusted it in favour of the MNOs. If you have two parties negotiating and one wants one price and one wants the other and you, as regulator, come along and are to resolve that, which ever way you go, whether you give one party all that he wants, or the other party all

that he wants, or something in the middle, you are adjusting the price between them, and therefore, you are necessarily looking at both sides of the equation.

Now, we do think that Ofcom may actually have been in a position of conceding this point because I will cite part of the transcript to you from day two, p.18, line 1. There was the following interchange - I do not know whether the Tribunal actually has the transcripts.

THE CHAIRMAN: Well does Ofcom want to say whether or not it is conceding this point. Perhaps you could just say what the point is again, Mr. Read.

MR. READ: The point we make is that in setting a price under a dispute determination process you are necessarily regulating the price that is charged and the price that is paid, and therefore the price relevant to both parties.

THE CHAIRMAN: This, you say, was a point that they made as against H3G in the SMP part of this case.

MR. READ: Yes, madam.

MR. ROTH: Yes, we do accept that, and I will develop the implications of that further in due course.

MR. READ: Well that helps to at least narrow the parameters within which we are working. We say that once that concession is made you necessarily accept that the price determination is a two-way process, and therefore any price that you set for the MNOs is fulfilling a regulatory function, and therefore you have to have regard obviously to all the other requirements.

It is really a two-way process, that if you are saying a price is reasonable, and you are being asked to look at that in the context of regulating both sides of the equation, then you necessarily have to look at both sides of the equation because in gauging what a reasonable price is you are regulating it for both sides of the equation, you have to be looking not only at the effect on BT, but also the effect on the MNOs, as well.

Now, we say that it is that failure to do that that leads to this erroneous price that you can set a price appreciably above the competitive level. BT says that if you have reached that conclusion your reasoning must have been fallacious to have got there in the first place, because you are setting a price between the two parties and you are effectively supporting that balance between them. We say that the result of that is this focus that allows them to come up with the gains from trade test where you are only focusing on the result vis-à-vis one party, and really in sense that is almost the end to point on this part. If you are regulating both sides of the equation you have to look at the context of reasonableness in the context of both sides of the equation. That is where one moves on to this rather bizarre way

of describing reasonable price as being one that somehow applies to the upper band of the price that is imposed that is reasonable to impose upon BT.

With respect, that is almost suggesting that you can have a reasonable price for one party and a different reasonable price for another party. If you are merely looking at the upper bound that you set on BT, you are ignoring the position vis-à-vis the MNO on the other side of the equation. Obviously in all of this, madam, we pray in aid all the points that I made earlier on about Article 8 and how that ought to apply to it, and Article 5(1) as well, which requires specifically a reference to the promotion of efficiency, sustainable competition, etc., etc.

It also, in our respectful submission comes back to the Article 3 point that I made at the end - which is that if you are imposing this one-sided, lop-sided view of the equation, then actually you are constraining the parties' ability to negotiate because BT is being forced to buy without looking at reasonable price in the context of looking at the other side of the equation.

Madam, this is almost an Alice in Wonderland effect - that somehow you look at the physical interconnection, and that that leads you on to focus solely on the price from BT's point of view and ignore the price from the MNOs' point of view. One has to say that surely there must be something that has generated an almost Alice-in-Wonderland look at the end-to-end connectivity obligation. I think it is necessary here to look a little at the motivation behind Ofcom's approach. Although I do not want to be too pejorative about it, I think the genesis of this test helps explain why Ofcom's focus has fallen into error. We say it is a direct result of Ofcom's approach to the market review. One can see this if one looks, for example, at para. 5.161 in the market review. It is a passage you have been referred to several times. I am not very keen to take you back to it. However, the reference is Bundle B, Tab 1, p.101. There, Ofcom considers the expectations of a party to a dispute. If a charge appreciably above the competitive level were in dispute, Ofcom would be unlikely to impose a charge for MCT that was not appreciably above the competitive level. In other words, Ofcom was likely to set a charge appreciably above the competitive level if there was a dispute resolution.

So, one sees from the market review that this was being used as a justification for saying, "Well, H3G's arguments about, 'It will all be constrained by the dispute resolution process' were incorrect because in fact Ofcom would not necessarily set a price at a competitive level in the context of a dispute resolution". Indeed, to the contrary, we have set one

appreciably above it. That was confirmed in Ofcom's oral arguments on Day 2, p.26, l.17 onwards.

> "There are various ways, in any event, that this tribunal may hold that Ofcom should act in resolving those disputes. But, it is critical that for present purposes in order to sustain their [H3G] argument that the dispute resolution power of Ofcom in itself precludes SMP, it must be on the basis that disputes resolution always results in a determination of the price which means that the supplier cannot supply at appreciably above the competitive level".

Then he goes on to make the point that Professor Bain made about the competitive level being at cost based price.

"We will be submitting in the TRD appeals that this is not a proper interpretation of dispute resolution. So, there is no basic error in the various passages in the MCT statement that H3G relied upon". One of those was the paragraph I have just given to you.

So, it is almost as if the genesis for this test of looking solely at BT and allowing the prices to be set above a competitive level came about as a result of its approach in the market review.

For all the reasons that Mr. Anderson expounded so eloquently on Tuesday, we do not say that H3G's arguments are correct. But, we do say that as a result of the approach that Ofcom took in the market review they managed to constrain their approach to the end-to-end connectivity obligation in the context of this dispute. As a result, madam, we say that that may be one of the issues that skewed the whole of the approach to the end-to-end connectivity obligation wrongly in these determinations.

In any event, even if I am wrong about that, the key point is that one is looking at it in the context of this dispute, and the facts of these disputes, and it is difficult, we would say, to think of a circumstance where it is more important to actually stand back and say, "Are these prices that distort competition, or are they achieving the Article 8 framework?"

That is all I want to say about end-to-end connectivity obligation.

I will move on to the third complaint, which is the erroneous methodology. We have effectively identified three serious flaws, we say, in Ofcom's methodology - namely, the gains from trade test, the focus on blended rates, and the refusal to consider other relevant material, in particular, 3G cost information and international benchmarking. I am going to deal with each of those in turn, and I am going to start with the gains from trade.

I think it is important to start by looking at how Ofcom actually deployed the gains from trade test. I think it is important to make four points: (1) the test was employed as a means

of gauging whether the charges were reasonable. That can be seen from para. 4.67 of the determination at B4, p.30. So, in our eyes, in the gains from trade test, the starting point has to be whether the test can achieve a proper consideration of reasonableness.

(2) It is an assessment of the incremental cost to BT of providing fixed mobile calls to the relevant MNOs, comparing the proposed charges of the MNOs with the BT revenues associated with those calls. In other words, it is an incremental test looking at the break-even point -- the margin that BT actually has. One can see that at para. 4.57 of the determination.

(3) Ofcom looked at the test in two stages. They made firstly an assessment only be reference to the actual downstream cost levelled by BT (one sees that at para. 4.59 of the determination). It is what Mr. Keyworth I think describes as prevailing prices for the GFT test. They then went on to make the assessment on the basis of whether BT had the potential to increase its own prices in response to increases in the MNOs termination rates. We see that from para. 4.61 of the BT determination. I am going to call that - and it has been called it throughout - the pass-through assumption.

THE CHAIRMAN: Mr. Keyworth calls it the variable.

MR. READ: Absolutely, madam.

THE CHAIRMAN: Let us try and stick to that terminology so that everybody knows what we are talking about.

MR. READ: I am happy with either. I think it is fair to say that the pass through assumption is the one that is used in the determination. So, perhaps one ought to stick to the pass through assumption. It is also obviously described by Mr. Keyworth in those different terms as the variable prices to the GFT test.

Following on from that, obviously there are very real concerns expressed by BT and H3G and Cable & Wireless about the merits of this test, but we see that it continued throughout. If you want the references, that is 6.2, 6.13, and 7.2 of the determination. The fourth point is that Ofcom use the blended charge rates as the starting point. That is a point we will obviously come back to. On the basis of that, the four 2G operators passed the gains from trade test for the prevailing prices gains from trade test on that basis. I will come back to why we say that is erroneous because of the focus on the blended rates in due course.

However, vis-à-vis H3G, the proposed charges only pass the gains from trade test by reason of the pass through assumption. It may be worth looking at what the pass through assumption meant in practice by looking at the determination at 4.88 and 4.89.

THE CHAIRMAN: Do we need to go to that? I think we all understand that.

MR. READ: Madam, can I make just two points about it? The point is that because BT have the potential to pass the increase through, the test was met.

THE CHAIRMAN: That is the potential under the contractual framework.

MR. READ: That may be a conclusion that one can draw from the way that Ofcom subsequently dealt with the retrospective charging issue.

THE CHAIRMAN: That is a different point.

MR. READ: That is a different point. I am not sure that it is actually explicit in the determination that they were hanging it on the precise contract. We would say that they certainly must have been because that is how the retrospective charge comes into play in this. It is not a separate issue as Ofcom seeks to suggest. It is, in fact, a direct consequence of a view they took on the contract construction. So, from that it is implicit that they must have been working on the principle that BT could pass the charges through. But, what undoubtedly was recognised by Ofcom in the course of the determination was that BT probably would not be able, in fact, to actually pass the charges through. In other words, because of the focus on the potential to pass the charges through the test was met, but it was done in the knowledge that in fact the charges were not being passed through, and we say that is clear from para. 4.88 to 4.90 of the BT determination.

What we draw out of that, in particular, is that there is almost an explicit acceptance there that in reality was not going to make a profit out of this. It was not simply that they might have made a profit out of it, but actually it was done in the knowledge that BT would not make a profit out of it. We say that that just shows in itself that there is a degree of unreality.

We say that the test in itself was flawed, and because it is flawed it means manifestly that you cannot produce a reasonable result. If it is a flawed test, you cannot end up with a reasonable result. I will come back to that in a while, but I do preface it up by linking it with that last point - that in respect of H3G it manifestly was not reasonable because BT simply were not in a position to actually make a profit. We say that that in itself is a feature for saying, "Well, if this is the result of the test, how can it possibly produce a reasonable price?"

But, if one looks at the theory of the test - and I do want to do this by reference to Mr. Keyworth, and so it may be useful to have his report open at D1, Tab 7, p.623 -- I want to draw out twelve points from this evidence. I will not necessarily read the whole of it, but I will just refer to the paragraphs as we go. Firstly - and I think this is probably self-evident - as he says at para. 19 at p.629 "This was a binary pass/fail test". He makes clear there is no

sophistication involved in this in trying to weigh the nature of the MNOs proposed increases. It is a mechanistic test. It is a "yes/no, pass/fail test". We say that that in itself is a factor that suggests that it is not actually achieving a reasonable price, it is simply resulting in a mechanistic unfocused, unprincipled test when it comes to gauging what a reasonable price is.

Secondly, he makes the interesting point at para.25 that there is no reason to believe that a monopoly price would fail the gains from trade test. We say that if that is the consequence of this particular test then how can it be compatible with the objectives set out in Article 8 of the Framework Directive and elsewhere to ensure that competition is not distorted.

Thirdly, as we have already indicated, it takes no account of how much profit BT may make provided BT makes a minuscule profit just above the break-even point. One can see that, for example, in para.20 of his report where he is dealing again with that pass, fail test. We would suggest that a test that simply does not look at the levels of profit that the respective parties to the equation may actually be making again cannot be consistent with a purpose of trying to set a reasonable price. If you take no account of how much someone is actually making in the context of a dispute, or at least looking at it, and you go out of your way saying, "This test is passed provided he makes the break-even or just above break-even", we say that is not a proper assessment in reality of what a reasonable price is.

Fourthly, he makes the point that it does not – and this is the point I have already touched on – even show that BT will make a gain from trade, only it might have if there was a potential to increase the prices. He makes that point at para.28 in his report. He expands on that in para.41 where he says in terms that it is not a commercially realistic test.

THE CHAIRMAN: Just go back a moment, they are not saying that you should not earn any profit from this because pass through could apply even in a case where there was a bit of profit if BT decided it wanted to make more profit. So the assumption that you can pass through the price is not only relevant in the situation where, on the actual price, you do not make a profit, but would also apply if you felt your profit was unduly squeezed by the price that you were having to pay. I do not think it is an assumption that you should not make a profit on this.

MR. READ: The starting point for it is that you start by looking at whether the price is sufficient that BT can actually make a profit – in other words, it is not just breaking even on that. It is only once you have failed that part of the test that you make on to the pass through assumption. In other words, the pass through assumption is necessarily a residual part which only comes into play if you start making a loss. It does not deal with the first part of

gains from trade test, as they have applied it, which is to say how much profit BT may actually make out of it. What, in essence, Ofcom is saying is that providing BT makes just sufficient profit then it has passed the gains from trade test. It does then, if you like, bring the pass through assumption into play, because the pass through assumption only comes into play if you have already failed that part of the test – in other words, BT have not made a profit. It is only then you move on to the pass through assumption. I do not think, with respect, madam, that ----

THE CHAIRMAN: I see what you are saying, that the gains from trade test, in order to apply it, you have to assume that the price, the BT charges, is static, otherwise you cannot apply the test at all. You only regard it as potentially increasable if you are moving on to the second stage.

MR. READ: The fifth point that Mr. Keyworth makes in para.42 is that it also takes no account of how the test plays out in future scenarios, because it assumes that prices can be passed through with the effect that that may have on attendant negotiations. One sees that in particular at para.42 of his report.

Sixth, it takes no account of the effect on volumes of call because, as he indicated by his graphs earlier on, or as is clear from his graphs earlier on – I think he makes the point in para.29 of his report – this test is passed providing BT continues to make a profit. It takes no account of the fall-off in the volume of traffic.

Seventh, he makes the point that this is a unique use of the gains from trade test, that it has been used in the context of international trade in the past in a very different way. I think Ofcom themselves accept that it is novel being applied in this situation. They say that that is not a reason for rejecting it. We have put it round slightly the other way, if you are using an economic concept in this way, we do not say novelty is fatal to it but we do say that if it is completely untried it does become a strong pointer to the fact that it may not be an appropriate test. There may be a very good reason why nobody has come up with this test before and used in this particular situation. It is not fatal, we agree, but it does reinforce the point that it may well be, in itself, be an indication of why this is a flawed test.

Next, madam, he makes the point in footnote 19 that the test solely focuses on the position of BT, and this links in obviously to the way that Ofcom have interpreted the end-to-end connectivity obligation, as we say, wrongly. There was nothing in the original draft determination that at any stage suggested it was looking at anyone else other than BT. We know that by the time we got to the final determination various of the MNOs had objected and said in terms that it is wrong, it should be applied to the MNOs. We end up in para.6.15

of the determination with Ofcom then purporting a gains from trade to the MNOs as well. In our respectful submission, and we have made this point at footnote 100 of our notice of appeal, it is really impossible to see how that approach can ever provide any meaningful information. All they are saying, in effect, is, "The MNOs must have been making a profit because they would not have asked for this price unless they were making a profit". It is self-evident that any MNO requests is actually going to be set at a level providing an MNO with a profit unless there is some pretty clear indication to the contrary.

It is a circular argument, because it is simply confirming the result that you already wanted, which is to say, "We will let the MNOs ask for whatever price they actually want and therefore they must have been making a profit because they would not have asked that price unless they were making a profit". It is simply a non-point. It comes back to this fact that the test itself is necessarily focused on BT and nobody else.

Next he makes the point in paras.44 and 45 that the gains from trade test takes absolutely no account of the impact on BT's downstream customers, which includes both transit and retail and the customers of those customers and the ultimate end users, the consumer. The reasonableness of the charge is simply not considered from the perspective of those downstream customers. Firstly, we say that is contrary to Article 8 for all the reasons I have rehearsed earlier; but secondly, it is a very odd test, when you are looking at a reasonable price, and it reinforces the point we were making earlier, it is simply looking at BT and there is no assessment of what is going on in the rest of the price structure up and down the line in terms of prices being passed on.

As Mr. Keyworth does point out, the annual revenue from mobile call terminations in the order is in the order of £2.5 billion, and therefore any variation that an MCT charges could potentially have a material and significant effect on BT's downstream customers. This was not a situation where one is looking at relatively small sums. Minuscule movements in the price could actually make quite significant differences downstream.

Tenth, at para.47, Mr. Keyworth makes the point that – and it really follows on from that ninth point, he makes it again in para.47 – because of the effects of prices going to downstream competitors the changes to the termination charges has the potential to materially affect the prices of those competitors and therefore their ability to compete effectively. We would say there are three areas where this could potentially impact. Firstly, you are dealing with the effects between fixed and mobile operators because obviously BT, being a fixed network hub, as we have seen by their presence in court, it has an effect on the fixed network operators further down the line, and increases in the mobile network

operators' charges have the ability to distort the prices between the fixed and the mobile network operators.

THE CHAIRMAN: The transit prices that you can charge, those are not regulated – is that right?

MR. READ: I think one set is single transit and one set is not. That is the position. Some are regulated, some are not. I think one has to take this in stages because as regards retail customers there are different considerations – BT's direct retail customers have different considerations.

THE CHAIRMAN: Yes, those are not regulated prices.

MR. READ: As regards the transit customers, some of the calls will be regulated, some of the calls will not, and I think that is the point because it will depend upon whether it is single or double. Perhaps I can clarify the position over the short adjournment, rather than commit myself irrevocably at this stage.

Secondly, there is obviously the position between large and small operators. It is one of the points that BT makes at para.14(e) of its notice of appeal. Obviously BT's position in all of this is fairly central to the interconnection network. Indeed, Ofcom recognised that quite clearly in the course of the market review paper because they have said in terms that BT's prices effectively set the price for the market, or at least the ceiling (or whichever way you want to look at it) for the market.

Thirdly, it has the potential to distort interconnection because it favours, we would say, direct interconnection rather than transit through BT. If BT can be forced to elevate its prices vis-à-vis the MNOs, it makes it much less attractive to people to interconnect with them rather than going and seeking a direct interconnection elsewhere. We do draw on the fact that the very fact that the Altnets are here, the fixed network operators are here, with some vehemence demonstrates the problems that this gains from trade test actually generates, and you have the evidence that they have produced.

The eleventh point is that it is reinforced by the fact that Ofcom has taken no account of other material which might have a bearing on the reasonableness of the charge. That is developed by Mr. Keyworth at paras.49 to 54 of his statement, other than of course the previous 2G assessment which is, we say, inherently flawed anyway for reasons I will come on to when dealing with blended rates.

Finally – he makes this point, and it is a point I think I have already made – the fact that uncompetitive charges could be addressed in other circumstances does not make "reasonable" a charge that is unreasonable, and he makes that point in para.69 of his statement.

BT is worried about this test because it has already appeared in another instance, which is the 0870 number dispute. Madam, it may be worth just looking very briefly at that. I am conscious that I am using up my time, but I think it would be worthwhile having a brief look at that (bundle F4, p.411).

It basically is a dispute around non-geographic numbers for the 087 number range, but it is about termination charges and it involves a number of fixed network operators as well. If one picks it up at para.6.14, on p.469 you can see that it states Ofcom's approaches.

> "… Ofcom has considered the following approaches to assessing reasonableness in the context of these disputes:
>
> * Develop an understanding of the extent to which BT obtain gains from trade on the basis of the disputed charges. In considering this, Ofcom has also considered the extent to which, the risk of arbitrage opportunities would impact upon BT's ability to obtain gains from trade."

So we suspect that Ofcom is trying to have some regard to the flaws that we have highlighted already in the test by adding a caveat regarding arbitrage opportunities. Then if one goes on:

> * Develop an understanding of the extent to which a TCP would obtain gains from trade on the basis of the disputed charges."

And I think that is dealing with the point that gains from trade is only looking one way, and then undertake a benchmarking analysis.

Madam, I do not want to spend a long time looking at it, I just want to show and make the point that this gains from trade test is setting some form of precedent. Ofcom say: "We look at it in the context of each individual dispute, and I am quite sure that they will say: "Look at the differences that we are building into the test here", but when all is said and done it is quite noticeable that they have relied upon the exceptional circumstances clause in s.188 to withhold publishing a final determination obviously on the basis that because the criticism is being made in the gains from trade test they do not want to commit themselves to another gains from trade test until they have actually heard whether or not it is right. We say that this is quite an important illustration of why the test has to be put under the microscope in our respectful submission.

That point is also made in Mr. Richardson's statement where he sets out, and I will not ask you to look at it, in paras.22-29, D2, p.10, he deals with the issue of the potential effect on other markets of the way that Ofcom has approached it.

Obviously, BT says that a number of these flaws arise from BT's failure to approach it from the proper way of the dispute resolution process. In other words, they have not looked at it from the point of view of Article 8 and so on. But in any event we say that this test is flawed and it is flawed for, in summary, some very important reasons.

THE CHAIRMAN: Well are those the same reasons that you have just gone through?

MR. READ: They are more or less, and I am keen, obviously, not to repeat myself. I am conscious of the time and so I will park that to one side. If there is anything else that I feel one needs to look at I will ask you to do so. I do want to focus now on the practical effects of it, because we say that all goes to the flaws in theory, why the test is flawed, simply on a theoretical basis, but also one needs to see what the practical consequences of this test are. Perhaps the clearest illustration of that is at para.139 of Ofcom's defence, which I would ask the Tribunal very briefly to look at (D3, tab 6, p.157)

As one can see it is talking about H3G charges.

> "As regards H3G, the charge proposed in November 2006 was indeed high; and it is possible that if the charge had been accepted by BT, and passed through to consumers, it may have infringed Chapter II and/or Article 82 EC. In such circumstances, Ofcom would have considered using its powers under the 1998 Act to impose interim measures to suspend the charges pending a full investigation. However, given that (a) BT did not accept the charges, which were therefore not passed through to consumer; and (b) for the future an SMP charge control would apply with effect from 1 April 2007, Ofcom did not consider, in such particular (and unusual) circumstances, that it would be appropriate to open an investigation under the 1998 Act. Nor have any of the parties suggested that it should have done so. If a situation arose in which Ofcom was faced with potentially excessive charges and it had not recently completed a market review, it would consider postponing resolution of the dispute on the basis of exceptional circumstances under s.188(5) and initiating a market review in order to address the excessive pricing."

Madam, one only has to look at that statement to say ----

THE CHAIRMAN: "… the charge proposed in November 2006" is that the 16.6 pence?

MR. READ: Yes, that is right, madam, because what happens is BT issues an OCCN effectively trying to reduce the prices and then we get the November, we say 'letter' but we are not taking that point, we will call it an 'OCCN', in November raising the prices, which as we

know is in the region of 150 per cent above the 2G price levels. I will come back to that point in a little while.

We say this, first, it accepts that at the very least it could lead to the potential distortion of competition, so much so that there was the possibility of a competition complaint. It follows, therefore, we say that if BT had actually passed these charges on it would have had a real impact on end users because what Ofcom are saying there is the reason that they did not pick up the complaint, or consider it as a complaint, is because BT did not pass the charges on. But it follows from that matter that Ofcom is accepting that BT would actually suffer a loss, because it is saying in terms that these prices may have been potentially excessive if they had been passed on, but then accepts that actually BT did not pass it on and therefore there was not a competition particular angle, but it is implicit from that that actually far from BT making a profit it must have been making a loss, and therefore the gains from trade test was not being associated with reality, and we say there is a commercial unreality about the test.

We also think that you can see ----

THE CHAIRMAN: You say in the third line: "It may have infringed Chapter II", that is BT may have infringed ----

MR. READ: No, that is H3G I think it is referring to, because it is their charges.

THE CHAIRMAN: "As regards H3G …it is possible that if the charge had been accepted by BT, and passed through to consumers …" is the "it" "charge"?

MR. READ: It may simply mean the charge – the charge to consumers.

THE CHAIRMAN: But an abuse by whom then? Well it is not your document, it is perhaps unfair to ask you.

MR. ROTH: You are quite right, madam, it is not well phrased, it means H3G, the "it" is not grammatically correct.

THE CHAIRMAN: Well perhaps we will take this up with Mr. Roth later. The point that you want to make from this is a fairly short one then, Mr. Read?

MR. READ: Absolutely, and I will come back to this in a short while, but Ofcom actually went further in the course of their submissions to you last week, but in any event we say that that is the clearest instance you could possibly have of saying that this obviously cannot be a reasonable price if you are ending up with results like that.

MR. SCOTT: Mr. Read, just one follow-up point on that. Were BT to have accepted that price on the basis that it could pass it through, do you think that BT would have been exposing itself

to a risk of being accused of abuse of a dominant position if H3G could have been so accused?

MR. READ: I think the answer to that maybe that if it was not charging above its costs it would not necessarily leave itself open to a Competition Act complaint.

MR. SCOTT: Even if it had agreed those costs with another party? It may not matter.

MR. READ: The point that is going through my mind, and I am trying to get from my very learned Junior, who is much more suited to answer questions like this, but there is the question of whether or not there might be a joint dominance being exercised here if BT simply goes along with what H3G ----

MR. SCOTT: That is the point that arose in H3G (1) and we may need to come back to that.

THE CHAIRMAN: Well your point is that one ought not to be in this ball park if you are engaging in dispute resolution as a regulator.

MR. READ: Absolutely. It is totally inconsistent with proper exercise of dispute resolution powers. It illustrates as a specific example how the test was necessarily fundamentally flawed.

Madam, there is quite a lot of evidence in the case before you about the precise effects that this is actually having in practice, and the result ----

THE CHAIRMAN: I think you did refer us to that at the beginning.

MR. READ: I did refer you to some, there is more. I am conscious though that if I take you to it I will probably go over ----

THE CHAIRMAN: Perhaps you can just give us the references?

MR. READ: Well madam perhaps what I can do is just summarise the references and we will put it in a written document so that you actually have the references that we are looking at because it would actually physically take me some time to go through the references and the effects on it.

THE CHAIRMAN: Yes, okay.

MR. READ: So I will go over about six pages of notes. I think the basic points are driven in para.14 of the notice of appeal and I think that most of the references are there, although they will not necessarily be to the bundle references.

THE CHAIRMAN: Well if you want to check that and let us have the document.

MR. READ: We will check through, and it may be that we have, but I think the short answer is that one can see what most of the effects are from para.14 of the notice of appeal.

Madam, that leaves me a short canter through blended rates and ignoring relevant material, and a very short canter on reasonableness, I think I can do those probably in the space of

about 40 minutes, and then I can come back and still be within my four hour time period, finishing by 3 o'clock, to deal with the points on 115 in our notice of appeal, so if that is a convenient time to adjourn?

THE CHAIRMAN: Yes, so we will resume at 2 o'clock.

(Adjourned for a short time)

MR. READ: Madam, can I just deal with two short points on evidence that I have been reminded about. The first is that when I raised the issue of whether the evidence may have been higher than was in the witness statements, I was simply putting that in the context of what Ofcom was saying about the evidence. We, on this side, say our evidence is absolutely accurate about this, and that therefore it has not been challenge, and that therefore you rely on the evidence as it is actually in the witness statements. When I was making those comments - in case it has come out wrongly on the transcript - I was saying that that is what Ofcom say the effect of some of this evidence may be - that it may, in effect, have been overstated. We do not accept that, but ----

THE CHAIRMAN: I understand.

MR. READ: I have been nagged by both sides to make that clear. The second point is that I just briefly wanted to mention some references to adverse impacts on consumers - in particular, Mr. Richardson's witness statement at paras. 30 to 43 in Bundle D2, pp.13 to 18.

Having said that, madam, I will move straight to blended rates. Can I deal with the point that seems to have been suggested - that BT was seeking to challenge the blending of the rates themselves. BT was not. It was only saying that the critical issue involved in all of this was whether, if you have an unreasonable component of a price - to wit, the 3G element - whether or not that necessarily impacts upon whether the overall price for the particular item is reasonable or unreasonable. It was in that context that BT was putting it forward. There does seem to have been a suggestion that crept into the determination, saying, "Oh, it's difficult to keep the charges for the 2G and 3G components charge separately. That is why BT had to be charged the blended rate" - which one sees, for example, in para. 4.29 of the determination. The suggestion was that somehow BT was saying that it needed to be charged separately in respect of each item of calling between the 3G and the 2G rates. We were not saying that. We were focusing on the blended rate, and simply saying that if you have one element which is unreasonable, it does not necessarily mean that because it is swamped by the reasonable element of it, that that makes the price overall a reasonable price. We say that that is the starting point for the whole of our submissions on this.

In fact, the example that Mr. Budd gives in his witness statement - you will remember, he is the internal BT economist - at para. 43 ----

THE CHAIRMAN: That is the white and brown eggs.

MR. READ: Yes. It is a very useful analogy because it does illustrate the point quite neatly about how one component within the charge may be highly unreasonable - in his case, I think it was the brown eggs - but the averaging and overall effect can make the total charge seem, a the end of the day, less unreasonable than it might otherwise have been.

THE CHAIRMAN: That depends on how many brown eggs the farmer chooses to put into the box because if he puts in four brown eggs rather than two brown eggs, then of course the average price goes up. Then it becomes important to work out, "Well, who determines how many brown eggs there are in the box?"

MR. READ: That is absolutely right. But, in our submission, it still does not detract from the other point which is that even if you only got two, rather than four, brown eggs in the box, you may have made the price be not quite so unreasonable as it would have been with four brown eggs, but it is still an unreasonable price because you have an unreasonable component within it.

THE CHAIRMAN: Yes. If the white eggs are being charged at the regulated 10 pence rate, then of course anything extra that you charge for the brown eggs takes it above the price of the dozen that it would be if it was just charged -- Now, if you were charging only 8 pence for the white eggs, then you could charge more for the brown eggs without it getting above the maximum regulated level. That is what we gather Vodafone were initially doing - they were charging a blended rate, but you did not notice because it was actually not above the regulated 2G rate. In those circumstances it might be right to say, "Well, don't worry about the fact that part of it is for brown eggs because overall you are not paying more than if they had gone up to the maximum for white eggs".

MR. READ: In some respects that is true, but I think what one is actually looking at here, of course, is white eggs set at 10 pence which was at the regulated rates. So, therefore, the inclusion of the brown eggs necessarily involves a substantially unreasonable component which we respectfully submit makes the whole of the price unreasonable. You cannot, if you like, make a price less unreasonable by trying to, in effect, reduce the scale of the unreasonable component (to use your example, reducing four brown eggs to two brown eggs). But, we say that there was a fundamental mistake in it in that if you merge it in the way you do - and then particularly when one goes on and looks at what Ofcom did in terms of their one way test to it - then you are going to come up with the answer, full stop.

In reality we say that it is solely because the brown egg component was, if you like relatively small - it was only about 5 percent - that in fact you end up with the suggestion that blended rates can in fact be reasonable. BT says that that cannot be right. One can see the scale of it from the material that has been produced. I will just refer to it because it is obviously confidential. Annexe 3 to our skeleton argument at Bundle A9, Tab 9, which seems to have been confirmed by, again, the annexes of the Altnets (although that is dealing with a slightly different point, but showing the differences between the relative pricing amounts) -- Of course, it all has to be put in the context that Ofcom was looking at this dispute in the context of the consumers and the end customers and the end users of BT, and the direct users of BT gain no benefit from the fact that it was getting brown eggs rather than white eggs because of the limited facilities that a fixed network operator could derive from the 3G network.

Both Mr. Budd and Mr. Keyworth make clear in their evidence that it is wrong to characterise this as not being paid in any commercially realistic sense. I particularly would ask you to look at paras. 60 and 61 of Mr. Keyworth's report at D1, Tab 6, p.639, and Mr. Budd's statement at paras. 47 to 51 in Bundle D1, Tab 5, pp.285-287.

I would like to make one or two other remarks about this. Firstly, Ofcom itself appears to recognise that 2G and 3G require separate and formally different regulatory regimes. They indeed have to go through the process of checking the 2G element in order to see whether or not there has been compliance with the rates that have been imposed on it. So, then, to completely ignore trying to cross-check against what is actually happening with the 3G rates as well, in our respectful submission, was simply not tenable. It is a point which Mr. Budd makes at para. 46 of his statement. Also, it is made in para. 65 of our skeleton argument at A9, p.26, and para. 61 of Mr. Keyworth at D1, Tab 6, p.639.

In reality, I think that is what the argument comes down to. I think anything else would probably be repetition.

With that, can I move then on to the other relevant information that was available that we say was there to give them benchmarking parameters against which they could assess whether or not the charges that they came up with were reasonable.

Firstly, we do start with the 3G costs information. It never has been part of BT's case to suggest that there should be some form of market review process gone through each time one has one of these cases. But, what we do say is that if you have the material there available, it is a nonsense not then to at least use it as a reference point when you come to assess a reasonable price, particularly when you are putting it in the context of a gains from

trade test which we have already indicated is a novel test and has potentially a number of flaws in it.

So, an exercise in benchmarking cross-referencing to the 3G costs information, in our respectful submission, is simply almost common-sense. That is particularly so because Ofcom was actually casting around. It makes this clear in its determination at para. 4.62, which is at Bundle B, Tab 4, p.29. It was looking for relevant comparators. It actually says in terms - and, of course, I have already taken you to the passage - that they rule out being able to benchmark against other MNOs because all the MNOs were actually already involved in it.

Now, if you are casting around looking for benchmarking, we would say that the obvious place to start is at the 3G material you already had. Ofcom appears to have alighted on a justification for not using this material by saying that it was gathered for a different regulatory purpose. You see that at para. 62.1 of their defence (D3, Tab 6, p.131). But, there does not seem to have been any regulatory reason advanced as to why Ofcom is prevented from using readily available information. That is a point we make at para. 78 in our skeleton argument at Bundle A, Tab 9, p.30. Indeed, we have to say that it does appear that they have used the information for certain purposes actually in the determination which I think can be seen at para. 25 of their annexe B, at Bundle D3, Tab 8, p.205. I do not think we necessarily have to look it up, but one certainly sees them referring back to matters arising out of the market review.

It is surprising, we say, because a substantial amount of this material was already in the public domain at the time that these determinations were being dealt with. One notes in this connection that Mr. Budd himself in his statement actually relies on some of the information from the published document of the market review. Of course, I accept that that was not necessarily crystallised at the time, but it certainly was in a format whereby it was readily available. So, it is not as if there was some inherent confidentiality which was preventing some of the material being used. That is picked up by Mr. Budd in paras. 65 to 71 of his statement in Bundle D1, Tab 5, p.294.

The other matter of some note in this is that, of course, Ofcom were perfectly happy to use TG rates for the purpose of benchmarking the information. So, they were using information resulting from one regulatory process in the basis of benchmarking, although obviously with the 2G material it is questionable/debatable about the way that they actually used it with their one-way test.

So, we say that it undermines really the whole of the way it has been put in para. 62 of the defence. For example, Ofcom say that it has no bearing on the gains from trade test and therefore is irrelevant. We say that it may not have any direct input into the gains from trade test, but it is a very useful feature for benchmarking it and seeing whether the gains from trade test actually has brought the matter into focus.

Again, you cannot help but note in this context the fact that in the 2007 market review Ofcom were openly acknowledging that when compared to costs the 3G charges that were then being levelled were substantially greater than Ofcom's estimates of efficient 3G unit costs for those operators. The reference for that is para.5.53 of the market review at bundle B, tab 1. It is also important in this context that it did appear to us in the course of the submissions made last week that Ofcom did accept that in this instance of these types of disputes a competitive level is likely to be a price that is related to costs – ie it is likely to be a price based cost. Do you remember, there was an interchange between Professor Bain and Mr. Roth on the second day of the hearing (transcript p.27, line 2) where Mr. Roth dealt with it and indicated that in this market it was likely to be related to costs.

THE CHAIRMAN: When you are comparing something with the benchmark, the benchmark being the rates that were set in the MCT statement, those rates of course are based on certain assumptions about what the proportion of termination is going to be on 2G or 3G, in the sense that there are different costs inputs for those different services, but do we know how those proportions compare with the proportions that were used in the blended rates that were approved under the TRDs?

MR. READ: One of the problems we have with this – we can hazard guesses – is that the costs information resides exclusively with Ofcom and there is a limit to how much we can put forward a positive case to actually deal with this by saying, "This is the price you should have come up with". The only price that we could possibly identify is the price for saying what Ofcom should have reached so as to pin it to the 2G prices which is of course what BT specifically did ask the context of its referral letter. If one moves away from saying, 2G must be the absolute core benchmark level to set the price, once you move away from that, then obviously the other information is very much within the domain of Ofcom. Whilst we can make points and have made points in the course of the evidence about how much more excessive 3G was than the 2G prices, or indeed – and this is what Mr. Budd has tried to do on the limited information that he has got – how much more it seems to be than the actual cost of 3G. It is not really feasible for us to actually come up with a figure and give the material involved.

THE CHAIRMAN: No.

MR. READ: What we say is that it is a useful counterchecking for seeing whether the rate is reasonable or not. It is certainly a very useful check to see whether a gains from trade test is sensible or not. Simply by ignoring it, at the end of the day it ignores the reasonableness of the price involved.

We would also say that the 2G rates are a useful benchmark. What Ofcom did in this case was that they actually ended up using it as what they call a "one way" test (para.4.65 of the determination at B4, p.30). They said that if the disputed charges were close to the 2G charges then that meant they were reasonable, but if there was a large deviation between the disputed charges and the 2G charges that did not mean they were unreasonable. We say that that is an absurd test and it almost comes close to assuming the result you want to achieve, "because if the result supports what we want to achieve then we will use it, but if the result does not achieve the result we want to achieve then we will ignore it".

Statistically it is rather interesting to see how you draw the confidence intervals at either end of the scale, but perhaps that is embarking one too far because, just looking at it logically, it is a nonsense. Mr. Keyworth makes the point in paras.56 to 61 of his statement at D1, tab 7, pp.638-69. He concludes it by saying that there is no basis that this comparison formed any useful or relevant function. We absolutely agree.

We say that it does show, and it showed very clearly when you came to look at H3G's charges, that H3G's charges were grossly out of sync with that benchmark. That comes back to para.139 that I have taken you to in Ofcom's defence. The only reason it did not have the same comparison and the same effect with the other MNOs' rates is because of the blended rates and the fact that the issue of the 3G element was lost by the averaging process which swamps the overall total on the figures. I do not think I need to go into that in any more detail. But we do say this: in the 3G case it was clear that there was this massive discrepancy between 2G and 3G, and then to ignore it on the basis that it is only a one way test is, in our respectful submission, just sheer nonsense, and it demonstrates the underlying flaws in the way approach the whole basis of ending up with a reasonable price in this particular case.

Can I then turn very briefly to the international benchmarking material, particularly obviously the European material. As we have seen, Ofcom has accepted that it could not benchmark against other MNOs in the UK market, so therefore it lost one of the opportunities it might have had for using a benchmark. Then Ofcom went on to completely reject looking at any other countries in the EU because, it was suggested, that these were

unlikely to be sufficiently reliable – this is the way it is put in para.4.64 of the determination at B, tab 4, p.30. BT made quite clear its concerns about this, but Ofcom still declined to attempt any benchmarking exercise (6.20 of the determination at B, tab 4, p.48).

BT says that this completely ignores obviously a very useful reference point, and we have made that point in para.103 of our notice of appeal at D, tab 3, p.105. It is particularly relevant here because, although one can simply say that it may be different in other countries, one is looking at a harmonised framework in which telecommunications are supposed to be developed. In other words, one is not simply comparing something completely different to something else, but all the European countries are supposed to be developing their telecommunications networks in a harmonised fashion. Therefore, one might think that at the very least there might be an inference that the material bid you might look at is not quite as unrealistic and incomparable as Ofcom seem to have accepted.

Mr. Budd has dealt with this at paras.57 to 64 of his witness statement (D1, tab 5, pp.291-293). Can I summarise these, I will not ask you to turn them up, at para.60 he makes the point that the very fact of regulation and the way it is imposed in other countries can provide a useful indicator and a useful comparison about how one might look at this particular question. He makes the point that of the EC 15 – ie before the new entrants came in – 13 out of those 15 actually had some form of regulation in place in respect of 3G. He makes the point that 3G only entities on the whole tended to be new entrants to the market, one of which is Xfera. Then he went on to look at the Spanish regulator's decision in *Xfera*, which specifically decided the price by reference to a benchmarking exercise. It may, madam, be useful just to look very briefly at the Cullen International report on this, because it does summarise it quite well. That is in volume D1, tab 5, p.416. This is a report of Cullen International about the position about the position in Spain in June 2007. It deals with Xfera mobile termination rates. I will not read it all to you but I will briefly summarise it by saying Xfera was a 3G new entrant in the Spanish market. There was an interconnection dispute with a subsidiary or an associate of Orange, Telefonia Moviles, France Telecom Espana and Orange, and Xfera were asking for a 48.82 per cent mark-up on the weighted average set for the other three MNOs in Spain.

What then happened was that the Spanish regulator, CMT, took into account and looked at the position on 3G in various of the other countries. I do not think the table is in this extract, but it is actually in Mr. Budd's statement which one can see ----

THE CHAIRMAN: It is para.60 of Mr. Budd's statement.

MR. READ: Yes, and it is figure 1 where he sets the table out. It is on p.293 in tab 5. It does show the basic process that they went through in comparing 3Gs. Obviously, one of the problems is that, as he says in his statement, a lot of 2G/3G elements are actually set at one regulated price so you do not end up with two regulated prices.

THE CHAIRMAN: I was not quite clear what Mr. Budd was saying in para.60, because there are two different things. There can be a single rate for termination regardless of whether it is 2G or 3G, but that rate takes into account the higher costs of 3G termination. That is what we have got here under the MCT statement. That is a different thing from saying that they looked at it and decided that actually there should be a single rate and that should be the 2G rate and people should not charge more for terminating on 3G. I was not quite clear whether Mr. Budd was saying anything about which Member States had gone down that latter route rather than which of them have simply, as Ofcom now has, adopted a technologically neutral price which takes account in effect of blended costs, even if it is blended rate, if I can describe it like that.

MR. READ: I think he is basically, in para.60, simply dealing with a single price control. In other words, he is not talking about the price control necessarily being fixed by 2G costs, or a 2G rate, if I can put it like that.

THE CHAIRMAN: I think the table ----

MR. READ: The table is slightly different, because the table – perhaps I can explain the table ----

THE CHAIRMAN: Can we look at the table which is RMB4. I am not sure where that is.

MR. READ: I think table 4. The table is at 398, which is the one that he has relied upon. If one keeps one's finger open at 293 and also moves forward in the bundle to 398 – unfortunately, there is not a translation of the *Xfera* decision, which is why I was taking you to the Cullen International report. If one looks at it, that it is the table that he has relied upon in reaching his table 1 at p.293. The position appears to be thus, that what the Spanish regulator was looking at were 3G only operators, in other words, where there was no question of a unified 2G/3G rate applying. In other words, there were only looking, as I understand it, at 3G only entities.

MR. SCOTT: Except that we have already established that H3G is itself using a mixture of 3G and 2G in the United Kingdom. I do not think we have got evidence as to what the situation is in the other Member State mentioned.

MR. READ: I think we would need to check the position on this. It is being pointed out to me that above table 1 at p.398 there is reference to 3G Puros "esto es, sin espectro 2G" would suggest that it may be looking only at 3G but from this I certainly am not going to attempt

in any way to give a definitive answer. Perhaps we can look at that and if there is any conclusion to be drawn from it we can check on it. As I understand it, the way that Mr. Budd is putting the point is that 3G rates were being considered as a percentage above 2G/3G price rates and that is how he has been coming out with the percentage table on the fifth column in from the left in that table, and from that it could be seen that 3G in the UK had the highest rate above 2G/3G prices at 88 per cent, which was then the rate, of course the rate has gone up to 150 per cent as he makes clear in para.64 following this determination. That already was the highest.

I suppose the only point I am really trying to draw from this is that it is actually an exercise that can be performed in benchmarking, and if it had been performed there would have been some form of alarm bells signalling that the tests that Ofcom were applying in order to get the result that it did under the gains from trade test could not be right. We will check a bit more on the *Xfera* decision and see if there is anything else we can add to it, but that is how I understand Mr. Budd is putting the point.

Can I ask the Tribunal to very briefly look at bundle F4 in this context, which does not have any tabs, but does have the internal markings on the right. It is a document we looked at previously at p.589, which is the ERG consultation document which you may recall you were briefly referred to I think last week. I am being told that my submissions understate Ofcom's references. (Laughter) Perhaps if one looks at 645, which we did look at, it is quite fair to say, that shows that mobile call termination was being dealt with under this.

Perhaps interestingly, if we then move on to p.648 we come to a short section on "Tools used to obtain cost references and/or specified price control – different choices possible". It says there: "Potentially, NRAs have a broad choice regarding tools they may use for MT costing and pricing" and it lists four of them – top-down accounting data, bottom-up model, hybrid model and international benchmarks. So "international benchmark" there is being recognised as a sensible tool for benchmarking. It says that they may choose a main tool, they may also want to use complementary tools.

If one then goes on to p.650 under item 3 on that page:

> "3 – Implementation related to benchmark
>
> As already mentioned above 8 NRAs use international benchmark as a main tool for mobile termination costing and pricing. International benchmark is a complementary tool for 5 NRAs (3 as complementary tool to top-down data and one as a complementary tool to bottom-up model)."

Madam, the only point I make from this is that it is a recognised tool, so to disregard it, in our submission, is inherently flawed and they should have looked at it.

Finally, madam, can I turn to the fourth ground of appeal, which is reasonableness. Most of the points that have already been made obviously overlap with this, because we say that they have got the flawed dispute resolution test. They have a flawed gains from trade test, they have looked at the E2E obligation in the wrong way, that it necessarily impacts on the reasonableness issue. But we say separately, and in its own right, these prices were manifestly unreasonable. Even if we have the rest of everything wrong we are still entitled to say: "No, Ofcom, you have come up with a flawed price." Can I just identify the features we rely upon in this, and just summarise them – some of these are points I have already made but I am just summarising them.

First, all the MNOs are designated as having SMP since 2004.

Secondly, the 3G rates were significantly higher than the 2G regulated rates, but fixed line phone users derive no benefit from termination on a 3G phone.

Thirdly, at least in theory, and I put it no higher than that, newer 3G technology ought to result in lower costs and thus lower charges – not higher ones. A lot of these points can be seen summarised quite neatly in Mr. Richardson's statement at para.13.

Fourthly, obviously different charges did not apply to 2G and 3G origination, the charges were the same.

Fifthly, Ofcom knew that 3G charges were significantly above cost, because by the time of the dispute it already had undertaken a substantial costs measuring exercise and knew that from that.

Sixthly, in fact they knew that the 3G charges were more than twice Ofcom's estimate of 3G costs.

Seventhly, whatever the rate one should look at, i.e. whether one looks at blended charges, or simply at the 3G component within the blended charges, mobile call termination prices were bucking the trend. The normal pattern was for telecommunications' prices to fall significantly year on year, but this was not happening, they were going up.

Eighthly, The MNOs' pricing of on-net calls suggested that the MCT rates determined by Ofcom were high. If you remember this is in para.18 of Mr. Richardson's witness statement. He makes the point about how calls between the mobile networks, individual's own networks, were seemingly much lower than they were for the calls that were being originated on other networks and terminated on the MNOs' networks.

Ninthly, we say the international comparisons in themselves demonstrate that something was awry.

Tenthly, we say that the significantly higher levels than 2G was as demonstrated, for example, by the Altnets was as demonstrated for example, by the Altnets' annexes to their skeleton argument, in itself was a further factor that should be taken into account.

I have already taken you to para.139 of Ofcom's defence. It is interesting because Mr. Roth seemed to go even further than that when he was describing the matter on day two, and the transcript reference is at p.37, line 14. This is the point he made against H3G.

> "In November 2006 H3G sought to increase its price for MCT to BT by over 50 per cent. That is almost the classic demonstration of the exploitation of market power."

We say it is impossible to see how Ofcom can be making that point in the context of the market review appeal, and still be maintaining that the charges it actually adopted in the context of the TRD determinations can possibly be right; they cannot be reasonable, there must be something flawed with them if that is the result that comes out of them.

So leaving aside all the other issues, we say those points in themselves demonstrate that the reasonableness of the price that was being imposed was manifestly wrong, and that in a nutshell is the way we put our case on that.

That leaves me then to deal with the relief BT seeks. The starting point should be that BT, of course, has always asked for the determination to be set aside and the matter remitted to Ofcom for a further determination, and that is certainly made clear in para.13 of our notice of appeal.

THE CHAIRMAN: Just remind me which bundle that is in, Mr. Read.

MR. READ: That is D1, tab 3, p.66. As you can see in para.13 the relief sought summary:

> "BT asks the Tribunal to set aside the Determination and declare the disputed 3G MCT rates to be unreasonable and excessive."

It then goes on to ask that because obviously in a sense we would like Ofcom to have some guidance on how they should approach it, we seek specific directions, because obviously what we do not want in all of this is any form of pyrrhic victory where it just goes back again and comes back in a different format but with the same type of concerns that BT has now.

If one goes forward to para.115, at p.110. That sets out the first two matters that we wanted, namely, (a) and (b), and then (c) specific directions we wanted Ofcom to deal with.

I apprehend from this morning's interchange that the issue that may be of concern is

(c)(ii)(4) which is on p.52, and the issue of the reasonableness should be assessed by reference to, *inter alia*, the underlying 3G costs' material and other relevant data gathered by Ofcom as part of the 2007 Market Review, and whether that should be done on the basis of the material as it stands in the Market Review Statement itself (the MCT statement itself) or whether we mean as subject to the appeal that BT is putting forward to the Competition Commission, because obviously there are potentially different elements involved there. Perhaps I can make sure that that is the point that I was being asked ----

THE CHAIRMAN: Well the point is whether you are still pursuing in this appeal the point of principle which you certainly seem to have pursued in your submissions to Ofcom during the consultation periods of the TRD process, that the termination rate should not be more than the 2G regulated rate, and that therefore this whole blended rate business was inappropriate. Now, in (c)(ii)(4) you seem to be accepting there that underlying 3G costs' material is relevant to the setting of the rate in this dispute, and that seems to be a different position from the position that you took in arguing your case in the dispute, so I am trying to clarify whether that difference is a real one.

MR. READ: Perhaps I can put it like this: we are not pinning our case solely on the basis of Ofcom got it wrong, they should have fixed it by reference to 2G prices. We think that that may be going a stage too far in necessarily saying that that is the price that absolutely Ofcom must fix the price level at. We are not saying that they cannot fix it at that level; there may be good arguments why they should fix it at that level, but we do accept that there may have to be a more nuanced approach to it by, in particular, looking at all the factors to be taken into account, including, for example, the 3G cost material.

If I can put it like this: it is a more nuanced approach we are taking now.

THE CHAIRMAN: I can see it can be a more nuance approach in that you say, "Well, we don't solely argue that. We argue that, plus we argue, 'Well, if we're wrong on that, then we still say that the 3G component here was excessive'". But, that is different. If that is your case then you are still effectively asking us to decide that point - whether there should be an increase in the charge to reflect greater 3G costs. But, I think the tribunal needs to know whether that is your position, or whether you are effectively not pursuing that in the context of this pursuit so that there is not the potential for a situation where we may have to decide that point of principle, and the Competition Commission may have to decide the same point of principle in the context of the price control matters. I am not pressing you to abandon it at all. I am just trying to ascertain where we are on that point.

MR. READ: Perhaps if I can just pick up on one point you have made, madam, which is the higher 3G costs. I think that is the way you have put it. BT does not accept that if you do this 3G cost based analysis you come up with a higher level than the 2G level.

THE CHAIRMAN: Yes - because in your price control matters you say that it should be capped at the 2G costs because you should not take account of the 3G spectrum.

MR. READ: And various other matters, yes.

THE CHAIRMAN: An argument that you seem to be making there - that the 3G costs are actually irrelevant -- or should be irrelevant to the cost to be taken into account when determining the level of the voice call termination -- seems to be inconsistent with the direction that you are asking us to make in (c)(ii)(4).

MR. READ: Madam, I see the point. I think part of the answer may be as I have said, but I am very mindful that ---- It is an important point. I absolutely agree with you, madam. I do not want to hold the process up, but can I take some more instructions on the point now that we are absolutely clear the point that you are dealing with?

THE CHAIRMAN: You can. I think that the other parties - certainly Ofcom and the parties supporting Ofcom - need to know the answer to this in good time to incorporate whatever arguments in rebuttal they want to make.

MR. READ: Absolutely.

THE CHAIRMAN: Perhaps you could develop the rest of the points you wanted to make on 115?

MR. READ: Madam, can I say this: if we have the opportunity for me to get absolutely firm instructions on this point, we will certainly have notified by everyone by Monday morning precisely what it is - if that is an acceptable timeframe.

THE CHAIRMAN: You must organise that amongst yourselves.

MR. READ: We will make the position absolutely sure by then, madam.

MR. ROTH: It is not particularly helpful. I would have thought this is such a fundamental point, given the way the disputes were put to us. Now, it is said, as you picked up, madam, in terms that 3G costs are relevant. Now, what they actually are is a quite different point. One can see this argument as to whether they are higher or lower, etc. -- But, really, what is relevant and what is not relevant would assist us. We have to prepare our submissions for Monday. If it is possible for BT to have sorted this out, please, by the close of business today -- Surely it should be.

THE CHAIRMAN: Professor Bain also has a point.

PROFESSOR BAIN: I have a related point about the remedies you are seeking, Mr. Read. Suppose that the current level of MCT charge everybody is paying quite happily at X. An MNO comes along with a notice and says, "We want it to be Y", Y being greater than X. BT are not happy with this, and so they refer it to Ofcom. Ofcom go away and do their sums, and they find that the cost efficient price is in fact Z, being less than X. Are you saying that in the context of resolving this dispute, Ofcom should say that the price must be Z, which is lower than the price that BT were perfectly happily paying before, and which they had not challenged, and they gave no sign of challenging until the MNO tried to put it up to Y.

MR. READ: It is an interesting conundrum, but I think the short answer to it is ----

PROFESSOR BAIN: There may be a real situation.

MR. READ: Yes, it could be a real situation. We absolutely agree with that. The short answer is that I think one would have to look at it in the context of the dispute that is actually before Ofcom because obviously their determination powers are dependent upon the dispute before them. That is what is being referred to them. It may, in those circumstances, I think, be difficult for Ofcom to actually set it at Z, being below (to use your figures) X. So, in the context of dispute resolution there might be a problem with going ----

PROFESSOR BAIN: So, your argument that the determination by Ofcom should be cost based is subject to the qualification that it does not take them outside the range of the dispute itself.

MR. READ: Subject to the point that we do not necessarily argue that it has to be cost based -- It is a reasonable process involved -- That is right. I think we are limited to the dispute between the parties.

PROFESSOR BAIN: Thank you.

MR. SCOTT: But if, under Article 5(4) of the Access Directive, Ofcom were aware that the price should be Z ----

MR. READ: Yes, that is absolutely right. The point I was going to move on to is that I was talking there solely in the context of the dispute between the parties. Of course, that leaves out of the equation all the other ----

THE CHAIRMAN: Section 105 ----

MR. READ: Section 105 and all the other plans that Ofcom actually have. You are absolutely right, but I understood Professor Bain ... (overspeaking) ... of the dispute, and that is what I was asking there. We absolutely agree, because we think that if Ofcom came to that conclusion they would, of course, approach and deal with it in another way. Although I got truncated away from the Cullen Report on the *Xfera* case. That is actually what seems to

have happened in that case. The Spanish regulator appears to have said, "Well, we're prepared to agree these prices in the context of an interconnection dispute, but we will then move on by publishing a statement to deal with making Xfera subject to the SMP conditions ----" etc., etc. So, the two would go hand-in-hand. If, in the course of a dispute, Ofcom actually discovered that the reasonable price was actually Z and below Y, then one could do that. I think that is reinforced also by s.1904 ----

THE CHAIRMAN: Below X, in fact, I think.

MR. READ: Yes. I have probably got my Xs and Ys the wrong way round. That is why I like Mr. Budd's egg analogy. I can get my head around that one.

Of course, we would say that is also dealt with in part by s.1904 of the Communications Act which, of course, gives Ofcom specific rights to exercise certain powers in addition. So, that is the process by which one would go.

THE CHAIRMAN: We have taken you slightly out of your submissions.

MR. READ: Dealing with Mr. Roth's point about when we will come back to him, whether it will be 4.30 today - which I think is probably what he means by 'close of business' - may be difficult. But we will get an answer out by this evening so that he is not prejudiced in any way over the weekend.

MR. ROTH: I wish close of business were 4.30! (Laughter)

MR. READ: I think there is no answer to that.

Madam, as regards the other features, para. 4 is the problematic one. We say that all of that is consistent with everything else that we have been discussing through the course of the hearing - in particular, for example, (1) deals with the absence of -- the inability to have a free negotiation, if I can put it like that; (2) the effect of the end-to-end connectivity obligation coupled with Article 8, and the effect of Article 8; (3) is blending; (4) we will park as to what is actually meant by that until I have got some more instructions on the point; (5) is really Ground 3, and also it is linked into Article 8. (3) is the direction that we actually seek in aiming at a direction fixing the reasonable terms of 3G MCT between the parties during the relevant period.

THE CHAIRMAN: That also slightly suffers from the same problem as (c)(ii)(4) if actually your case is that the reasonable term of the 3G MCT is actually the 2G MCT. But perhaps you can clarify that at the same time.

MR. READ: I think I will add nothing further at this stage, particularly as I think I am getting very close to my time limit.

Were there any further points, madam, that you wanted any assistance on?

THE CHAIRMAN: Just to look again at the point that we had about para. 60 of Mr. Budd's statement, the Cullen International table which was at RMB4. That, as I understood it, was the table which is actually at p.376 of Bundle D1. That then does deal with both the points. Looking at the two right-hand columns - does the same control apply to 2G and 3G termination? If 'Yes' are 3G network costs and/or license fees taken into account?"

MR. READ: Yes. I think that is right. I think it is using it slightly for a different purpose, obviously, because he is extracting from this information how exactly the different countries deal with the matter. I am just looking for the reference to Spain which is at p.379.

THE CHAIRMAN: In Spain they do charge the same amount -- or, a composite amount, if I can call it like that -- but it does take into account 3G costs.

MR. READ: I think that is right for the majority of people in the country . I think this is the reason why the benchmarking exercise was done - because Xfera was a 3G-only entrant. That is why it was not necessarily easy to benchmark against those prices. That is why they went to look also at the international comparison. But, that does not derogate in any way, we say, from the use of international comparisons to cross-check the relevant likely 3G rates that are involved in it. I think this is the point that Mr. Budd is making - that, of course, you have to be careful in comparing like with like, because if, in Europe, you have a number of operators who effectively are on a single price, and it is a merged 2G/3G price, then obviously what you cannot do is use that as the comparator necessarily for the 3G price. What he has done by looking at Xfera is to have taken an instance where the Spanish regulator was looking solely at the 3G element, and then trying to draw out from that how much higher the 3G element was than the, if you like, 2G and, I suspect, 2G/3G benchmark costs in those particular countries - hence why they look at Austria and you have a percentage element uplift in, I think, the fifth column in from the left. There is a percentage element showing how much higher it is than the regulated 2G/3G element. I think that is the point that he is making.

THE CHAIRMAN: Thank you.

MR. SCOTT: Just one other small point on Table 28 - the Cullen International table. These, as we understand it, are all SMP conditions. They are not the result of dispute resolution. Is that correct?

MR. READ: I would have to check on that - I think is the answer. One is looking at Table 1 here, at p.293. The question was, as I understand it, whether those figures were in fact SMP-imposed ones rather than dispute resolution -imposed ones. I suspect that it is likely to be

SMP-imposed ones rather than dispute resolution-imposed ones, but without checking on it I could not be sure about that.

THE CHAIRMAN: Thank you very much, Mr. Read. Mr. Cook?

MR. COOK: Madam, I of course represent what I am going to call the 1092 appellants rather than any of their other aliases that have been used before this tribunal. We are, as you know, on the whole, with the bulk of BT's fixed network transit customers. It is, of course, one of our principal complaints that our interests were simply ignored or, at the very least, not give proper consideration by Ofcom in the determinations. Like Mr. Read, I rest my case on my notice of appeal and on my skeleton argument and to the extent I do not make every single one of the points, and it is likely I will not make every single one of the points that are in those documents, I am not resiling from them, I am simply time constrained.

Madam, I have a couple of short extracts from the transcripts, which may turn out to be slightly less necessary as we have already had a couple of them referred to by Mr. Read. Could I just hand those up to the tribunal so that I can come back to them later. (Same handed) Madam, there is no particular need to read them now unless you would like to. We can come back to them when they actually turn out to be relevant.

Madam, before I get on to the substance of my submissions there is an initial issue raised by Ofcom in its defence about the proper scope of this appeal and the jurisdiction of the tribunal. Ofcom make two arguments in that regard. First, they say, the tribunal should limit its appeal to a review of the decision rather than a re-hearing. They say the result of that is that the tribunal should be slow to interfere where errors of appreciation are alleged. In my submission, that argument is simply wrong. The reason why the tribunal has already received such voluminous new factual and economic material is this is a re-hearing of the matters rather than simply a review of an existing decision. It is also the case that the Act itself expressly states that the appeal shall be on the merits, a term that is not restricted or limited in any way. In my submission, it would simply not be consistent in determining the appeal on the merits for the tribunal to overlook certain kinds of mistake or limit its consideration of the issues in any way.

Madam, those points have been developed in some detail by T-Mobile in its skeleton argument at paras.8-14, and I do not intend to steal T-Mobile's thunder at this particular point by repeating those arguments. I would simply say that we agree with those points made by T-Mobile and would rest ourselves on the point that this should be a full hearing on the merits and not some *quasi* judicial review as Ofcom would, perhaps unsurprisingly, wish it to be.

The second point made by Ofcom is that it would be inappropriate to allow new arguments to be raised in the context of this appeal. This is a point, it must be said, that is levelled primarily at me, and it is particularly levelled at our Article 10 of the EC Treaty point about excessive pricing; and also at the point that is not directly relevant to me on my feet now but will be in due course, which is the point about some of the SIA issue points that we make. Again, they say those are all points that were not raised before it in argument. I am obviously conscious that one of the non-core issues that we will be coming back to is the fact that my clients make the point, and it is explained in detail at paras.129 to 139 of our notice of appeal, that we say we were not given a proper opportunity to be consulted or to make representations to Ofcom about a number of matters, including in particular the SIA issues, among many.

I am not going to go in to the detail of those points at this time. I am conscious of the fact that those are not the issues in front of us today. I would make the point, however, that both of the arguments they say were not raised previously are ones where we make exactly that point, that we were not in a position to make submissions earlier. The SIA point was not even raised in the draft determinations, so we simply did not know about it at all.

In relation to Article 10, excessive pricing, again if you go back to the draft determinations, the level of charges was redacted from all of those. So again we simply could not see, looking at the draft determinations, what the specific level of charges being proposed was.

So, without wishing to fight out the point now, I would say that it would simply be wrong for the tribunal to look at it as though we have not raised it before and, in my submission, as we may make good in due course, the reality is that we could not raise those points earlier because we were not given the proper opportunity, in reality any opportunity, to do so.

The second point, madam, and that is a factual matter that refers to us, is simply a legal answer to this in any event. One falls back on the decision of the tribunal in *Napp*. Of course, that was a decision focusing more on evidence than on arguments, but the principles, I would submit, are entirely reasonable and should apply in the context as well. As held in *Napp*, you can expand, enlarge upon, or indeed abandon a case and advance an entirely new one in front of the tribunal. That, in my submission, is an absolutely correct legal principle which should apply generally, and of course you will be more than familiar with the fact that the "on the merits" test is exactly the same both in Competition Appeal cases, which was what *Napp* was dealing with, and of course in this forum.

So, in my submission, there is absolutely no reason why the tribunal should not consider all of the arguments that we make on their merits and deal with them on that basis. Certainly it

is right to say that Ofcom does not turn round that it is in difficulty dealing with any of those points at this time.

Turning now to the substance of my submissions, I would like to start with the nature and scope of Ofcom's powers under s.185 of the Act. It is our case that Ofcom fundamentally misunderstood the nature and scope of its role under s.185 and consequently misapplied its powers. In looking at this issue, I would like to deal quite separately with two distinct periods, the period prior to 13th September 2006 and the period from 13th September 2006 onwards.

I will turn first to the pre-13th September 2006 period. This is obviously a point of very short duration, and I am not making a particular point about its importance or anything else. If it was only a 12 day period one might say it is *de minimis*. It is, however, crucial in this context and the context of this appeal, that it allows us the clearest insight into how Ofcom viewed its dispute resolution powers as operating. It allows us to see its dispute resolution without the additional complexity that the E2E Obligation adds to it.

In relation to the way in which Ofcom approached this, there was, we would say, a certain lack of clarity in both the determinations and in the defence about the exact view that Ofcom took of its s.185 powers, and in particular the extent to which it thought it was appropriate to impose different charges upon the MNOs from those which they proposed. We have set out in our skeleton argument in paras.26 to 35 an analysis of the approach that Ofcom appears to have taken. It is not my intention, given the time constraints that we are operating under, to take you through that analysis now in detail. I would invite you to re-read it, if it is not already fresh in your minds, at a later opportunity. I would, however, like to take the tribunal to para.88 of the defence, which is the paragraph that that analysis leads us conclude is the central paragraph in terms of understanding the approach and view that Ofcom took of its powers. That is in bundle D3, tab 6, p.142. It is para.88. I simply ask the tribunal just to read it to yourselves rather than me reading it out loud to you. (After a pause) What we say about that paragraph is that Ofcom is saying that, in general, in the absence of any ex-anti obligations upon the MNOs, there is no basis to impose a different price on the supplier and therefore the right approach is that you simply have to end up confirming the price, and that is the jump it makes. It is a very important jump, we would say. It says there is no ex-anti obligation which provides you with a reason to restrict their freedom to set their prices and therefore that is the result you end up with. Simply for a cross-reference, paras.30 to 37 of Ofcom's skeleton reiterate the approach they took, and I

would submit that is entirely consistent with what para.88 says and what I have just summarised it as saying.

A mistake, we say, which has fundamentally arisen there is Ofcom's focus solely on the position of one side of the equation. It has only given any thought to the MNOs and it has completely ignored BT on the other side of the equation. In parenthesis, I would say it has also completely ignored BT's customers, including the 1092 appellants.

What is, of course, fundamental to understand the pre-13th September 2006 period is the fact that neither party is under relevant ex-anti obligation. I say "relevant", obviously the 2G/3G MNOs were under restrictions on their 2G powers, but in this context when we are looking at 3G element that is simply not relevant. It does not impose any relevant restrictions. So neither party has any relevant obligations imposed on it at that time.

A footnote to that perhaps, which is the point made today by Mr. Read about Article 4, which results and general condition of 1.1 obligation to negotiate, it is of course true that both parties are under an obligation to negotiate. They both are. It was a matter for Mr. Read to persuade you where that gets you. I do not rest my submissions particularly on the fact that there is an obligation to negotiate. Both of them have negotiated. That has failed. I look at it on the basis that neither party has any obligation which forces them to contract at any particular price.

What that means though is that in the same way there is no ex-anti obligation on the MNOs requiring them to offer particular prices. There is no ex-anti obligation on BT requiring it to contract at particular prices. Therefore, on both sides of the equation, *prima facie*, neither has any obligation to contract with the other at any particular price at all. In a normal market if parties cannot agree they simply walk away.

The telecoms market is an unusual one in the sense that the possibility of parties simply walking away and not contracting is considered unacceptable and that is why, of course, we have dispute resolution which steps in to fill that gap. The problem is the fundamental flaw in Ofcom's approach ignores the facts that when it imposes a price, and if the price it imposes, whether it is the suppliers' approved price or not, it is regulating both parties.

That is a point Mr. Roth accepted standing up today, and also the passages from the extract I have given you show just over the page him accepting exactly that. I have simply given you the extracts involved. It is a point that is obvious, it is a point that is missing from the determination and the decision and the defence. It is the obvious point. You are imposing regulation on both sides of the equation. Once you understand that, in our submission, you must recognise the fact that you are, if you simply accept the MNOs' proposed price,

forcing BT and its customers to transact at the prices they propose. You are regulating. That is the reason why Ofcom's approach is flawed, because it simply starts from the position of saying that there is no reason to restrict the MNOs, but then does not give any consideration to why there is any reason at all to restrict BT and its customers. It is simply one-sided and does not consider the second side. Once you realise that there is a double regulation taking place at any price you cannot simply jump from saying, "There is no reason to regulate the MNOs" and say, "Therefore, I will impose the price they want", because you have not thought about why it is appropriate to regulate BT by forcing it to buy – previously it had the ability to walk away – while you are forcing it to buy at the prices the MNOs want.

THE CHAIRMAN: This rests on the assumption that there was E2E Obligation before 13th September 2006?

MR. COOK: I believe it is accepted by everyone that there is no E2E Obligation.

THE CHAIRMAN: Well, for some purposes it seems to be assumed that there was, but for this purpose I think you are right, that it is assumed that there ----

MR. COOK: I think the confusion that may arise is whether in the context of considering SMP you should take account of the fact that the possibility that it might be imposed if BT starts refusing to contract, but obviously in this context you cannot regulate BT by reference to an obligation you might impose later; you have not imposed it and so in this context, in this period, there is no obligation on either side, that is the reality. That is where they go awry, there is no obligation either side, but nonetheless they jump from that to assuming therefore you let the MNOs do what they like without thinking where is the justification for putting something on BT.

So since no *ex ante* obligation exists, there is no *ex ante* obligation to justify either BT's preferred price or the MNO's price you have a void, you do not simply jump to the MNO's preferred price. The fact that there is a void there does not mean that Ofcom walks away, it cannot, it is under an obligation to resolve the dispute. So how do you resolve that dispute? It is very, very simple indeed, sections 3 and 4 of the Act tells you how to resolve the dispute – at least in general terms – by taking account of all the considerations that sections 3 and 4 require you to do; they are very detailed they are very careful, they may in some cases point in opposite directions, but that is the process you want to go through. That is the problem – Ofcom never did that exercise, and the reason they never did that exercise, whatever lip service it may have paid in various places having mentioned these

considerations is it just assumed it was the automatic approach of once you decide there is no reason to regulate the MNOs, you therefore follow their price.

That was not the case, you realise there is no reason to go either way, and therefore the only way to get to a price is to carry out the balancing, the weighing exercise in accordance with the requirements of sections 3 and 4.

I say in parenthesis – it is not necessary for my argument particularly – that had it carried out that exercise, when you look at the considerations it is required to take into account under s.3(1) – further in the interests of consumers; under s.3(5) – having regard to the interests of consumers in respect of pr ice and value for money, under s.4(6)(a) – carry out its function as far as practicable, in a manner that does not favour one form of ECN, ECS, or associate facility of the other, and under sections 4(7) and 4(8) securing the maximum benefits for customers of providers. Once you realise that those are all the considerations that must be taken into account that you realise that had it actually carried out that exercise it could never have approved the wholly excessive prices that it did approve, and I will come back to how wholly excessive they are in due course.

I should at this point mention and deal with Recital 5 to the Access Directive, because that is a point that Ofcom rests its case on and now seeks to justify its case by reference to. We can go there if you like, (bundle H1, tab 4). It provides:

> "In an open and competitive market, there should be no restrictions that prevent undertakings from negotiating access and interconnection arrangements between themselves …"

And then subject to competition rules only. That is a point that Ofcom relies upon to say: "It says shall be free to negotiate access and interconnection, and that means that we should not be going and restricting the MNOs' freedom to set the prices for their products. That is wrong; that misses the point. The reason it misses the point is that of course t hey are free to negotiate (the MNOs) and so is BT. Both parties have that freedom to negotiate. However, what the dispute resolution provisions provide (Articles 5(4) and Article 20) is that once the parties have tried to negotiate and it breaks down, the regulator then comes in and sorts the problem out. It provides a solution for both parties. What that means therefore is Recital 5 provides absolutely no reason to say: "When you come and sort it out you must always favour one party – the supplier – over the purchaser", there is simply no reason to do so.

THE CHAIRMAN: It is a bit difficult to see how Recital 5 is consistent with the free-standing power of the NRA under Article 5(4) to intervene, even in the event that there is not a dispute between the parties.

MR. COOK: Well the simple answer to that of course is that an Article always wins over a Recital; I think it is meant to be a general principle that there should be freedom to do so. There will be particular circumstances where, of course, all of the obligations laid down by the Access Directive upon the regulator justify something that does restrict the power. But for my purpose the only point is to say that Ofcom is quite wrong to say Recital 5 provides any basis at all for saying you must always favour the supplier, it does no such thing. It says everyone should be free.

MR. SCOTT: I think it depends whether you think that Recital 5 is descriptive or prescriptive. If you believe that Recital 5 is descriptive, then it is simply saying that in an open competitive market there should be no restrictions that prevent undertakings and so on. That is a description of an open and competitive market, and that seems quite logical. You can also read it as being prescriptive. It is not obvious which it is, but if it is to be consistent then you can take it as consistent if it is a descriptive rather than a prescriptive comment.

MR. COOK: You say "consistent" in the sense of consistent with the independent power in 5(4), I would agree with you that does create an issue and as has been said by a number of people, the directives do not always mesh together nicely, but it does not matter from my perspective either way. I do not mind whether there is a flaw here or not, the point being is Ofcom is the party that that says Recital 5 provides a justification for always doing what the MNOs want, and the answer is "no", it does not; it does no such thing at all. It says you should give both parties the freedom essentially, and actually it is a point in my favour because they have not given both parties the freedom, they have only given MNOs the freedom so Recital 5 is a problem for Ofcom, not a support for it.

So that, we say, is the first mistake that Ofcom has made. It has simply proceeded on an assumption that you should not restrict the MNOs, therefore you must always follow their price, rather than bearing in mind there are two parties there and both of them have that freedom.

The second failure we say exists with this approach is it fundamentally neuters the dispute resolution power in a way that is entirely contrary to the statutory regime, and that is a further reason why it is obviously wrong, because it says that in the absence of *ex ante* obligations you always go in favour of the supplier. That is not actually active dispute resolution; it is dispute resolution in the sense the dispute is resolved, but there is no active

process being undertaken there. Once you have worked out there is no *ex ante* obligation the answer follows automatically. If it had been intended under the statutory regime that where there was no *ex ante* obligation you always upheld the supplier's charge the statute would have said so. In fact, it would not have actually pushed you down the dispute resolution route, there is no reason to send you down the route of actually having a dispute resolution process undertaken where the answer is always clear. You just have a rule saying: "In the absence of *ex ante* obligations the supplier's charge is upheld. That is an easy way to resolve a deadlock situation. So the fact that there is an active dispute resolution power suggests that the regulator was intending to do something. So there is nothing in the Act which supports Ofcom's approach, and we would say "on the contrary" there is everything in the Act which suggests you need to do something different, and what is there are sections 3 and 4, and what they require is the way, taking account of the interests of consumers, all of these matters, and the fact that it is focused on the fact that you take account of users (and the transit operators are users), you are required to think how the interests of consumers, value for money etc. tells you that an approach that always favours the supplier, that always goes in favour of the higher charge – because a supplier is never going to ask for a lower charge – cannot possibly be consistent with a requirement to take account of the interests of consumers because it is always going to be to their disadvantage – or at least prima facie to their disadvantage – to have to pay higher charges.

So the second point we say is that Ofcom has acted in a way which is inconsistent with the statutory regime.

Thirdly, we say this approach is simply contrary to the Tribunal's first decision in H3G (1). I am not going to take you to the decision you will be pleased to hear. The point is a fairly simple one which is they are falling back into the same mistake that they made in H3G (1), which is saying "We cannot regulate suppliers unless they have SMP" The Tribunal said "Absolutely not", this is an entirely separate, parallel jurisdiction, you do have an obligation to resolve disputes that is not price regulation under SMP, that is resolving a dispute, and of course it is regulation on both sides. In my submission, Ofcom is simply making the same mistake again – if anything its submission is even more absurd this time. It is saying: "You can never regulate, even if you found SMP – a supplier – if there is no *ex ante* obligation, and that is simply absurd; it is absurd and it is entirely contrary to the description of the dispute resolution process that the Tribunal gave in H3G (1), which is a positive dispute resolution process. It is a regulation which can produce a result where you come to a middle ground set of things, you do not always follow the supplier's preferred route.

We say the third mistake is it is simply contrary to established case law and established precedent in this area.

We say there are three clear reasons why Ofcom has entirely misunderstood its powers under s.185 and what we get from that 12 day period, otherwise *de minimis* there is a clear understanding that they have wholly misunderstood and misapplied those powers.

We then move forward to the bigger period the period from 13th September 2006 onwards, and the point flows through, Ofcom has made this fundamental mistake about its s.185 powers, and again while the E2E Obligation is there adding an additional layer of complexity, it is still starting from that fundamental misunderstanding of its powers and that is what you see – we summarise in our skeleton the approach (in the same paragraphs I referred to earlier) – the approach that Ofcom took in relation to that period. We see there that Ofcom looked at the E2E obligation, and really it looked only at the E2E obligation because it has already made the decision that it really does not have any positive power to regulate the MNOs, because they do not have an *ex ante* obligation on it, and then asked itself the question whether the E2E obligation provided any new justification for regulating the MNOs and unsurprisingly in that context they said: "No, that is not an obligation imposed on the MNOs, why would it provide new justifications", and therefore once again they simply uphold the MNOs' prices.

THE CHAIRMAN: That is something that I am not entirely clear about at the moment, whether there is a substantive difference in the test that is to be applied before and after 13th September, or whether the introduction of the E2E Obligation simply results in a different formulation of the test that after 13th September you formulate the test by saying: "Is this price a reasonable price for the purpose of the E2E Obligation?" But whether applying that test there is a narrower range of prices which potentially get approved, as compared with the range of prices that potentially get approved before 13th September, where there is no E2E Obligation, I am not clear what Ofcom's case is on that.

MR. COOK: I am equally in the dark I would say. Certainly what I would suggest is the correct approach – and whether Ofcom has taken this I suspect is not on the basis that its approach is wrong elsewhere – what I would say is the correct approach there, whatever way you frame the question the answer will be the same -----

THE CHAIRMAN: Well that is what I am wondering.

MR. COOK: Once you recognise under s.185 you have a positive power, and more than that a duty to carry out a balancing exercise taking account of all the considerations in sections 3 and 4 that we know about, you realise that when you come to consider the question of

reasonableness you are not obliged to take a view which always starts on the basis of: is there any reason to force the MNOs to accept a lower price? You know you have that power, so whether you think about it on the basis of what is a reasonable charge – to some extent what is a reasonable charge should be something that in broad terms should describe what Ofcom is doing in any event, in any circumstance, it should not be imposing an unreasonable charge ever.

THE CHAIRMAN: Perhaps this is a fairer question: is it your case that properly applying the test before the introduction of the E2E obligation there could or should have been any difference in the end result?

MR. COOK: There is a difference, I suppose, and I will deal with it as a matter of theory and a matter of practice. Theoretically, there are circumstances in which one might envisage a higher price being approved when the E-To-E obligation comes into place than one might otherwise. I suppose one can potentially envisage circumstances in which you need a slightly higher charge in order to ensure end-to-end connectivity potentially. As a practical matter it is very difficult, in reality, to envisage those circumstances arising, and the reason why is that you come back to why the E-To-E obligation was imposed. It is imposed on the basis that there is a worry that BT will not connect with the MNOs and they will have no-one wanting to buy. So, it pre-supposes the notion that the MNOs are keen to sell. Desperate to sell. On the basis that they do not want to sell, the E-To-E obligation has no relevance. They can happily sit there, letting no-one 'phone their customers, if they want - in theory at least. But, that E-To-E obligation does not touch that because no-one can force them - at least under the E-To-E obligation - to let people call their customers.

So, the E-To-E obligation assumes that they are keen to sell. The only circumstance in which they will not be keen to sell, I suppose, is if they are not going to make money on the transaction. So, while, in theory at least, I can see a potential argument to say the need for E-To-E connectivity might justify a slightly higher price, in reality, on the basis that you very much go back to what was said by H3G - that H3G closes up shop tomorrow of BT does not deal with it - that, in practice, is going to be the case with almost anyone. So, you never need to go to a higher price, but provided it is a profitable price for them there is never going to be a need to say, "We will give you an extra 2 pence per minute to make you connect", because they will connect at any price that is profitable.

That, of course, we say, is very much the fallacy that Ofcom gets into. It never ends up asking itself that question. Because of the assumption that it has no power under s.185 to really regulate -- It is important to be clear about the term you use. -- no power to specify a

different price from the one the MNOs want. Obviously it is regulation, but it is regulation which always results in giving them what they want. But, as they assume there is no power to bring it lower, the only question they ask is: is there any reason under the E-To-E obligation to justify lower prices? On that basis they say, "No, there is no reason think lower prices are any more likely to give end-to-end connectivity than higher prices". If you start from that position, that would be a reasonable argument. The problem is that it is the wrong way round. I would say you start on the understanding that the job under s.185 is to do the s.3(4) balancing exercise and E-To-E would only be relevant if there was a need for a higher price to sure of end-to-end connectivity. In practice that will never happen. That is not something I need to establish. It is something that Ofcom should have undertaken as part of its consideration. Simply as a matter of submission, I find it very difficult to see, on the facts of this, or really any other case, based on the UK market, why it would ever need a higher price in practice. That is what we say is the mistake that was made. It is all down to the s.185 mistake. It all flows through. But, once again Ofcom is standing back and saying, "We can't touch the MNOs without a reason". That is simply wrong. Again, the s.3(4) exercise is just never, ever carried out on that basis.

There are two further arguments advanced by Ofcom as to essentially why it would have been right, or why it was right to come to this approach in any event. The first point it makes is that it rightly considers it was not appropriate to use dispute resolution as a means of addressing ineffective competition in the market as a result of SMP. They say that is a separate framework for SMP. The reference is the defence at para. 46. The answer to that is very simple: as the tribunal said in H3G1 these are parallel processes. They are separate. Now, it may well be - and in fact is - the case that the right place to address SMP is under the SMP resolution powers. There is no doubt about that. It is an opportunity to do a proper consideration over a lengthy period of time.

That does not mean though that Ofcom effectively, as soon as it gets to dispute resolution, does nothing at all. It is under a separate power, and under that separate power it does its task that it is required to do as a dispute resolver - i.e. carrying out the s.3(4) balancing and weighing exercise. Whether that produces the result which in part mitigates the effect of SMP, removes SMP -- you are not addressing it in that context particularly. We will come back to the effect of Article 10, which means that the one thing that you really cannot do - and the one thing that Ofcom did do - is permit an anti-competitive price to be approved. But, on the whole, what you are doing there is just simply that different exercise. It is different -- it is parallel -- and the fact that there is SMP does not stop them doing the

process. It is the reverse of the argument that was wrong in H3G 1. There they were saying, "You cannot regulate a party unless they have been found SMP". Now they are saying, "You can't regulate a party if you have found SMP" - which, again, is wrong, and it is wrong because there is an independent parallel process and you go down that process and you do your job under that. You do not make the fact that there is an SMP designation determinative of anything in this parallel process.

The second point Ofcom makes is that it argues that taking this approach was designed to ensure that it was not acting inconsistently with its decision in the 2004 CTM review not to regulate the 3G charges. Again, that is in the defence at para. 47 where it makes that point. Again, we simply say that it is exactly the same point. The fact that in the context of SMP, applying all of the rules and regulations that apply to when you can impose SMP conditions, and when it is appropriate to do so -- the fact that in that context it did not consider it appropriate to impose price regulation does not mean, when you come to look at it under dispute resolution -- It might have been asked to do it that week -- In fact they were not for several years, and matters have moved on. But, even if they had been asked to do it that week, it does not mean in those circumstances that they did nothing under the dispute resolution. They simply carry out exactly the same balancing exercise under (3) and (4) and they get to the right result because it is their job to resolve the dispute in accordance with those matters. It is not inconsistent with other regulatory actions. That simply recognises the fact that there are two separate parallel processes with different triggers, and the fact that one set of triggers under SMP may not apply -- may not justify regulation, it does not mean when you come to apply a different set of tests that you will always get exactly the same result. But, of course, matters in any event have moved on very considerably three years later.

MR. SCOTT: Am I right in thinking that they could, if they felt it was the right course, claim the exceptional circumstances and stay the TRD and proceed with the SMP and then, through the SMP decision, effectively produce a price that solved the TRD?

MR. COOK: They certainly could. If, as a result of the SMP process, you end up with a price that is going to be satisfactory under TRD, and you can tell, looking at it, because you know what has gone into it, that going down the (3)/(4) route is going to produce effectively a similar result -- There may, I suppose, formally be a need to go through the process quickly but, in reality, it is not going to produce any different result at the end of it. Of course, the whole point here was that they were not going to do anything under the 2007 CTF. So, they

were simply saying it had no advantage or benefit. So, they did actually have to carry out a positive dispute resolution process. And they did not do so.

We say, therefore, as a result of that s.185 mistake, the whole set of determinations is flawed and should be quashed. We set out some matters of guidance that we say the tribunal should give in order to allow Ofcom to go back and do the job properly this time.

THE CHAIRMAN: So, you say that the 2004 decision should not have created any expectation in the minds of H3G or the other MNOs, as and when they brought their 3G termination on stream, that that was going to be unregulated for the period of the 2G price control.

MR. COOK: There are two answers to that point. One is that the reality is that 2004 created no such expectation in any event. It made very clear they were saying, "This is a matter we need to keep under permanent review". So, to the extent of an expectation, it was a very weak expectation. It was, "You're not going to regulate us until you tell us you're going to regulate us".

THE CHAIRMAN: That is the point that BT make.

MR. COOK: Of course. I think the point is beyond that. The point is that the only expectation that can be created is that you are going to be free of SMP regulation. There is no expectation created that if you are unable to agree a price dispute resolution will be completely neutered. That is what Ofcom are saying. They are saying, "Having made a determination that we are not going to impose SMP conditions, we have also said that we have fettered our powers that we will never engage in any active dispute resolution process involving these for the foreseeable future until we decide to SMP regulate". That is wrong. There is no possible way you can fetter your powers in that way on an ongoing basis, and certainly not on the basis of saying, "There is no basis for SMP regulation" That does not in any way follow your saying "There is no basis for dispute resolution". Manifestly there will be if there is a dispute that needs resolving. Then, when that dispute arises, you then carry out the process.

It all comes back to the point made by the tribunal in H3G 1 which is that these are parallel processes with, ultimately, different triggers - entirely different triggers - for this to happen. You know, you cannot assume, on the basis that they have said that the triggers for SMP regulation are not present, that therefore they are saying, "We will never engage in a process of dispute resolution". Quite the contrary. You know that they should be saying, "Obviously we've made a decision on SMP. We have taken no decision on dispute resolution. It's not before us. We haven't considered it".

The next mistake we say that Ofcom made was that it disregarded the available cost information about the cost of 3G termination. Of course, I am focusing here upon the information that was available under the 2007 CTM review. We would say that this is information that was absolutely vital. It was information that was clearly relevant. It was clearly relevant firstly when you understand the obligations under s.3 - taking account of the interests of consumers, price, value for money, and all of those obligations. You absolutely have to consider in that context of whether something is value for money how much it costs to produce that product. Therefore, to ignore information that was within their power -- within their possession at the time under the 2007 CTM review for not reason at all really was simply wrong, we would say.

Ofcom makes an attempt to sort of explain that this was not really a mistake. It says, "No, we looked at the 2G regulated charges". With respect, that simply shows the falsity of the approach that they took. What they are doing is saying, "Looking at costs and charges is relevant", but they have just simply not bothered looking at the most appropriate and most relevant information - the ones that are 3G.

There is also a quick point made by Ofcom that says, "We did take account of them in deciding whether the MNOs would make gains from trade". Once again, it shows that these are relevant. They just did not bother taking account of them in the important part, which is deciding whether the charges were justifiable, or not. Ofcom also makes the point that they are gathered for a different regulatory purpose. In our skeleton at Footnote 24 we give a citation to the bit in the Act which says that that is absolute nonsense. It is s.393(2)(a) of the Act. I am afraid it is not in the bundle, but we can provide a copy if it would assist. That makes quite clear that you can use information obtained under one set of functions in the Act for the purpose of facilitating the carrying out of any functions. So, the information can obviously be used. Ofcom knows that because Ofcom has in fact used information which was obtained under the 2007 CTM review elsewhere in the determinations - in particular in relation to the gross margin made by originating operators.

Madam, would you like me to pause while you look at the reference? (After a pause):

MR. ROTH: Madam, if it helps on this point -- It may be that our point has been misunderstood. We are not suggesting that we are legally prevented from using the information. I think that is the point that Mr. Cook thinks we are making. He is quite right - we are legally entitled to use it.

THE CHAIRMAN: Thank you, that is helpful.

MR. TURNER: Madam, I hesitate to interrupt, it would be useful for me and perhaps for Mr. Cook as well, to know what is the point that Mr. Roth is making before we make our submissions.

MR. ROTH: The cost information was going forward from April 2007 for the period of the review, and here we are dealing with disputes for a previous period. That is the point.

THE CHAIRMAN: That is the point. Did you catch that, Mr. Cook?

MR. COOK: I did catch the point. If so, that is another bad point, if I might say so. It is a clearly bad point because the cost data, but simply looking at the tables – I know very little about the CTM review – in each case they all go back historically, and you look at some of the ones we have seen about 3G costs in the charts going back a number of years. I do not know if Ofcom made up those numbers, I suspect not. I suspect that they have, in fact, gathered the data that ensures those numbers are accurate. It does appear, without knowing anything in detail about that, that they were, in fact, gathering information for the period to date at that time. The reason you do that is obvious, which is you look at the historical trend of costs because thereafter you are going to try and predict them. So they had data about the actual costs at that time under the CTM review. That information, we say, was relevant. We do not say that you should look at extrapolated costs four years hence, you look at the actual costs as at that date, which they have.

MR. SCOTT: So you could run the model backwards as well as forwards?

MR. COOK: I would say actually quite the reverse. You do not run the model backwards. In order to have a model, you have current data, so you just look at what is in your model, what is in your model in the sense of what the data is you have plugged into it. You have got that data, it tells you what the costs were at that time. That is easy. That is the reason why we say they have the data, they should have used it, it was obviously relevant. That alone tells you that this was a flawed decision.

The next flaw we say exists in the determinations. It is a failure by Ofcom to comply with its statutory duties by failing to take account of a number of relevant matters. I have already made the broad point that effectively they never got into the process of doing the balancing exercise at all, because they cut off their process much, much earlier. The end result of that is that there were a number of obvious failings that take place here. The ones we point to are, firstly, just looking at it in terms of the interests of consumers, or perhaps one should say the interests of users. Of course, the point made by Mr. Read earlier, which I would fully support, is that under Article 8.2(a) of the Framework Directive the term "users" – and the requirement there is ensuring that users derive maximum benefit in terms of choice,

price and quality – includes all of BT's users. That includes initially the transit customers, ie the 1092 appellants among them, and then of course ultimately end users. So our interests are right there to be taken account of, but obviously as well we are with the interests of the ultimate end user consumers.

Then of course there is the other requirements of s.3(1), furthering the interests of citizens in relation to telecommunication matters; s.3(5) with regard to the interests of consumers in respect of choice, price, quality of service and value for money. We say that all of those matters are ones that, in particular in relation to consumers, simply were not considered.

In the defence Ofcom says that it did not explicitly consider the impacts of the disputed charges on retail prices for fixed and mobile call origination. There is the use of the word "explicitly", which might lead you to think it was implicitly considered. They do not go on to say that, so I take it to mean that they accept that they did not consider that at all. That, in itself, tells you the decision was flawed as they failed to take account of matters they were required to take account of.

Ofcom's answer to this is to say, "Well, actually, if you look at the way 3 and 4 work there is a duty to carry out a balancing exercise and end-to-end connectivity was important. In effect, they are saying that defeated those matters. While it is true, of course, that ss.3 and 4 raise a number of matters and at times they may go in conflicting directions, the first thing is you physically cannot carry out a balancing process without knowing what the amounts you are balancing are worth effectively. You need to know the impact on consumers to decide if end-to-end connectivity is so important that you should discount that. You simply cannot do that process without knowing the impact on consumers. More importantly, I would say, the point is actually just nonsense. There is absolutely no reason set out in the determinations why higher charges were required to ensure end-to-end connectivity, and it is back to the point about H3G saying, "We had to contract on any basis we possibly could to have a business", and that is, I suggest, true of any of the MNOs.

So you are not in a situation where there is a conflict, you are actually in a situation where, yes, consumers have an interest in end-to-end connectivity, they also have an interest in low prices, value for money. In actual fact, provided the price is, I suppose, profitable for the MNOs, end-to-end connectivity will be achieved in any event. So there is not a situation where they point in opposite directions. A low charge that is still profitable for the MNOs will achieve both, and Ofcom therefore just has not carried out a balancing exercise at all.

The second point then is the failure to take account of the interests of the transit customers, which we say is a fundamental flaw. As I said, Article 8.2(a) of the Framework Directive,

we are users, we are required to take account of ensuring we derive maximum benefit in terms of choice, price and quality under that. Article 8.3(a) of the Framework Directive, no discrimination in the treatment of undertakings providing telecommunication services; Article 8.2(b) of the Framework Directive, duty to ensure no distortion or restriction of competition. We say all of these matters break down as a result of Ofcom's fundamental failure to give any proper consideration at all to the position of transit customers.

This is something that Ofcom attempts to step back from on the basis that you are only considering the interests of the parties to the dispute, it is too complicated to look at the world, the hundreds and hundreds of different companies that are out there, all involved in transit.

With respect, that is simply wrong for a number of reasons. Firstly, the trigger for this, certainly in relation to the period post 13th September, includes the E2E Obligation. The whole justification for that, and the whole reason to have an E2E Obligation is the result of the fact that BT has this special transit role. It is the only company that does. So, as soon as you are looking at the E2E Obligation, you are fundamentally considering the fact that BT is not simply there as BT alone, it is there as a proxy for itself and a huge portion of the rest of the industry who are transacting through it. So it is a fundamental matter you need to consider as soon as the E2E Obligation is there at all, and we would say that it is something you obviously need to consider in any event because they are users, and that is what the statutory regime says.

Also, of course, there is the point that they say a key part of the Ofcom decision is the fact that BT could pass these charges on to, among others, its transit customers. That is a fundamental part of it. As soon as you say that, you need to start thinking about what the impact on transit customers is. It is obvious.

Ofcom's answer to this is to say that it did give a little bit of consideration to transit customers and that little bit of consideration was enough. What it did is it said it considered the relative position of BT's retail operations as compared to BT's transit customers and ensured that transit customers would not pay a higher rate than BT; secondly, it said it did consider whether they would make a loss and concluded not in the light of evidence from the 2007 CTM review in relation to gross margins.

We would say, firstly, the fact that limited consideration was given proves our point that consideration should have been given and Ofcom therefore accepts it. So the starting point, we are there right away saying proper consideration needs to be given. What was done, we say, in our submission, clearly was not proper consideration. The first mistake that was

made was most obviously made by Ofcom, and the reason why it is the most obvious mistake is that it is a failure by Ofcom to take account of a regulation it, itself, imposes on retail operators. I am referring to the 22nd July 2003 Access and Billing Directive, which I believe you will find in bundle H1, tab 14. There is no reason to turn it up at the moment. The mistake, briefly what it does is it makes it impossible or impermissible for anyone to backdate bills in terms of retail operations by more than four months. We set out in detail in our skeleton argument, para.78(a), what that in terms means in terms of the fact that the determination has come out on 7th July 2007, and that that means in terms of the fact that we are only talking about a period that runs up to April. In reality, we can pass on none or virtually none of this cost through retrospective increases in prices. We say that is a fundamental consideration which is simply missing entirely from any consideration that is made by Ofcom in the determinations. It is a matter that should have been very obvious to it since it is its own regulation. Again, they have simply missed that consideration.

What they are doing is loading a cost on to us that, by definition, we can never pass on. Therefore, they are simply taking money from our top line.

Madam, you are looking quizzical.

THE CHAIRMAN: I am wondering whether this is a point that is linked to the retrospective point, or whether it is a point that simply arises because of the lapse of time between the serving the OCCN and the determination of whether that is an acceptable rate. As we heard this morning, in the gains from trade test, what is important is the ability prospectively to pass through the additional charge. The difficulty we have here is that what is prospective and what is retrospective is slightly confused, first of all, because of the delay between the service of the OCCNs and the actual determination in July, and also because we then had, in fact, a cut off date in April, although we heard this morning it may have been later than that, because then the prices came down anyway to take into account the 2007 MCT glide path.

MR. COOK: The way in which it operates is that BT receives the various OCCNs starting from roughly the beginning of September – by the earliest, August, I believe – 2006, so that was a 7th July 2006 grabber point anyway. At that stage, BT knows that there is a risk that it will have to pay higher charges. It is in a position at that stage prospectively to increase its charges for its customers if it chooses to do so. It is taking a risk. If it chooses not to increase its prices it may subsequently not be able to recover those costs. I am talking here just about retail customers. It also knows there is a risk if it raises its prices and subsequently it is right in the determinations it may have raised its prices and lost customers for no reason. That is unfortunately the problem of a dispute resolution process that

ultimately ends taking all too frequently much longer than the four month period. It is meant to be exceptional circumstances, it seems to be in ordinary circumstances – a cheap jibe perhaps. The position, therefore, is that BT is in a position to make prospective provisions itself.

That is not true in the case of transit customers who will not know about this unless BT specifically tells them, and that is a matter we can perhaps come back to on the SIA point to the extent BT ever does, but we would say BT did not here.

Does that answer the question? Perhaps you would like to ask the question again and I will try once more.

THE CHAIRMAN: I will think about it further.

MR. SCOTT: In summary, what you are saying is that there is a prejudice on transit customers not knowing of prospective hits – that is the essence of it?

MR. COOK: Yes, absolutely.

THE CHAIRMAN: That prejudice only arises if, at the end of the day, BT is ordered to backdate its payments to cover the period during which the dispute was live and then it tries to recover that figure from the transit customers. So it is only a problem that arises if BT is able retrospectively to pass the charge on to its transit customers?

MR. COOK: You are absolutely right, and it is fair to say that I will be subsequently be arguing in front of you that it has no entitlement whatsoever to do so. The point we are taking is very much that, firstly, I am hedging my bets slightly as to whether I win that point, but more importantly in saying either way we should not have to pay it, but I am saying that Ofcom has made a decision that says they are entitled retrospectively to charge us back, and it is justified in accepting much higher prices from H3G as a result of that determination without ever giving consideration to the position of the transit customers as to whether they themselves could pass it on to their customers. Had they given it any consideration at all the answer is obvious and it is one that is completely missed, because Ofcom made the point in their defence, they say that it will be necessary to consider hundreds of contracts to reach this determination. No, the answer is very simple, you look at your own access and billing direct. So that is where we say it has missed an obvious point there which simply undermines a huge portion of its analysis in any event.

The second point we make in relation to a consideration of the gross margin, they say: "We looked at the generalised gross margin across the industry; it was higher than BT's, so if BT was not making a loss neither would any of the customers, that is what it assumes, and we say taking that kind of average across an industry and making an assumption based on that

average that everyone is going to be fine, or enough people are going to be fine is completely impractical. We are talking about that average applying straight away to fixed and mobile operators, two completely different patterns of doing business with different costs and everything else.

It is also applying the same assumption in relation to wholesale and retail, and wholesale of course has much, much lower margins because you are not providing value added service to customers, you are providing a real commodity product, or your ability to charge much above cost is very limited, so that type of average tells you absolutely nothing. It may have been appropriate for Ofcom to identify some key categories, and look at some general figures for categories, but to take an industry average and give them simply no information of any kind properly to evaluate the effect this was going to have on in transit customers generally.

I would say as well that looking simply on the basis of gross margin is a fundamentally flawed process for a regulator to take, and the reason is first, gross margin tells you nothing about recoupment of things like fixed costs and it also provides absolutely no return on capital, and even if they were going to say you were going to look at something like break even charge, at the very least it should have been break even taking account of a reasonable proportion of fixed costs and a reasonable return on capital. So what they have done is, in effect, accepted the notion that transit customers – assuming their average was right, and I have just explained why it is not – that potentially would make not a penny in terms of contribution to its fixed overheads, and as well in terms of return on capital and that, in my submission, is just an absurd approach to take.

Another point Ofcom takes here which is to say that the determinations do not require BT to pass it on, as thought that absolves them and gets them off the hook; in my submission it simply does not. They have said BT can pass it on – we say that is wrong but that is what Ofcom has decided – and BT of course has every incentive to pass it on given that it is a large sum of money. So at the very least they should have taken the view that it was a very realistic possibility it would be passed on and, of course, it is more than simply a realistic possibility and has, in fact, happened, as anyone might have expected. We say in relation to that it was a very realistic possibility; it was something they should have considered.

We say all of these matters add up to a complete failure to comply with the various requirements under Article 8 of the Framework Directive. Failure to consider the interests of … i.e. transit customers, failure to ensure no discrimination in the treatment of undertakings, and with that it is probably a completely erroneous approach to treating BT

and transit customers equally, because it simply does not know what the impact on transit customers is going to be and has ignored the Access and Billing Directive.

Secondly, it has made no attempts to balance the interests of BT and its transit customers and, of course the MNOs, because it has adopted this entirely lopsided approach that assumes no loss, without giving any consideration at all to the MNOs. It also does this check that says: "No, we are happy, the MNOs have not suggested an entirely suicidal price". But that is simply not sufficient. In order to ensure that you are not discriminating the treatment of undertakings you should not just see that both of you make some money, you should ensure that you have not reached a situation where one side makes an extraordinary amount of profit and the other side simply breaking even. They made no attempt to perform that sort of non-discrimination approach, and exactly for that reason again Article 8(2)(b) of the Framework Directive has been ignored ensuring no distortion or restriction of competition; again it fundamentally alters competition, the one side can make potentially extreme profits – excessive profits – while the other side makes no money at all.

The next flaw we say exists with Ofcom's approach is the gains from trade test, which we simply sum up as no test at all. In reality once you accept Ofcom's premise that pass-on is entirely possible for the transit market, this is not test; it never can be a test. You can pick a ludicrous price, £100 a minute and it can always, theoretically at least, be passed on. BT can always make retail prices £100 a minute plus a penny and it will not suffer a loss – it will not have very much custom, it probably will not have any custom at all but it can theoretically do that. It is the same with transit customers, you can always charge us £100 plus a penny if it can pass them back retrospectively. Again, it might not get very much custom, but it can do that.

What that tells you is that there is no price that can ever fail the gains from trade test, and we would simply say that if you can never fail a test it is not test at all. The fundamental flaw in the gains from trade test – if that is not enough – comes back to it is not just a flawed test, it is a fundamentally flawed test in the context in which you are applying it, because the justification for it is supposed to be end-to-end connectivity. It comes back to a point Mr. Read made this morning, that it is very simple, you have theoretical connectivity, you have connectivity – a price that you are actually going to use. If you have connectivity at £100 a minute you do not have connectivity because no one is ever going to make use of that service, so the test is doubly flawed, and it is fundamentally unsuitable in any event, or particularly in the situation in which they are trying to use it.

What is interesting is Ofcom's response to this argument in its skeleton argument and also its defence. It does not explain that this ultimately is a fantastic test that will restrict a number of prices. All it is able to say is: "Well if the prices become ridiculously high obviously Article 82, the Chapter II prohibition on the Competition Act will step in and stop there being a problem." Ultimately all that tells you is that it is no test at all. If you have to use another test to stop problems with this one because there are prices that will pass this test, that tells you the right test would have been to dispense with gains from trade anyway, and take account of Article 82. That is not the right answer. The right answer is that you actually have a proper test in the first place rather than start tying to say: "This test does not really work, but we will try and patch holes in it later on with other provisions".

I turn now to the blended rate and we say that again is simply a fundamentally flawed approach. This is something I do not intend to go through in detail. We have the eggs' analogy from earlier on and that is something I would fully endorse. I would say that there is a mistake in the eggs' analogy, and the mistake is in only using a dozen eggs – it makes sense in the context of eggs, but the point to bear in mind here is we are talking about 20 eggs and only one of them is brown; that is a rather extreme ratio of numbers we are talking about here. We are talking about specific numbers in the confidential annex A1, and I am not going to go to those. I think everyone in the room knows 5 per cent is roughly a good number, so I am not giving anything away in referring to "broadly 5 per cent". So it is one in twenty and that is the reason why it is absurd to look at the blended rate on its own, because all that the blended rate tells you is that 95 per cent of anything that goes into the blended rate is regulated. Well, we are always happy with the regulated rate, or we accept the regulated rate. The only bit that is the problem is the 3G rate which should always be a very tiny component of the blended rate. So actually one ends up here with: "It's only five per cent" – the point Ofcom goes on to make later is that the blended rate was only up to 10 per cent higher. Actually what it means is that I am being forced to pay 10 per cent more for the 19 2G calls, and that is justified simply by reference to the single 3G call. Once you look at it like that you realise that using that example it is only 10 per cent higher, and that means the underlying 3G price is 200 per cent higher, and that is the reason why, looking at the face value figure, once you realise that Ofcom should have known, and did know from the CTM review, that 3G is a very small component of this, you are simply masking the whole thing out. So that is the reason why the blended rate was simply a flawed approach to take.

That brings me to Article 10 of the EC Treaty, which we say is a fundamental failure on the part of Ofcom in its performance of its duties under the treaty, and its obligations as a regulator in this context. Article 10 of the EC Treaty of course provides that Member States, which of course includes regulators, includes Ofcom, shall not take any measures which could jeopardise the attainment of objectives of the Treaty, and that has been interpreted in European legislation as including measures that require or favour the adoption of anti-competitive measures or reinforce their effect. The authority for that is *Ahmed Saeed* [1989] ECR 803 (bundle H2, tab 5) – I will not take you to it for the moment.

In addition to that general statement of principle, *Amed Saeed* is actually a very relevant case from our perspective, because it is on very similar facts. It deals with a situation in which a national regulator – in that case it was an aeronautical authority – approved tariffs agreed between two companies, and the ECJ turned around and ruled that it was contrary to Article 10 for the regulator to approve those tariffs, and the tariffs were contrary to competition law. We say that is exactly what Ofcom has done here, as a regulator it has approved tariffs which are contrary to competition law.

THE CHAIRMAN: And that was an Article 82 case?

MR. COOK: I think it was both, but the principle remains good which ever one it was, but I believe in fact it was both, and both were discussed in the judgment.

Less there be any doubt in that case about the application of Article 10(2) of the Telecommunications' sector, if I refer you to H1, tab 1, which is the Commission's Notice on the application of EC Competition Law to Access Agreements in the Telecoms' sector, which makes exactly that point. "NRAs must ensure actions taken by them are consistent with Community competition law and they may not approve arrangements which are contrary to competition law". That notice is also of relevance because it goes on to explain what is meant in that context by excessive price, and mentions the fact that it is excessive in relation to the economic value of the service provided, and one of the ways to do that is determining it objectively by making a comparison between the selling price of the product in question and its cost of production.

This is a point which is of some importance, it is the point that comes of the *Attheraces* case which is: do you consider that a competitive price is one that is cost based or not? It is a point that Ofcom took in its skeleton argument, and it referred to what *Attheraces* said, that not in all circumstances will that necessarily be the approach, and Ofcom flagged that up. The note I have handed up refers to Mr. Roth stepping back from that paragraph in is skeleton argument and saying: "Yes that is true generally, but obviously in the

telecommunications' sector, we are not talking about intellectual property or anything like that, where you can look at the economic value of a product, you should look at it on the basis of cost plus a reasonable return on capital." In my submission that is undoubtedly the correct approach to take because there is no justification in this type of commodity market to departing from that as being the right way to settle a competitive price, and of course that is what Ofcom has done under the SMP conditions, it has set a cost base price.

So we would say once you recognise that the blended rate is not the way to go, not the correct way to do it, and recognise that what you are looking at is: is something appreciably above a cost base price? The answer to the question: has Ofcom complied with its Article 10 responsibilities is very easy and that is what we sought to do in part annex A.1, but also annex A.2 of the confidential annexes to our skeleton argument in terms of showing you just how extreme these prices are – in some cases they are up to 200 per cent. higher than any level that we say could possibly be justified in terms of the 2G prices and up to 150 per cent higher than justification of the 3G prices. That demonstrates these prices are manifestly excessive based on data that was readily available to Ofcom at the time, and that demonstrates that Ofcom has failed to comply with its duties, it has approved prices which constitute an abuse of a dominant position because they are appreciably above the competitive level, and they are set by operators that at least Ofcom accepts – and I accept H3G would challenge this – have SMP and have the incentive and the ability to raise prices to a level above a competitive level. So they have not complied with that duty and that, in my submission, shows that their entire approach to this is fundamentally flawed because they have done something they are not permitted to do.

Ofcom has made an attempt in its defence that actually the prices are not as excessive as all of that. It has carried out a couple sets of analyses . Firstly what it has sought to do is simply cross-refer the blended rate to the 2G rate, which is obviously what was in the determinations in any event. That really does come back purely to the blended rate point. If you look at it and say, "Look at the blended rate which is 95 percent 2G", well, the end result is not hugely different from 2G. But, once you have realised that what you are actually doing is make every single telephone call cost 10 percent more than its usual rate as a result of the one in twenty that is 3G, you understand that the underlying 3G charge is much, much higher than 10 percent. So, that analysis simply does not stand up at all. You can see that obviously when you go and look at H3G's prices where we do not have this complexity of it being blended out to quite the same degree, though of course it is right to observe that H3G does in fact have some underlying 2G in it because, of course, it transits a

certain amount of its business through some of the other MNOs. So, it is sort of a half 2G/3G price, but obviously not to the same pronounced extent that the others are. It is not as 2G weighted.

We see there that Ofcom was well aware that the price it approved for H3G, which was 16.6 pence per minute, was over 160 percent higher than the regulated 2G rates, and even the higher of those was 6.3 pence per minute. That just demonstrates the vast gulf between prices -- between the underlying 3G elements (and H3G's was not the highest by any means in that context) and the underlying justified 2G prices. That should, at the very least, have excited enormous alarm bells. Ofcom simply ignored it.

There is also a new analysis that has been carried out in the defence. It is not an analysis that is in the determination. So, it is the one where they compare, again, for the first time the blended rates to the new blended rates in the CTM review. Again, they make the point and say that, actually, when you look at that, the two sets of blended rates are not that different. Again, it is not appreciable. That is only a point they can take in relation to the 2G/3G MNOs because in relation to H3G the difference is still very pronounced. H3G - the figure was accepted by Ofcom, and these determinations were 16.6 pence per minute, and the approved rate is slightly around 9 pence per minute. So, again, it still remains nearly double.

As we display in our skeleton argument, firstly Ofcom's table is somewhat misleading - unfortunately so. What Ofcom has done is to ignore two factors that were well-known ----

THE CHAIRMAN: Can you give us the reference to the table to which you are now referring?

MR. COOK: We put a table in our skeleton at para. 97. (After a pause): It is para. 138 of the defence, Bundle D3, Tab 6. That is Ofcom's table. We say this table is flawed for two reasons: firstly, it takes no account of inflation. This is not a point we are making ourselves for the first time. This is what Ofcom itself says in the CTM review. It says, "In order to ensure like-for-like we will set out charges on a nominal basis, but every time we quote a charge we will give it to you on a nominal basis, and we give it to you in 2006/2007 prices to allow you compare like-for-like". What they have done here is given you the nominal charge. They have not re-stated it on a 2006/2007 basis. Since what Ofcom is doing is to allow prices to go up by RPI minus X, or whatever, each year - it allows that growth -- So, you are not looking at like-for-like. So, you remove that element from it.

The other mistake that is made - and again it is a point where Ofcom itself in the CTM review re-states all of the figures in order to allow like-for-like comparison, just taking account of this factor - is that because of when Ofcom carried out the 2007 CTM review, it was not in a position to actually regulate the full twelve months from 1st April, 2007, it can

only regulate the last ten months -- So, what it did in terms of telling people what number they had to meet -- It said, "We know you have had two unregulated months, and we know what your numbers are for that. We're going to tell you what your average for the year should be, in effect on the basis that we are going to regulate the last ten months. So, the average for the whole year will reflect your two months of prices we accept are unacceptably high". So, actually, the figure that they end up with as being their, "You can have this average for the year" is influenced by the two months where they say that prices were too high. Ofcom itself reflects that in the 2007 CTM review and says, "In order to properly understand this number, here it is actually quoted on a proper basis and allows like-for-like comparison between years". All those numbers are there. All we have done in our table at para. 97 of our skeleton is to take Ofcom's own numbers - but the like-for-like numbers and not the misleading ones. We have shown there the extent of the disparities, which do vary in that context by up to 11.7 percent as you can see.

Obviously we are back to blended rates. In each case we are talking about knowing the roughly 5 percent figure for the 3G calls. In each case you have the 95 percent of 2G rates that are regulated in both examples. So, we are back to exactly the same point. It is only the fact that the change in prices is in large measure due to the fact that you have gone from unregulated 3G rates to regulated 3G rates, and that, again, is all lost by blending. So, while we say that it is only between 5.5 percent and 11.7 percent, we are back to the point that it is a blended rate, and in reality while we actually do not have the data to see the underlying 3G charges, the fact that there is a 5 percent unregulated 3G now going to 5 percent regulated 3G, it makes it likely that what has happened is that the 3G charge has been very substantially cut. That is entirely consistent with the fact, as we see at the bottom of the table - the position in relation to H3G - where that factor is not present that H3G's approved figure is nearly 100 percent higher than the equivalent figure on a like-for-like basis.

So, once again, once you ignore the blended rates it is very likely - and we have done a calculation at Annexe A2, which is our best attempt to try and re-state, based on the limited amount of data that is publicly available from the 2007 CTM review what seems to have been the approved 3G charge for each operator -- Again, that shows the differences between the approved 3G charge in the 2007 review and the approved 3G charge under these determinations, and the underlying 3G charge is very pronounced indeed and in some cases well over 100 percent, again demonstrating, we would say, that Ofcom has, in the full knowledge of what it was doing, approved anti-competitive, abusive and excessive prices.

For all those reasons we say that the determinations are all fundamentally flawed. They should be quashed. They should be remitted. The tribunal should provide Ofcom with the detailed guidance that we suggest in our skeleton argument in relation to each issue in order to ensure that Ofcom go back and do the job properly this time. We do not say, of course, that there should be twenty-five paragraphs at the end of the decision setting out all of those matters. If they are dealt with in the judgment, that will provide all the guidance that Ofcom needs. We do say that it would be very helpful to have clear guidance in relation to the matters we identify there.

Unless I can help with any questions those are my submissions.

THE CHAIRMAN: No. Thank you very much, Mr. Cook. Unless anybody has got anything else they want to raise before we close for the week ----

MR. COOK: I just want it noted that being the person who suggested guillotines, I have managed to come in ----

THE CHAIRMAN: Yes. Well done. You have given us an extra five minutes of our lives. On Monday we are starting at ten with Mr. Turner for two hours, and then Miss Rose for one hour ----

MISS ROSE: Madam, having heard the submissions today, I think it likely that I will be less than an hour. If Mr. Turner thinks he is going to be less than two hours it may be that we could start at 10.30 and still be finished by lunchtime.

MR. TURNER: Miss Rose is right. I am likely to be less than two hours.

MR. COOK: One point that does occur to me is that we are seeming to move faster than perhaps we needed to. I do not know how long Ofcom is likely to take, but even if Ofcom takes a full day there is only a little bit of intervener submission to come. It is likely that we may well finish by Tuesday lunch-time, in which case it would be credible to go back to the previous timetable and hear the SIA issue. The only reason I flag that up as, at the very least a potential matter, is that if that is likely I would like to prepare my submissions over the weekend. I am not suggesting that we should tie anyone that that must happen now, but certainly that we should start thinking that it might happen.

MR. REED: Madam, there is the question of replies that have to be dealt with somewhere along the line. At the moment they are in writing. It may be possible, if we do condense the time that we might be able to do them orally, but what we cannot do, I think, is get through replies and through the SIA at the same time. I think that will be straining things greatly. I just put that down as a market. If we have spare time, then perhaps that can be devoted to replies rather than necessarily dealing with the SIA.

THE CHAIRMAN: Let me just consult with my colleagues. (After a pause): Those who are going to be arguing the SIA point are Mr. Cook -- Who else? Vodafone. And BT. Is it going to be possible to do that within the half-day?

MR. COOK: I will be leading off. I do not anticipate that my submissions are going to take more than half an hour, madam. It is a fairly short point ultimately.

THE CHAIRMAN: It might be useful to do that, given that now, in the overflow days at the end of February, we have the questions to the Competition Commission slotted in there in the MCT appeals. I do not want in any way to constrain Mr. Roth or the interveners in support of Mr. Roth in the TRD appeals. As far as whether it is better to use the time for the SIA or for replies, the difficult with the replies is, of course, that you are only going to hear what Mr. Roth and the others say on Monday and Tuesday morning.

MISS ROSE: Madam, from our perspective, we would prefer to have the SIA issue dealt with now and have written replies. Of course, we are producing a written reply in any event in relation to remedies, and we would appreciate having a bit of time to digest what Ofcom says and put in a written reply.

THE CHAIRMAN: (After a pause): We will accept your suggestion, Mr. Cook, and do the SIA construction point on the assumption that we have time on the Tuesday afternoon. We cannot sit later than 4.30 on Monday. That is the only point. Where does that leave us as to whether we are starting at 10.30 or ten o'clock on Monday?

MISS ROSE: Madam, I am only going to need thirty minutes.

THE CHAIRMAN: We will start at 10.30.

MR. TURNER: Doing the mental calculations, even if I have two hours, with Miss Rose's half an hour, we are fine

THE CHAIRMAN: We will start at 10.30. We will have from 10.30 until -- How long did you say you will be, Mr. Turner?

MR. TURNER: The estimate up till now was two hours. Having heard the submissions of my friends, I anticipate that I will be substantially quicker than that, but I would like to go away and reflect.

THE CHAIRMAN: We will give you fro 10.30 until twelve noon.

MR. TURNER: Madam, I am content with that.

THE CHAIRMAN: Is that too little or too much time?

MR. TURNER: It should be sufficient, madam. It was two hours prior to having heard the arguments put by my friend, but having heard those arguments, an hour and a half should be sufficient.

THE CHAIRMAN: We will start at 10.30. We will assume that you and Miss Rose will take us up until lunch-time. Mr. Roth might start before lunch or might start after lunch.

MR. ROTH: Madam, I noted that other counsel are saying they would like to have time to reflect on the submissions. Of course, I will be hearing on Monday morning submissions from two appellants. It would be helpful to start at two. I doubt I shall take a whole day. I know that has been allowed, I do not know what is coming, but so far I think it is unlikely.

THE CHAIRMAN: The two interveners in support of Ofcom – Miss Demetriou, how long do you think you are going to be? I know you have not heard Mr. Roth, but ----

MISS DEMETRIOU: I would say no more than twenty minutes.

MR. WISKING: Again, subject to hearing Mr. Roth, I will be no more than about ....

THE CHAIRMAN: We can probably get all that into Monday afternoon and Tuesday morning. We will then hear the SIA construction point on Tuesday afternoon and hope to finish that then. We do not want to go part-heard on that obviously, but it looks as though that is going to be entirely possible. Then we will have written replies as we suggested originally. Thank you, everybody. We will re-assemble at 10.30 on Monday morning.

(Adjourned until 10.30 am on Monday, 4th February, 2008)